Appeal No. UKEAT/0073/13/RN

EMPLOYMENT APPEAL TRIBUNAL

FLEETBANK HOUSE, 2-6 SALISBURY SQUARE, LONDON, EC4Y 8AE

At the Tribunal
On 28 June 2013
Judgment handed down on 9 May 2014

Before

HIS HONOUR JEFFREY BURKE QC

(SITTING ALONE)

SECRETARY OF STATE FOR BUSINESS, INNOVATION AND SKILLS APPELLANT

MRS P KNIGHT RESPONDENT

Transcript of Proceedings

JUDGMENT

APPEARANCES

For the Appellant	MR DAVID BARR (of Counsel) Instructed by: TSOLS One Kemble Street London WC2B 4TS
For the Respondent	MR MATTHEW JACKSON (Representative) Free Representation Unit Ground Floor 60 Grays Inn Road London WC1X 8LU

SUMMARY

CONTRACT OF EMPLOYMENT

The Claimant claimed from the Insolvency Service the redundancy payment which her company, of which she was the Managing Director and sole shareholder, had not paid to her. The Tribunal found that she was an employee of the company when it ceased trading, as insolvent. The Claimant had not been paid any salary for the last 2 years of the company's trading; her evidence was that because times were hard she forfeited her salary in that period to enable other employees and creditors to be paid.

On appeal by the Secretary of State, held:-

1 The Tribunal had not failed to consider the position as it had been at the time when the claimed obligation arose but had decided that the Claimant was an employee at that time.

2 On the findings of fact there was no lack of mutuality or of consideration.

3 It was open to the Tribunal to conclude on the facts that the Claimant had not discharged or varied her contract of employment by not taking salary for the last 2 years. Perversity was not made out.

Appeal dismissed

HIS HONOUR JEFFREY BURKE QC

The nature of the appeal

1. By this appeal, the Secretary of State for Business, Innovation and Skills appeals against the judgment of the Employment Tribunal at Watford, constituted by Employment Judge Smail, sitting alone, which was sent to the parties on 23 October 2012. By that judgment, the Tribunal found that the Claimant, Mrs Knight, was an employee of Receptors Security Systems (UK) Ltd ("the company"), which was insolvent and that she was, as a result, entitled to a redundancy payment from the Insolvency Service of £7296.

2. There was, before the Tribunal, no issue as to the insolvency of the company and no issue but that, if Mrs Knight was an employee of the company at the relevant time, she was entitled, pursuant to section 166 of the **Employment Rights Act 1996**, to payment of the sum awarded by the Insolvency Service. It was equally common ground that if she was not an employee of the company at the relevant time she had no such entitlement. Nothing turns on the words of the statutory provisions. The definition of "employee" under that Act is well known, namely "an individual who has entered into works under (or, where the employment has ceased, worked under) a contract of employment". The issue before the Employment Judge was – was Mrs Knight an employee of the company at the relevant time? And the issue before me on appeal is – did the Employment Judge err in law in deciding that issue in favour of Mrs Knight?

The facts

3. The primary facts were set out by the Employment Judge in admirably brief terms: and I will endeavour to do the same. The company was incorporated in February 1991 and ceased trading, as insolvent, on 18 October 2011. Mrs Knight was the Managing Director of the company and owned 100% of its shares. When the company started business, a contract of

employment was drawn up between it and Mrs Knight; it was dated 13 June 1991 and referred to Mrs Knight's employment as Managing Director starting on that date and continuing thereafter, subject to termination on two months notice or otherwise in certain circumstances, including gross misconduct. None of those circumstances applied in this case. The document provided for working hours of 9am to 5:30pm from Monday to Friday and for a salary of £20,000 per annum and discretionary bonuses. There were other terms into which it is not necessary to go. That document was never formally executed; but Mrs Knight worked for the company from its inception until its end. The Employment Judge found that she had particular responsibility for sales and marketing and wrote all the tender documentation for contracts for which the company put forward bids; she worked, he found, from 8am to 7pm and travelled extensively on behalf of the company.

4. Although the document provided for the salary to which I have referred, Mrs Knight's evidence was that, when the company was operating satisfactorily, she would be paid £1000 per month "take-home". The judge found that, apart from paying the other employees, the intention was that any profits would be ploughed back into the business and that Mrs Knight had taken no money from the business other than what she received by way of pay.

