Defining the parameters of employment: The position of the company shareholder and close corporation member

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1 INTRODUCTION

Only 'employees' within the legislative definition stand to benefit from the protective provisions of labour legislation relating to unfair dismissal, unfair labour practices, unfair discrimination, minimum conditions of employment etc. Most employers are therefore aware of the importance of distinguishing between employees and other types of workers.

Section 213[1] of the Labour Relations Act 66 of 1995 provides that an 'employee' is:

(a) any person, excluding an independent contractor, who works for another person or for the State and who receives, or is entitled to receive, any remuneration; and

(b) any other person who in any manner assists in carrying on or conducting the business of an employer.

Despite its seemingly wide reach, the courts have held that the essential distinction to be made in terms of this definition is between employees and so-called independent contractors. The prevailing test to discern employees from independent contractors is the 'dominant impression' test, which requires an adjudicator to weigh all the relevant factors[2] in a particular case in order to decide whether her dominant impression of the parties' relationship is of one between employer and employee or between employer and independent contractor.[3]

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1 See also ss 1 of the Basic Conditions of Employment Act 75 of 1997, Employment Equity Act 55 of 1998, and the Skills Development Act 97 of 1998.

2 These would include, *inter alia*, whether the worker is subject to the control of the employer, works regular hours, is a member of the employer's medical aid or pension schemes, uses the employer's equipment in the performance of her duties, works solely for the employer and pays employees' tax.

3 The dominant impression test has been subjected to a great deal of criticism. See Mureinik 'The contract of service: an easy test for hard cases' (1980) 97 *SALJ* 246; Brassey 'The nature of employment' (1990) 11 *ILJ* 889; Benjamin 'An accident of history: who is (and who should be) an employee under South African law' (2004) 25 *ILJ* 787.

In 2000 the legislature identified 'two categories of workers who do not receive the protection of labour law –

(a) those who fall within the definition of an employee but who are in practice unable to assert their rights as employees;

(b) those who the courts classify as independent contractors but are nevertheless in a position of dependence on the organisations or the persons to whom they provide services'.[4]

In order to address this problem, the Labour Relations Act and the Basic Conditions of Employment Act were (somewhat paradoxically[5]) amended in 2002 to introduce a rebuttable presumption of employment.[6] It provides that, regardless of the form of the contract, a worker is presumed to be an employee where one of seven factors is present in a work relationship; ie–

- the manner in which the person works is subject to the control or direction of another person;
- the person's hours of work are subject to the control or direction of another person;
- in the case of a person who works for an organisation, the person forms part of that organisation;
- the person has worked for that other person for an average of at least 40 hours per month over the last three months;
- the person is economically dependent on the other person for whom he or she works or renders services;
- the person is provided with tools of trade or work equipment by the other person; or
- the person only works for or renders services to one person.

The presumption will not apply to those who earn more than a certain amount per annum,[7] and NEDLAC is to bring out guidelines for determining

4 Explanatory Memorandum to the Basic Conditions of Employment Amendment Bill 2000 in *Government Gazette* 21407 of 17 July 2000. Theron 'The erosion of workers' rights and the presumption as to who is an employee' (2002) 6 *Law, Democracy and Development* 27 at 28 comments cogently that 'the reasons for the regime's inability or failure to protect these two categories of workers, as set out in the memorandum, are cryptic if not contradictory. The first category comprises unprotected employees. The examples given in the memorandum are those engaged in part-time work, homework or casual work. It is said that the courts regard these persons (referred to as 'vulnerable workers') as employees. At the same time it is said that the courts undermine the effectiveness of the protection legislation provides these workers. There is no indication given as to which protections are referred to or, given that these workers are regarded as employees, why this is so'.

5 See the discussion in Theron 'The erosion of workers' rights and the presumption as to who is an employee' *supra* esp at 28–29.

