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A legal update from Dechert's Employment Law Group

UK Court of Appeal: Fixed-Share LLP Member Was Not an Employee

This *DechertOnPoint* reports on the Court of Appeal's recent decision confirming that, on the particular facts of the case, a member of a fixed share Limited Liability Partnership (LLP) was not an employee and was not therefore entitled to the statutory rights — such as to claim unfair dismissal — that attach to employee status. Whilst each case must always be considered on its own facts, this decision will be welcomed by both professional services firms and businesses in the financial services sector which utilise the LLP structure.

Introduction

The LLP, as a business structure, is widely used not only by professional services firms but also in the financial services sector. One concern for those establishing and operating LLPs is whether a member of an LLP can argue that he or she enjoys the statutory rights to which employees are entitled. This is a particular concern with regard to the removal of a partner/LLP member and has been addressed in several cases over recent years, the most recent of which is *Tiffin –v- Lester Aldridge LLP* in which the issue of whether Mr Tiffin, as a fixed share partner of an LLP, was an employee was considered by the Employment Appeal Tribunal ("EAT") and now the Court of Appeal.

Mr. Tiffin, a solicitor, was a fixed-share partner at Lester Aldridge LLP. When he became a fixed share partner, Mr Tiffin received a P45, his National Insurance contribution classes changed, he was required to make his own pension arrangements, he made a small capital contribution to the firm and was paid monthly drawings based on estimated annual profit (rather than a salary). Mr Tiffin also received five profit share points and was a signatory on the firm's client and office bank accounts. After a provisional dismissal notice was served on him, Mr. Tiffin left the firm on 14 February 2009 and subsequently brought claims, based on his contention that he was in reality an employee, for unfair dismissal, breach of contract and a statutory redundancy payment.

Employment Appeal Tribunal

The EAT upheld the Employment Tribunal's original decision that Mr. Tiffin was a partner and not an employee. In reaching this decision the EAT made the following points:

- although Mr. Tiffin only had a limited right to attend, vote and make representations at partnership meetings, there is no minimum number of votes or minimum type of rights to vote or to participate in management decisions which a person must have before he or she can be regarded as being a partner;
- although Mr. Tiffin had only contributed £6,500 of capital to the firm (whereas the full equity partners had contributed £150,000 each) and he was only entitled to a fixed share of profits plus a very small share of residual profits and losses, there is no minimum level of profits or contribution which a person must make before he or she can be regarded as being a partner;
- Mr. Tiffin was entitled to a share of the residue of the firm when it was wound up.

The EAT considered that the Employment Tribunal had examined the true nature of the relationship between Mr. Tiffin and the firm and had not been unduly influenced by his label as a 'fixed-share partner'. Although there were some factors consistent with Mr. Tiffin being an employee, including the fact that he was provided with benefits, had an obligation to work during core hours and work was provided to him by others, the EAT found that the employment tribunal had asked itself the correct question as to whether Mr. Tiffin was a partner and not an employee.

The Statutory Test for LLPs

Section 4(4) of the Limited Liability Partnerships Act 2000 (LLPA 2000) is the starting point for determining the employment status of an LLP member and provides that:

> *A member of a limited liability partnership shall not be regarded for any purpose as employed by the limited liability partnership unless, if he and the other members were partners in a partnership, he would be regarded for that purpose as employed by the partnership.*

So, if the individual would have been a partner in a "traditional" partnership, had the business been formed as a partnership rather than an LLP, then he or she will not be an employee. In applying this provision to the question of an LLP member's status, the Court of Appeal confirmed that there is a two stage analysis which must be applied to determine whether an LLP member can establish employee status. The two questions to be addressed are as follows:

- on the hypothetical assumption that the LLP is being carried on as a partnership, would that particular individual be a partner?
- only if the individual would **not** be a partner in the notional partnership, would he or she instead be an employee of the partnership (rather than, for example, a self-employed consultant)?

The Court of Appeal stressed that, if the answer to the first question is yes (i.e. that the individual **would be** a partner in the notional partnership), then employee status is not established — one cannot be simultaneously a true partner and an employee.