5. Mrs Knight produced P60s which showed that she had been paid by the company as an employee: the amounts varied; in the year 06/07 the amount on the P60, was £4728; the same applied in the following year; for 08/09 the amount was £11394. The existence of P60s indicated that PAYE was deducted from payments which Mrs Knight received; and there was no suggestion that any tax and national insurance due were not paid as if she was an employee. However, the judge found that, in the last two years of the company's trading, Mrs Knight, in an effort to keep the company afloat, did not enforce her contractual entitlement to pay and, therefore, received no monies at all. In her witness statement, she said that she was unpaid

because of the difficulties which meant that there was insufficient money to pay her and that she had forfeited her salary in favour of her colleagues and in order to pay suppliers. Her efforts did not succeed; the company became insolvent and ceased to trade; hence her claim to a redundancy payment from the Insolvency Service.

The Appellant's submissions

6. On behalf of the Secretary of State, Mr Barr of counsel sought to put the appeal against the conclusion of the Employment Judge that Mrs Knight was an employee and was therefore entitled to the payment which she sought under 3 heads; they were, in the order in which they were put: –

1. The Employment Judge had reached a perverse conclusion which no reasonable judge could have reached;

2. He had erred in law in that, Mrs Knight having forfeited her entitlement to pay by the company, she had changed her position; there was thereafter no consideration moving from the company and no mutuality between them which would support the existence of a contract of employment which continued up to the relevant time, when the company ceased trading and Mrs Knight became redundant;

3. He had erred in failing to focus on whether Mrs Knight was an employee at the moment of the company's insolvency, whatever the position had been earlier.

The new point issue

7. I will come to each of those points; but before I do so, there is a preliminary point which I must address. Mr Jackson on behalf of Mrs Knight objected to Mr Barr's seeking to put forward the second of those 3 arguments. He submitted that the case against Mrs Knight before the Employment Judge had not been run on the basis that, if she had ever been an employee of the company, that contractual position changed when she stopped drawing salary and worked without remuneration during the last two years of the company's existence. The case of the Secretary of State before the Tribunal had, he submitted, been run on the basis simply that Mrs Knight was never an employee and that, since she was not drawing any remuneration at the date of the termination, she was not entitled to any award if she was an employee (a point which has not been raised in this appeal, I should state).

8. Mr Barr did not accept that the position before the Employment Judge was as Mr Jackson had submitted. He argued that the Secretary of State had put Mrs Knight to proof of her claim, that that manifestly involved her proving her entitlement as at the date of the termination of the company's cessation and that the Employment Judge had been taken through the leading modern decision in this area of the law, **SoS for Business, Enterprise and Regulatory Reform v Neufeld** [2009] ICR 1183, which set out the factors to be considered in a case such as the present, which factors included consideration of whether there had originally been a genuine contract of employment and whether, if there had been, it had been varied or discharged; the Employment Judge, he submitted, had been expressly asked to consider whether, if there had in the past been a genuine contract of employment in the present case, on the evidence it no longer subsisted at the relevant time. The point which he wished to argue was not a new point at all; nor , if it were, should I refuse to allow him to put the point forward; contrary to Mr Jackson's submission, no new evidence was required to enable the point to be resolved.

9. Neither Mr Jackson nor Mr Barr appeared before the Employment Judge. I was not invited to make enquiries of the Employment Judge in order to obtain his recollection, if any, of what had happened at a relatively brief hearing, with one witness only, some months previously. I informed the parties that I would address the new point issue in my judgment and proceeded to hear the substance to arguments on both sides.

10. I do not need to set out the familiar principles which apply when a party seeks to take, on appeal, a point not taken before the Tribunal; they are set out in well-known authorities such as **Kumchyk v Derby City Council** [1978] ICR 1116 and **Jones v Governors of Burdett-Coutts School** [1998] EWCA Civ 602. If I were to have been persuaded that Mr Barr's point was truly new, I would, applying those principles, nevertheless have allowed him to make it. I do not accept that any new evidence would be required; the only evidence available was that of Mrs Knight, who had made a witness statement and was no doubt cross-examined on it; she produced the documents which were available; there is no suggestion that there were any more; the factual material was all before the Employment Judge; it was for him to resolve the issues on the basis of what Mrs Knight said and what the documents showed.

