



EMPLOYMENT TRIBUNALS

BETWEEN

Claimant
MR R LYNN

AND

Respondent
THE SECRETARY OF STATE
FOR BUSINESS AND TRADE (R1)

ROBERT W LYNN LTD (IN
CREDITOR'S VOLUNTARY
LIQUIDATION) (R2)

JUDGMENT OF THE EMPLOYMENT TRIBUNAL

HELD AT: BRISTOL ON: 19TH APRIL 2024

EMPLOYMENT JUDGE MR P CADNEY
(SITTING ALONE)

MEMBERS:

APPEARANCES:-

FOR THE CLAIMANT:- IN PERSON

FOR THE RESPONDENT:- MR P SONI (R1)
NO ATTENDANCE (R2)

JUDGMENT

The judgment of the tribunal is that:-

1. The claimant was not at the date of the insolvency an employee of Robert W Lynn Ltd (in Creditor's Voluntary Liquidation) (R2) within the meaning of s230 Employment Rights Act 1996.
2. The claimant's claim that the Secretary of State (R1) is liable to make payments to him pursuant to s166/182 Employment Rights Act 1996 is not well founded and is dismissed.

Reasons

1. By this claim the claimant brings claims against Robert W Lynn Ltd (R2) for a statutory redundancy payment, notice pay, unpaid wages and unpaid holiday pay. He asserts that he was an employed director of the company. R2 has not entered a response and has not participated in this hearing. R2 has no funds to meet any judgment, and the only purpose of any judgment being entered against it would be to obtain payments from the Secretary of State, to whom the claimant has made a claim which has been refused.
2. He also pursues the claims against the Secretary of State (R1 "SoS") for payments from the National Insurance Fund pursuant to s166/182 of the Employment Rights Act 1996. R1 accepts that R2 is insolvent within the meaning of those sections but disputes liability on the basis that it asserts that the claimant was not an employee of R2.
3. The parties have agreed that I determine in principal whether the claimant was an employee within the meaning of s230 (ERA 1996). If I do further time will be given to calculate the amounts owed by the SoS.

Facts

4. The claimant was prior to 2004 a painter and decorator operating as a sole trader. In April 2004 R2 was incorporated and used as the trading entity via which he carried on his painting and decorating business. The claimant is and has always been the sole shareholder and director of the company. He asserts that he was an employed director which the SoS disputes. He was never issued with any formal or written contract of employment, and none of the terms were ever reduced to writing.
5. Since incorporation he has always been paid, via PAYE, income at or about the limit of the personal allowance for income tax purposes and/or national insurance contributions. The claimant's evidence, which I accept, is when he incorporated the company that he was advised by his former accountant that it was standard practice to pay earnings at or below the Income Tax / NI threshold as earnings from employment, and to take any further amounts from the Director's Loan Account, and he accepted his accountant's advice. Thereafter he withdrew money from the companies bank account, which on the evidence before the tribunal was all marked "wages". His accountant produced payslips showing his earnings for any given month but they did not necessarily correspond with amounts identified as withdrawn as wages in the bank statements. His income in the last three years of employment was £12,071.42 (2021), £12,487.68 (2022), and £12,588.00 (2023). He worked a 47 hour week, giving average hourly pay in his last year of £5.09. It is not in dispute that he was consistently paid below the national minimum wage. He was paid for 28 days holiday per year and if sick would receive sick pay. At the point of liquidation he was owed his last two months' salary which he had taken the decision not to pay himself

as the company had no money; and £6,050 on his Director's Loan Account. He had put some £18,700 into the company since June 2022.

6. As he is the sole director/shareholder he accepts that the only person who could control or direct his work was himself; the only person who could discipline him, if for example he failed to attend work during normal working hours, was himself; and equally the only person who could hear any grievance was himself.
7. The company went into liquidation when he discovered that his previous accountant had not filed accounts with HMRC for the previous five years and he was advised by his new accountant to place the company into liquidation

Secretary of State's Liability

8. The liability of the Secretary of State to make any payment derives from the Employment Rights Act 1996 as set out below:

i) Section 166 of the Employment Rights Act 1996 ("ERA") provides:

s166 Applications for payments.

(1) Where an employee claims that his employer is liable to pay to him an employer's payment and either—

(a) that the employee has taken all reasonable steps, other than legal proceedings, to recover the payment from the employer and the employer has refused or failed to pay it, or has paid part of it and has refused or failed to pay the balance, or

(b) that the employer is insolvent and the whole or part of the payment remains unpaid,
the employee may apply to the Secretary of State for a payment under this section.

(2) In this Part "employer's payment", in relation to an employee, means—

(a) a redundancy payment which his employer is liable to pay to him under this Part,

(aa) a payment which his employer is liable to make to him under an agreement to refrain from instituting or continuing proceedings for a contravention or alleged contravention of section 135 which has effect by virtue of section 203(2)(e) or (f), or

(b) a payment which his employer is, under an agreement in respect of which an order is in force under section 157, liable to make to him on the termination of his contract of employment.