6 S 200A of the Labour Relations Act 66 of 1995 and s 83A of the Basic Conditions of Employment Act 75 of 1997.

7 S 200A(2). The amount is currently set at R115 572 per annum. See GN 356 in *Government Gazette* 25012 of 14 March 2003. For the purposes of that notice: '"earnings" means gross pay before deduction ie income tax, pension, medical and similar payments but excluding similar payments (contributions) made by the employer in respect of the employee'.

whether persons, including those who earn in excess of the relevant amount, are employees.[8]

It is noteworthy that the introduction of the presumption does nothing more than shift the onus of proof if it finds application.[9] In determining whether a worker is an employee arbiters will still have regard to the dominant impression test. The scope of application of labour legislation has ostensibly not been broadened. I would, however, suggest that the legislature's recognition of economic dependence as a factor relevant to the inquiry into employment status might go some way to changing the outcomes of such inquiries. That is a factor which has not traditionally been considered by the courts in deciding the employee/independent contractor question.

Given that the nature of work relationships has changed dramatically in recent years[10] it has become more difficult for the courts to determine which workers are employees and which are independent contractors, especially considering that they have traditionally been conservative in their approach to that issue.[11] The purpose of this article is to consider a question that has arisen in recent case law: ie, in deciding whether a worker is an 'employee', what significance should be attached to the fact that that worker has a shareholding or a member's interest in the company or close corporation (CC) for which she works?[12] Can that worker be regarded as an 'employee' of the company or CC when she is in effect 'part' of the employer and thus apparently running the business for her own account – and, depending on the size of her shareholding or interest, might be in a position to dictate her own terms and conditions of employment and prevent disciplinary action against her as well as her own dismissal?

In that regard it is worth noting that the Supreme Court of Appeal and the Labour Appeal Court have repeatedly emphasised that one of the primary distinctions between an employment relationship and that of an independent contractor is that:

> [t]he employee is subordinate to the will of the employer. He is obliged to obey the lawful commands, orders or instructions of the employer who has the right of supervising and controlling him by prescribing to him what work he has to do as well as the manner in which it has to be done.

8 At the time of writing those guidelines had not yet been produced.

9 Where the presumption is not applicable the onus is on the applicant worker to prove that she is an 'employee'. Where the presumption is applicable, the onus shifts to the employer to rebut the presumption by proving that the relevant worker is not an employee. The applicant will, of course, have to present *prima facie* evidence that one of the factors mentioned in s 200A or s 83A is present in the work relationship.

10 See Thompson 'The changing nature of employment' (2003) 24 *ILJ* 1793 and Theron 'Employment is not what it used to be' (2003) 24 *ILJ* 1247.

11 Brassey *Employment and Labour Law* B:iii.

12 While directors could also be considered part of the controlling heart and mind of a company and thus not employees, the courts have long been prepared to accept that directors may be employees for the purposes of labour legislation. See *Long & Another v Chemical Specialists Tvl (Pty) Ltd* 1987 (8) *ILJ* 523 (IC); *Oak Industries SA (Pty) Ltd v John NO & Another* 1987 (8) *ILJ* 756 (N); *Whitcutt v Computer Diagnostics and Engineering (Pty) Ltd* 1987 (8) *ILJ* 356 (IC) and most recently *PG Group (Pty) Ltd v Mbambo NO & Others*, unreported Case No JR215/2004, 26 October 2004.

> The independent contractor, however, is notionally on a footing of equality with the employer. He is bound to produce in terms of his contract of work, not by the orders of the employer. He is not under the supervision or control of the employer. Nor is he under any obligation to obey any orders of the employer in regard to the manner in which the work is to be performed. The independent contractor is his own master.[13]

The courts have held that, while this factor is not the sole indicator of the existence of an employment relationship, it remains an important indication of such a relationship.[14] It is a consideration that becomes particularly relevant when the worker is effectively in a position where she dictates or might dictate the manner in which the organisation operates and to a certain extent controls her own destiny within an organisation. Such circumstances arise where a worker has a shareholding in a company or interest in a close corporation

2 THE TRIUMPH OF FORM OVER SUBSTANCE

In *Johnson v Piccollo Mama CC*[15] the applicant worked as the manager of a restaurant owned by a CC. When the CC decided to close down the restaurant, the applicant approached the members of the CC with a business proposal for the establishment of a late night bar in the same premises. The applicant obtained a 25% interest in the CC with an agreement that he would actively participate in the carrying on of the business of the CC, being responsible for the daily running of the business. At a members' meeting a decision was taken to terminate the applicant's relationship with the CC. The applicant had allegedly been negligent, had failed to make certain important administrative arrangements and had gone overseas without prior consent or discussion with the other members of the CC. The applicant felt aggrieved by this decision and approached the CCMA claiming that he had been unfairly dismissed. The commissioner was required to decide a preliminary point as to whether the applicant was an employee of the CC when his relationship with it was terminated.