The Court of Appeal

The Employment Tribunal had made a finding of fact that, in relation to the first part of the test, Mr Tiffin, in his capacity as a fixed-share member, would have been a partner in the notional Lester Aldridge partnership. The Court of Appeal noted that the Employment Tribunal had expressly found that the members' agreement was not a sham and that it accurately reflected the intentions of the parties. Mr Tiffin's bid for employee status therefore failed at the first hurdle - since he would have been a partner (and he could not be both a partner and an employee), there was no need to go on to consider the second part of the test.

In reaching this conclusion, a distinction was drawn between, on the one hand, the fixed share partners of Lester Aldridge LLP, who were judged to have partnership status, and the salaried partners of Lester Aldridge LLP, who made no capital contribution, had no share of the profits, including on a winding up, and no voice as of right in relation to the management of the firm, and who therefore were judged to have employee status. The Court of Appeal recognised that, as well as having a significantly greater say in its management, the full equity members put considerably more into the business by way of capital and also expected to get considerably more out of it in the way of profits than the fixed-share equity members.

However, the Court of Appeal found that the **character** of the interests in the LLP of the full equity members and the fixed-share members were nevertheless essentially the same: all had to contribute capital, all had a prospect of a share of profits depending upon the performance of the LLP in any particular accounting year, all had a prospect of a share in the surplus assets on a winding up and all had a voice in the management of the affairs of the LLP. These two categories of member were not employees whereas, as the members' agreement itself made clear, the salaried members were employees — they made no capital contribution, had no share of the profits, no share in surplus assets on a winding up and no say as of right in relation to the management of the firm.

The Court of Appeal confirmed that there is no legal authority which specifies that matters addressed in a membership agreement which might indicate partnership rather than employee status such as, for example, an individual's profit share, contribution or voting rights, must reach a certain minimum level before he or she can be regarded as being a partner and therefore not an employee.

A Previous Example: *Kovats*

The possibility of a member of an LLP nonetheless being an employee of the LLP was also addressed in 2009 in *Kovats -v- TFO Management LLP and the Family Group of Companies.* In that case, the EAT confirmed that a member of an LLP can also be an employee but upheld the employment tribunal's decision in the LLP's favour rejecting Mr. Kovats' claim. Mr. Kovats was appointed as TFO's Chief Investment Officer after being headhunted to develop its London presence. To formalize the relationship, Mr. Kovats signed a deed of accession to the LLP's Membership Agreement as well as a separate side letter setting out his additional responsibilities as CIO. Two years after Mr. Kovats joined the LLP, the relationship soured when the other members felt he was failing to meet their expectations. Mr. Kovats was forced to retire. He subsequently brought a claim in the Employment Tribunal alleging that he had been unfairly dismissed. To succeed, Mr. Kovats needed to persuade the tribunal that he was an employee.

In its finding that Mr. Kovats was not an employee, the Employment Tribunal used the Membership Agreement as its starting point, but also delved into the underlying realities of the relationship between the parties. The factors which the tribunal took into consideration in denying Mr. Kovats employee status were that he:

- was intended to share in the profits of the LLP;
- had no direct contractual relationship with the group of companies (save for his membership of the LLP);
- operated with a substantial degree of autonomy (in respect of the LLP's London operation);
- could and did choose for his salary to be paid gross; and
- had not, before his retirement, alleged that his membership of the LLP was a sham.

Implications

Individuals may well be content to give up their statutory employment rights for the increased rewards that may accompany promotion to partnership or membership of an LLP and the possibility of favourable tax treatment for the organisation. However, if the relationship breaks down, an LLP member may seek nonetheless to establish employee status in order to be able, for example, to claim unfair dismissal. There can never be total certainty as to whether or not a particular fixed-share partner or LLP member will be found to be or not to be an employee as the question is clearly dependent on the specific facts of each case i.e. the particular circumstances of the LLP in question and the precise entitlements attaching to the particular type of LLP member in question under the specific arrangements being challenged. Nonetheless, the Court of Appeal has in *Tiffin* given a clear indication that fixed-share LLP members can be considered not to be employees despite the fixed nature of their profit share and less extensive entitlements than those of full equity partners.

Those structuring LLP arrangements will need to bear in mind the issues raised in *Kovats* and *Tiffin*. Not only do they need to ensure that their arrangements are genuine and cannot be attacked as a sham, they will also potentially need to address, in circumstances where there may be doubt about an individual's legal status and the individual might assert a statutory employment right (such as not to be unfairly dismissed or to maternity leave), whether the approach to be adopted should be closer to that applied to an employee than might otherwise be the case.

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