...

ii) Section 182 of the ERA provides:

182 Employee's rights on insolvency of employer.

If, on an application made to him in writing by an employee, the Secretary of State is satisfied that—

(a) the employee's employer has become insolvent,

(b) the employee's employment has been terminated, and

(c) on the appropriate date the employee was entitled to be paid the whole or part of any debt to which this Part applies,

the Secretary of State shall, subject to section 186, pay the employee out of the National Insurance Fund the amount to which, in the opinion of the Secretary of State, the employee is entitled in respect of the debt.

iii) Section 184 of the ERA applies section 182 to arrears of pay; accrued holiday pay and statutory notice pay (but subject to maximum amounts).

iv) For the Secretary of State to be liable the Claimant must be an employee:

S. 230 of the Employment Rights Act 1996 provides

"230 Employees, workers etc

(1) In this Act "employee" means an individual who has entered into or works under (or, where the employment has ceased, worked under) a contract of employment.

(2) In this Act "contract of employment" means a contract of service or apprenticeship, whether express or implied, and (if it is express) whether oral or in writing.

(3) In this Act "worker" (except in the phrases "shop worker" and "betting worker") means an individual who has entered into or works under (or, where the employment has ceased, worked under)—

(a) a contract of employment, or

(b) any other contract, whether express or implied and (if it is express) whether oral or in writing, whereby the individual undertakes to do or perform personally any work or services for another party to the contract whose status is not by virtue of the contract that of a client or customer of any profession or business undertaking carried on by the individual;
and any reference to a worker's contract shall be construed accordingly.

(4) In this Act "employer", in relation to an employee or a worker, means the person by whom the employee or worker is (or, where the employment has ceased, was) employed.

(5) In this Act “employment”—

(a) in relation to an employee, means (except for the purposes of section 171) employment under a contract of employment, and

(b) in relation to a worker, means employment under his contract; and “employed” shall be construed accordingly.”

Employment Status – General

9. The s230 definition distinguishes between “employed” individuals on the one hand, and self-employed individuals, or independent contractors, on the other; that is between those working under a “contract of service” and those working under a “contract for services”. However, the statute does not set down the circumstances in which an individual may be said to work under a contract of employment.
10. In the absence of any comprehensive definition of a contract of employment, courts and tribunals have developed a number of tests over the years aimed at helping them identify such a contract. It is now accepted that no single factor will be determinative of employee status and a number of factors must be looked at.
11. There are three essential elements which must be present in every contract of employment. They are frequently referred to as the ‘irreducible core’ without which a contract cannot be regarded as a contract of service, taken from MacKenna’s judgment in *Ready Mixed Concrete (South East) Ltd v Minister of Pensions and National Insurance* [1968] 1 All ER 433, QBD. They are:
 - a. An obligation for the Claimant to have provided the work personally;
 - b. Mutuality of obligation;
 - c. The Claimant must have been expressly or impliedly subjected to the control of the Respondent.

Personal service

12. With regards to the first element, even if the contract contained a limited power to delegate, there may still have been the obligation present for the employee to have provided work personally, but where there was a clear express contractual term which did not impose personal obligations, that would ordinarily militate against an employment relationship unless it was a sham or had been varied (*Staffordshire Sentinel-v-Potter* [2004] IRLR 752).

Mutuality of obligation

13. With regards to the second element, an employer and an employee must have been under legal obligations to one another during the entire contractual period under focus. Ordinarily, the obligations will have been upon the employee to undertake work when required/asked and upon the employer to have paid for it. Casual workers ordinarily fall outside of the ambit of this principle (*Carmichael-v-National Power* [2000] IRLR 43). Further, where the express terms of a contract made it clear that such obligations did not exist, there cannot have been an employment relationship. Gaps between assignments were just as relevant as the assignments themselves when considering all of the circumstances (*Sec of State for Justice-v-Windle* [2016] EWCA Civ 459).

Control

14. Finally, the employer must have had a sufficient degree of control, in terms of the general sense of authority exercised over an employee, for such a relationship to have existed. 'Control' in this sense was not to have been equated to the undertaking of work under close supervision.

15. If the three essential elements were present, the relationship *can* have been one of employment, but it was also necessary to consider all of the other surrounding circumstances to finally determine its true nature. Those circumstances can include the degree of personal financial risk, the extent to which the individual provided his/her own equipment, whether the claimant was paid holiday and/or sick pay and whether he/she paid their own tax and national insurance or whether that was achieved through PAYE. There are many different factors that could be relevant.