To the commissioner's mind the question to be decided was 'not whether [the applicant] was an independent contractor . . . Rather the question [was] whether [he] was an employee or a member of a close corporation working for "himself"'.[16] The commissioner distinguished the case before

13 *SABC v McKenzie* (1999) 20 *ILJ* 585 (LAC) at 591.

14 In *Smit v Workmen's Compensation Commissioner* 1979 (1) SA 51 (A) at 62D Joubert JA was of the view that the presence of the employer's right of supervision and control over an employee is 'indeed one of the most important *indicia* that a particular contract is in all probability a contract of service' and in *Liberty Life Association of Africa Ltd v Niselow* (1996) 17 *ILJ* 673 (LAC) at 682 Nugent JA felt that 'control is not essential, in my view it is at least of such "prime importance" . . . that its absence should cast serious doubt upon whether the relationship is one of employment. Its presence, on the other hand, is by no means a sure sign that the relationship is one of employment'. See also *Niselow v Liberty Life Association of Africa Ltd* (1998) 19 *ILJ* 752 (SCA) at 756 and *Hannah v Government of the Republic of Namibia* (2000) 21 *ILJ* 2748 (LCN) at 2751.

15 (2001) 22 *ILJ* 759 (CCMA).

16 At 764.

her from that in *Oosthuizen v CAN Mining and Engineering Supplies CC*[17] on the basis that in the latter case Oosthuizen had been an employee with one organisation and little changed when he moved across to work for the CC, except his acquisition of the interest in the CC. That had been found insufficient to alter the nature of the parties' relationship. In the *Piccollo Mama* case, in the commissioner's view, something did happen to alter the nature of the parties' relationship – the initial business (the restaurant) had closed down and the applicant had seized the opportunity for another business, got the consent of the members of the CC and acquired an interest in the CC. The result, in the commissioner's view, was that 'the relationship changed from that of employer-employee to that of members in a close corporation, in reality, "co-owners" of the business'.[18]

There is, with respect, no real distinction between the two cases. In both cases a worker who was an employee with one organisation acquired an interest in the CC for which he worked, and in each case there was very little difference in the manner in which he worked from one organisation to the next. The factors to which the commissioner referred did not weigh particularly strongly against Johnson being viewed as an employee. It is beyond the scope of this piece to analyse each of the factors highlighted by the commissioner. Suffice to say that the impression that one is left with after a survey of the relevant factors is that Mr Johnson was effectively in the position of a managerial employee. He received a salary and the other members of the CC exercised control over him. They took operational decisions which he had to implement and, despite his being allowed to control the daily running of the business, were effectively in a position to take punitive action should they be dissatisfied with his performance. Their ability to 'punish' Johnson is evident in the fact that when they were dissatisfied with his performance they 'dismissed' him. The extent of the other members' control over Mr Johnson is also illustrated in that he apparently needed their permission to take leave (despite his sentiments to the contrary). His failure to consult with the other members or get permission to take leave was one of the grounds for the termination of his relationship with the CC.

The factor that appeared to weigh most heavily with the commissioner was the fact that Johnson was a member of the CC and stood to share in the profits generated by the business as a result of his management thereof. He was found not to be an employee assisting in the business of his employer, but rather part of the employer by virtue of his member's interest in the CC and the nature of the relationship.

As indicated by the commissioner in the *Johnson* case, in cases where a worker has a shareholding or interest in the business for which she works, the inquiry can be directed at establishing whether she is about the employer's business or her own.[19] Another related, and more traditional, line

17 (1999) 20 *ILJ* 910 (LC). This decision is discussed more fully below.

18 At 765.

19 This is by no means a novel idea, as is evident from the words of Schreiner JA in *R v AMCA Services Ltd & Another* 1959 (4) SA 208 (A) at 213H where the learned judge said that '(a) test of service is sometimes said to be whether B is about A's business or his own'.

of inquiry might focus on the extent to which the employer exercises control over the worker. The greater the worker's control over his own destiny the less likely (and necessary, it is submitted) that the court will consider him an employee.