11. However, I am not persuaded that the point was new at all. The Secretary of State's ET3 was in very general terms; it put Mrs Knight to proof that she was an employee. It was clear that she had to be an employee at the time when she claimed that the redundancy payment fell due; that must have been clear to the Employment Judge; she could not succeed if she had once been an employee but, by the time the claimed liability was said to have arisen, she had ceased to be so; and the Employment Judge did not decide the case on any other basis. It appears that the emphasis has changed to a degree in that it is no longer contended that Mrs Knight never

was an employee; but the Employment Judge had to approach the case on the basis of her status at the relevant time and no other.

12. Accordingly, I will proceed on the basis that all of Mr Barr's arguments have to be addressed, as - pending my decision on the new point issue - they were in argument.

The law

13. Although I was provided with a comprehensive bundle of 15 authorities, stretching from 1922 to 2012, and containing over 200 pages, to assist me in an area of the law in which clear guidance was set out by the EAT, Elias P presiding, in **Clark v Clark Construction Initiatives Ltd** [2008] ICR 635, and by the Court of Appeal in **Neufeld** (see reference above), I was taken to only a small proportion of those authorities; and for the purpose of this appeal it is not necessary to go beyond that guidance to any substantial extent. I should first refer, as a point of departure to which any employment lawyer turns by nature when considering whether an individual is or is not an employee, to the judgment of McKenna J in **Ready Mix Concrete v Minister of Pensions and National Insurance** [1968] 2 QB 497 in which, at page 515C to D, he said:-

> **"A contract of service exists if these three conditions are fulfilled. (i) The servant agrees that, in consideration of a wage or other remuneration, he will provide his own work and skill in the performance of some service for his master. (ii) He agrees, expressly or impliedly, that in the performance of that service he will be subject to the other's control in a sufficient degree to make that other master. (iii) The other provisions of the contract are consistent with its being a contract of service……..As to (i) there must be a wage or other remuneration. Otherwise there will be no consideration, and without consideration, no contract of any kind. The servant must be obliged to provide his own work and skill…"**

14. There is much in the authorities as to the way in which the law has developed in cases in which a claimant, who was a director and/ or majority or sole shareholder of a limited company, asserted that he or she was an employee of that company. Decisions such as **Lee v Lee's Air Farming** [1961] AC 12 HL, **Bottrell v SoS** [1999] ICR 592 CA and **Smith v SoS** [2000] ICR

69, EAT, established that, whether the claim under consideration was a claim against the company or a claim against the Secretary of State for a payment from public funds in respect of the sum claimed to be owed to an employee but unpaid because the company was insolvent, the fact that the claimant had a controlling interest in the company did not prevent him or her from succeeding; the facts of each case had to be individually considered.

15. In **Clark** at para 68 the EAT, said:-

> **"That case demonstrates that even someone who has total control over the operation of the company – because in that case he was governing director, as well as being effectively the sole shareholder – can enter into a binding and effective contract of employment with the company."**

And at para 61, the EAT said:-

> **"We turn first to consider the case law relating to this question. Two principles seem to be firmly established. The first, enunciated in a stream of cases, is that whether the contract of employment exists is for the tribunal to determine as an industrial jury."**

16. The specific guidance given by the EAT in **Clark**, at paragraphs 92 to 94, put forward 3 sets of circumstances where it might be legitimate not to give effect to what was alleged to be a binding contract of employment. The first such set arises where the company itself is a sham; the second is where the contract is entered into for some ulterior purpose; and the third is where the parties do not in fact conduct their relationship in accordance with the contract. At paragraph 98, the EAT put forward the following factors as being of assistance in determining whether what appeared to be a contract of employment should be given effect or not, namely:-