In *Blismas v Dardagan*[20] Dardagan was contracted to work as the manager and controller of a business owned by Blismas. The net profits made from the business were to be shared equally between the parties. It was a provision of the contract that B would not interfere with the running of the business except, where necessary, in an advisory capacity. His right of control over D was thus contractually excluded. In seeking to ascertain the nature of the relationship between the parties the court was of the view that '[it] is the essence of a contract of master and servant that the servant should submit to the direction of his employer and obey his employer's instructions not only in the things he has to do but as to the time and manner in which he has to do them. (See *Colonial Mutual Life Assurance Society v MacDonald* 1931 AD 412 at 435.)'[21] The clause in the agreement prohibiting B from interfering in the running of the business was seen as quite inconsistent with a contract of master and servant. Rather, the contract was a contract of the hire of D's services and fell within the class of contract known as *locatio conductio operis* (independent contractor) as opposed to *locatio conductio operarum* (employee).

Granted, this decision was handed down in the era when control was still viewed as the most important indicator of employment, and it does not deal with a case where the worker stood to share in the profits of the business with a member's interest or shareholding. However, it leaves the impression that where a worker controls his own fate and stands to benefit directly from the performance of the business, he will not be viewed as an employee of that organisation.

In light of the above decisions, and returning to the issue of employee shareholding, it would appear difficult to argue that the holder of a *controlling* (ie majority) interest or shareholding is an employee of the organisation for which she works. She appears to be the master of her own destiny and can apparently not be compelled to do anything in the organisation as she can block any decision with which she does not agree. Nor can she be dismissed,[22] unless she votes in favour of her own dismissal, in which case there is no 'dismissal' at all. This removes two basic elements of an employment relationship and raises serious doubts regarding the need for labour legislation to apply to such a person. However, as will emerge from the discussion below, the controlling shareholder is not always in a position to dictate her own workplace destiny.

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20 1951 (1) SA 140 (SR).

21 At 146.

22 The power to dismiss was considered a very important indicator of employment by Satchwell JA in *Board of Executors Ltd v McCafferty* (1997) 18 *ILJ* 949 (LAC) where the court was called upon to decide who was the employer of an employee. In the learned judge's view, 'assumption of the right to terminate employment and the exercise of such power is a distinguishing feature if not a specification of an employer [and thus an employment relationship]' (at 968).

In the United Kingdom the courts came 'very near to asserting the existence of a rule of law if they did not quite reach that point'[23] that a controlling shareholder cannot be an employee.

In *Buchan & Ivey v Secretary of State for Employment*[24] Mr Buchan was the director of a firm in which he had a 50% shareholding and worked for the company full-time as a scanner operator and sales manager. He spent only about 5% of his time in the role of director, received a salary with deductions for PAYE and got 5 weeks leave *per annum*. Mr Ivey owned 99% of the shares in the company of which he was a managing director. He received a salary, pension benefits, worked a 44-hour week and was granted 22 days' holiday *per annum*. The Employment Appeal Tribunal found that the tribunal *a quo* had been entitled to find that Mr Buchan and Mr Ivey were, due to their shareholding, not employees but running their own businesses through the medium of limited companies, not subject to the control of the boards of directors of those companies.

3 SUBSTANCE PREVAILING OVER FORM

It is problematic to take the view that controlling shareholders or member's interest holders are not employees because of that holding. The effect of such a view is effectively to add a requirement to the definition of 'employee' that the worker also not be a majority shareholder. A majority shareholder could thus, depending on other relevant factors, change his status from non-employee to employee by divesting himself of some of his shareholding. Similarly, an employee stands to forfeit his employment status should he, for example, inherit or purchase a controlling shareholding in the business for which he works.[25] It is also possible that the controlling shareholder may have entered into an agreement to vote his share in accordance with the dictates of a third party. Does that mean that he is then an employee because he apparently no longer has control over his destiny? It should also not be forgotten that the shareholder might in reality have no role in the running of the company and is thus not exercising any control in that sense. They do not generally have a right to interfere with the decisions of management, unless by means of resolutions passed in general meetings – and by the time those come around the dismissal or other prejudicial event may long have come and gone.[26] The shareholder in question may not have rights of such a kind that he is answerable only to himself and capable of being dismissed. In addition, he may not be permitted to vote on matters in which he has a personal interest; eg the termination of his contract of employment.[27]

23 Lord Coulsfield in *Fleming v Secretary of State for Trade and Industry* 1997 IRLR 682 (Court of Session) at 684 commenting on the decision of the Employment Appeal Tribunal in *Buchan & Ivey v Secretary of State for Employment* 1997 IRLR 80 (EAT).

24 Above.

25 See the comments of the Employment Appeal Tribunal in *Secretary of State v Bottrill* 1998 ICR 564 (EAT) at 571–572.

26 *Secretary of State for Trade and Industry v Bottrill* 1999 ICR 592 (CA) at 602.

27 *Ibid* 604.

It is also noteworthy that in the insolvency context it is the liquidator of the business, and not its shareholders, that is in control of the business and thus in a position to dismiss workers. There is therefore much to be said for adopting an holistic view of a work relationship and deciding whether a worker is an employee based on a proper conspectus of all the relevant factors.

In *Oosthuizen v CAN Mining and Engineering Supplies CC*[28] the applicant (while employed by another company) had paid a close corporation R150 000, a fifth of its capital. The applicant came to work for the CC and was registered as a member thereof a few months later. The staff of the CC were informed that the applicant was an 'owner' of the CC and one of the employers at the CC. The relationship between the applicant and the close corporation was terminated and the applicant went to the Labour Court claiming that he had been unfairly dismissed. It fell to be determined whether the applicant had been an employee of the CC.

Grogan AJ stated at the outset that 'the mere fact that an employee holds shares in the company or an interest in the [close] corporation by which he is employed does not *per se* exclude him from the statutory definition of employee'.[29] The court acknowledged that there are relationships, like partnerships, in terms of which a person works for or with another person, that would not be classifiable as employment relationships. Those relationships are distinguished from employment relationships by an application of the dominant impression test, and *in casu* the court formed the dominant impression that the applicant was an employee of the respondent CC.

The Labour Court pointed out in *Rumbles v Kwa Bat Marketing (Pty) Ltd*[30] that '[s]haring in the profits and losses of a business would, in the normal course, be a significant factor indicating a relationship other than one of employment'. But, as the court went on to note, it is not a conclusive factor. There is no reason why a worker cannot be 'part of the employer' by having an interest or shareholding in the company or close corporation for which she works and simultaneously be viewed as an 'employee', provided that the other factors in the relationship would support such a conclusion.

This view finds considerable support in the decisions of the appellate courts in the United Kingdom. In *Fleming v Secretary of State for Trade and Industry*[31] the Scottish Court of Session[32] was confronted with a situation similar to that in *Buchan*. Mr Fleming was the managing director of a company in which he held 65% of the shares. He worked alongside the other employees

28 *Supra*.

29 At 913. This approach was adopted in *Bas v Psimark (Pty) Ltd & Another* [2001] 6 BALR 559 (CCMA) where the commissioner found that a shareholder and director was not an employee based on the application of the dominant impression test.

30 (2003) 24 *ILJ* 1587 (LC) at 1594.

31 *Supra*.

32 This court has a status in Scotland equivalent to that of the Court of Appeal in England (and Wales). An appeal lies from both courts to the House of Lords.

for the same number of hours. He received a salary subject to PAYE. The company found itself in financial difficulty and was later put into liquidation. All the employees (including a director with a 35% shareholding) received redundancy and statutory notice pay. Mr Fleming's application for such payments was refused by the Secretary of State for Trade and Industry as he was not considered to be an employee of the company. The industrial tribunal agreed. The court was of the view that there was more than enough material in the circumstances of the case to justify the industrial tribunal's decision that Fleming was not an employee. Important were the facts that he gave a personal guarantee for loans to the company and had chosen not to draw his salary when the company first got into difficulties. Mr Fleming's shareholding in the company was treated as a relevant, but not determinative, factor.