> **"(1) Where there is a contract ostensibly in place, the onus is on the party seeking to deny its effect to satisfy the court that it is not what it appears to be. This is particularly so where the individual has paid tax and national insurance as an employee; he has on the face of it earned the right to take advantage of the benefits which employees may derive from such payments. (2) The mere fact that the individual has a controlling shareholding does not of itself prevent a contract of employment are rising. Nor does the fact that he in practice is able to exercise real or sole control over what the company does; *Lee*'s case. (3) Similarly, the fact that he is an entrepreneur, or has built the company up, or will profit from its success, will not be factors militating against a finding that there is a contract in place. Indeed, any controlling shareholder, will inevitably benefit from the company's success, as will many employees with share option schemes;… (4) If the conduct of the parties is in accordance with the contract, that would be a strong pointer towards the contract being valid and binding. For example this**

would be so if the individual works the hours stipulated or does not take more than the stipulated holidays (5) Conversely, if the conduct of the parties is either inconsistent with the contract (in the sense described in paragraph 96) or in certain key areas where one might expect it to be governed by the contract is in fact not so governed, that would be a factor, and potentially a very important one, militating against a finding that the controlling shareholder, is in reality an employee……"

17. The Court of Appeal in **Neufeld** approved of that guidance and both developed and applied it to cases of claims against the Secretary of State (which **Clark** was not). The judgment of court, at paragraphs 80-81, sets out these principles:-

> **"There is no reason in principle why someone who is a shareholder and director of a company cannot also be an employee of the company, under a contract of employment. There is also no reason in principle why someone whose shareholding in the company gives him control of it – even total control (as in *Lee*'s case) – cannot be an employee. In short, a person whose economic interest in a company and its business means that he is in practice properly to be regarded as their "owner" can also be an *employee* of the company. It will, in particular, be no answer to his claim by such an employee to argue that (i) the extent of his control of the company means that the *control* condition of a contract of employment cannot be satisfied; or (ii) that the practical control he has over his own destiny – including that he cannot be dismissed from his employment except with his consent – has the effect in law that he cannot be an employee at all.…**
>
> **Whether or not such a shareholder /director is an employee of the company is a question of fact for the court or tribunal before which such issue arises …"**

And, at para 83 the court said:-

> **"An enquiry into what the parties have done under the purported contract may show a variety of things; (i) that they did not act in accordance with the purported contract at all, which would support the conclusion that it was a sham; or (ii) that they did act in accordance with it, which will support the opposite conclusion; or (iii), that although they acted in a way consistent with a genuine service contract arrangement, what they have done suggests the making of a variation of the terms of the original purported contract; or (iv) that there came a point when the parties ceased to conduct themselves in a way consistent with the purported contract or any variation of it, which may invite the conclusion that, although the contract was originally a genuine one, it has been impliedly discharged. There may obviously also be different outcomes of any investigation into how the parties have conducted themselves under the purported contract. It will be a question of fact as to what conclusions are to be drawn from such investigation."**

Error of law

18. The Employment Judge is said to have fallen into error by failing to consider not whether there was historically a contract of employment between Mrs Knight and the company but whether there was a subsisting contract of employment at the date of the insolvency. The essence of Mr Barr's argument was that, if the judge had followed the guidance set out above, he would and should have appreciated that Mrs Knight had impliedly agreed to work for no

consideration during the last two years; she had never drawn the apparent £20,000 per annum which the unsigned contract of employment purported to agree, said that she had taken £1000 per month take-home pay for several years, took substantially less in the years for which she had produced P60s and then forfeited pay altogether. Mr Barr placed emphasis on Mrs Knight's use of the word "forfeited" as demonstrating that she had agreed to work for no salary and, indeed, without any consideration; but the judge had failed to appreciate that the only inference from the facts was that she had agreed to change her status.

19. I do not accept these submissions. I prefer Mr Jackson's argument on behalf of Mrs Knight that the Employment Judge did not make the error for which Mr Barr contends. At paragraph 2 of his judgment the Employment Judge set out that it was necessary for Mrs Knight to have been an employee, so that the company would have been under an obligation to pay her a redundancy payment. That is a clear indication that he was directing himself that she could only sustain her claim if she was an employee at the relevant time, when the obligation on which she based her claim arose. At paragraph 7 he specifically considered whether the contract of employment, which Mr Barr expressly admitted (although this does not seem to have been admitted before the Tribunal) had existed before Mrs Knight forfeited her right to salary, existed during the last two years of the company's existence and held that Mrs Knight had chosen not to ask the company to honour her contractual entitlement to pay in order to keep the company afloat. That finding is inconsistent with her having agreed with the company that no salary would be payable – thereby agreeing that she would be unpaid even if, hypothetically, the company had suddenly landed a highly profitable new contract and found itself in a position in which it could pay what otherwise would have been her contractual salary. When the admirably concise judgment is read as a whole, it is clear that the Employment Judge found Mrs Knight to have been an employee during those 2 years in which she drew no salary and that

she was an employee at the relevant date, the date at which the claimed obligation arose. No other date was relevant.