In the court's view:

> [w]e do not see how it can be doubted that the fact that a person is a shareholder is a relevant factor. The significance of that factor will depend on the circumstances, and the weight to be given it may vary with the size of the shareholding . . . The decision as to whether a person is or is not an employee must, however, be taken on all the relevant factors at the material time. The shareholding position must, in our view, be a relevant factor. It will, however, usually only be one of a number of such factors, and it is not impossible that regard might be had to the way in which the person in question comes to be a shareholder, or to be a majority shareholder. As in any such decision, all the circumstances have to be considered.[33]

This approach was endorsed by the Court of Appeal in the case of *Secretary of State for Trade and Industry v Bottrill*[34] where the court was confronted with the issue of whether the sole shareholder of a company who had entered into a contract of employment with the company, worked fixed hours, was granted sick leave and was paid a salary from which deductions for PAYE were made could be regarded as an employee. The court, per Lord Woolf MR, found that the industrial tribunal had not erred in finding that Mr Bottrill was an employee for the purposes of claiming a statutory redundancy payment.[35] While reluctant to lay down rigid guidelines, the court stated that in situations such as this:

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33 At 684.

34 *Supra*. See also the more recent decision of that court in *Sellars Arenascene Ltd v Connolly* 2001 IRLR 222 (CA). In that case the applicant had been the majority shareholder in a company, E Ltd, of which A Ltd was a subsidiary and subsequently the employer. The applicant was managing director of both companies. The applicant had been dismissed following the acquisition of the two companies by a holding company, but the tribunal had no jurisdiction to entertain his application unless his employment had begun before the acquisition. The court held that a controlling shareholding in a company, although significant, was not a determinative factor when considering whether a shareholder or director of a company was an employee.

35 For an interesting example of the application of the principles espoused by the Court of Appeal in *Bottrill* see the decision of the Northern Ireland Industrial Tribunal in *Fitzgerald & Another v Department for Employment and Learning (Status of Applicants)* 2002 NIIT 190 (18 December 2002).

> [t]he first question which the tribunal is likely to wish to consider is whether there is or has been a genuine contract between the company and the shareholder. In this context how and for what reasons the contract came into existence (for example whether the contract was made at a time when insolvency loomed) and what each party actually did pursuant to the contract are likely to be relevant considerations.
>
> If the tribunal concludes that the contract is not a sham, it is likely to wish to consider next whether the contract, which may well have been labelled a contract of employment, actually gave rise to an employer/employee relationship. In this context, of the various factors usually regarded as relevant . . . the degree of control exercised over the shareholder employee is always important. This is not the same question as that relating to whether there is a controlling shareholding. The tribunal may think it appropriate to consider whether there are directors other than or in addition to the shareholder employee and whether the constitution of the company gives that shareholder rights such that he is in reality answerable only to himself and incapable of being dismissed. It may be relevant to consider whether he is able under the articles of association to vote on matters in which he is personally interested, such as the termination of his contract of employment. Again, the actual conduct of the parties pursuant to the terms of the contract is likely to be relevant. It is for the tribunal as an industrial jury to take all relevant factors into account in reaching its conclusion, giving such weight to them as it considers appropriate.[36]

4 CONCLUSION

From the above survey of decisions by the South African and United Kingdom courts it is apparent that a worker's shareholding or interest in an employer may count against that person being viewed as an employee. However, the mere fact that the worker has such a shareholding or interest, even a *controlling* shareholding or interest, should not be considered sufficient in itself to preclude that person being viewed as an 'employee' for the purposes of the application and protection of labour legislation. This question is going to become increasingly important in light of black economic empowerment initiatives. There is a drive to empower workers by way of increasing their shareholding in companies or interests in close corporations.

The question to be answered in each case is whether labour legislation should find application to particular kinds of workers. It has been forcefully argued that it should apply to workers who are dependent on their employers and thus vulnerable to exploitation. It is inherent in labour law to protect the vulnerable worker and ensuring their protection and, in light of section 23 of the Constitution, is now a constitutional imperative.[37] In 2002 the legislature signalled that economic dependence is important in assessing whether a worker is an 'employee'. The entrepreneur business-owner pursuing his own ends in the commercial world is clearly not the intended target of labour law. A distinction must therefore be drawn

36 A similar approach was suggested by the Labour Court in *Building Bargaining Council (Southern and Eastern Cape) v Melmon's Cabinets CC & Another* (2001) 22 *ILJ* 120 (LC).

37 Cheadle in Cheadle *et al South African Constitutional Law: The Bill of Rights* 366–369.

between, on the one hand, those who are in business for their own account and who dictate their own course and, on the other hand, those who (in the context of their work) are controlled by others and obliged to render personal services to one entity only. Only the latter should be covered by labour legislation.

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