20. The fact that an employee decides not to require her company to pay her salary as an employee does not necessarily lead to the conclusion that she must be taken to have entered into an agreed variation of the contract or a discharge of that contract. That proposition is amply supported by the guidance to which I have already referred and is underlined by paragraph 51 of the decision in **Neufeld**, which is in these terms: –

> **"As to his not drawing his salary, we can see that it would point against the existence of a contract of employment if his remuneration had been generally irregular. But we find it difficult to see how it could be concluded that he was not entitled to the payment of a salary if it had been paid with regularity until the final month: and if he was contractually entitled to it, the fact that he did not take it could not retrospectively diminish his right."**

21. Whether the regularity of payment in this case negatived the continuing existence of a contract of employment was a matter of fact for the Employment Judge; he had to decide whether the evidence showed that the contract of employment had been varied or discharged or whether there had only been a choice by Mrs Knight not to take her salary when the company was in difficulties: and the judge found on the facts in favour of the latter alternative. I have concluded that the judge did not make the error of law for which Mr Barr contends; there is no trace of his thinking that, because there was once a contract of employment, there was, necessarily, a contract of employment at the relevant time. He examined the position at that relevant time and made a factual conclusion as to it.

22. Mr Barr laid emphasis on the use by Mrs Knight of the word "forfeited"; but this did not have to be understood as meaning that Mrs Knight had agreed not to take any salary at all or had brought her contract of employment to an end: it is not inconsistent with the Employment Judge's findings as to what had happened.

Consideration/mutuality

23. On the findings to which I have referred, the argument that the arrangement between Mrs Knight and her company in the last two years had no mutuality or was not a contract at all because there was no consideration moving from the employer to the employee cannot, in my judgment, succeed. In any event, although McKenna J suggested in **Ready Mix** that remuneration in some form is an essential ingredient of a contract of employment, there may be a contract of employment, as I see it, in which the employee does not seek payment, yet which would not fail for lack of mutuality or absence of consideration. Under such a contract an employee could owe a duty to carry out whatever work he or she had agreed to do; and the employer would have to fulfil obligations which might not involve the payment of money, e.g. the provision of tools and equipment or the taking of reasonable care for the employee's health and safety. Money is not the only consideration which may move from an employer under a contract of employment. However, it is unnecessary for me to speculate further on matters which are, in the context of the findings of fact wholly theoretical; the findings of the Employment Judge and my analysis of them lead me to conclude that there was no absence of either consideration or mutuality.

Perversity

24. The authorities to which I have referred set out the clear principle that the decision on an issue such as that which confronted the Employment Judge in this case is essentially one of fact. The absence of payment under what is said to be a contract of employment is a factor which the tribunal of fact has to consider and take into account. If an appellant seeks to demonstrate that there has been perversity in the sense that an employment judge has reached a decision which no reasonable judge could have reached, he must demonstrate that perversity overwhelmingly; see **Yeboah v Crofton** [2001] EWCA Civ 1309 per Mummery LJ at para 93.

25. Mr Barr submitted that the only reasonable conclusion here was that the contract of employment came to an end two years before the claimed obligation arose. In my judgment, it was open to the Employment Judge on the evidence to reach the conclusion that Mrs Knight had not brought her contract of employment to an end, but had simply chosen not to enforce her entitlement to pay in order to keep the company afloat. Whether he drew the inference for which Mr Barr now contends, that she had brought the contract of employment to an end or the inference that she had simply decided not to draw her salary because of the company's difficulties was a matter for him and for him alone; it has not been demonstrated that he could only have chosen the first of those two alternatives. Perversity has not been demonstrated, still less overwhelmingly demonstrated.

Conclusion

26. For the above reasons this appeal fails, and is dismissed.