Sham arrangements

16. A number of cases are relevant to a consideration of situations in which a party alleges that the contractual documentation was a sham and did not reflect the reality of the parties' relationship in law; *Autoclenz Ltd v Belcher and Others* [2010] IRLR 70 CA and [2011] UKSC 41; *Consistent Group Ltd v Kalwak* [2008] IRLR 505 CA; *Firthglow Ltd (t/a Protectacoat) v Szilagyi* [2009] ICR 835 CA and *Snook v London and West Riding Investments Ltd* [1967] 2 QB 786].

17. For the reasons set out below I have not concluded in this case that the agreement was a sham, and it is not necessary to set the authorities out in detail.

Employment Status - Directors and Shareholders

18. The position of shareholders and/or directors has been considered in a number of cases. The former view was that controlling shareholders were not under the control of the employer because they could block any attempt to dismiss. A director's level of control over the business undertaking generally led to a similar conclusion (see *Buchan-v-Secretary of State for Employment* [1997] IRLR 80 EAT in which the Claimant was the

managing director and a 50% shareholder, but was not deemed to have been an employee).

19. However, in *Neufeld v Secretary of State for Business Enterprise and Regulatory Reform* [2009] IRLR 475, the Court of Appeal held that there was no reason in principle why someone who is a shareholder and director of company cannot also be an employee under a contract of employment. It was held:
- a. Whether or not a shareholder/director is an employee is a question of fact. There are in theory two issues: whether the putative contract is genuine or a sham and secondly, where genuine, that it is a contract of employment. (para 81)
 - b. In cases involving a sham, the task is to decide whether such document amounts to a sham. This will usually require not investigation into the circumstances of the document, but also the parties purported conduct under it. The fact that the putative employee has control over the company and the board, and was instrumental in the creation of it will be a relevant matter in the consideration of whether or not it was a sham (para 82)
 - c. An inquiry 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. (para 83)
 - d. In deciding whether a valid contract of employment was in existence, consideration will have to be given to the requisite conditions for the creation of such a contract and the court or tribunal will want to be satisfied that the contract meets them. In *Lee's* case the position was ostensibly clear on the documents, with the only contentious issue being in relation to the control condition of a contract of employment. In some cases there will be a formal service agreement. Failing that, there may be a minute of a board meeting or a memorandum dealing with the matter. But in many cases involving small companies, with their control being in the hands of perhaps just one or two director/shareholders, the handling of such matters may have been dealt with informally and it may be a difficult question as to whether or not the correct inference from the facts is that the putative employee was, as claimed, truly an

employee. In particular, a director of a company is the holder of an office and will not, merely by virtue of such office, be an employee: the putative employee will have to prove more than his appointment as a director. It will be relevant to consider how he has been paid. Has he been paid a salary, which points towards employment? Or merely by way of director's fees, which points away from it? In considering what the putative employee was actually *doing*, it will also be relevant to consider whether he was acting merely in his capacity as a director of the company; or whether he was acting as an employee. (para 85)

- e. We have referred in the previous paragraph to matters which will typically be directly relevant to the inquiry whether or not (there being no question of a sham) the claimed contract amounts to a contract of employment. What we have *not* included as a relevant consideration for the purposes of that inquiry is the fact that the putative employee's shareholding in the company gave him control of the company, even total control. The fact of his control will obviously form a part of the backdrop against which the assessment will be made of what has been done under the putative written or oral employment contract that is being asserted. But it will not ordinarily be of any special relevance in deciding whether or not he has a valid such contract. Nor will the fact that he will have share capital invested in the company; or that he may have made loans to it; or that he has personally guaranteed its obligations; or that his personal investment in the company will stand to prosper in line with the company's prosperity; or that he has done any of the other things that the 'owner' of a business will commonly do on its behalf. These considerations are usual features of the sort of companies giving rise to the type of issue with which these appeals are concerned but they will ordinarily be irrelevant to whether or not a valid contract of employment has been created and so they can and should be ignored. They show an 'owner' acting qua 'owner', which is inevitable in such a company. However, they do not show that the 'owner' cannot also be an employee. (para 86)

20. In *Eaton v Robert Eaton Ltd v Secretary of State for Employment* [1988] IRLR 83, it was ruled that a director of a company is normally the holder of an office and not an employee. Therefore evidence is required to establish that the director was in fact employed.

21. In *Fleming v Secretary of State for Trade and Industry* [1997] IRLR 682, the Court of Session held that whether or not a person is an employee is a question of fact. The fact that a person is a majority shareholder is always a relevant factor and may be decisive. However the significance of the factor will depend on the circumstances and it would not be proper to lay down any hard and fast rule. In that case the Claimant was not found to have been an employee because, amongst other things, he had personally guaranteed loans, had no written contract and had decided not to draw a salary in the hope of saving the business).

22. In *Rainford-v-Dorset Aquatics Ltd* EA-2020-000123-BA, UKEAT/0126/20/BA, it was further said that;

“Although there was no reason in principle why a director/shareholder of a company could not also be an employee or worker, it did not necessarily follow that simply because he did work for the company and received money from it he had to be one of the three categories of individual identified in s. 230 (3) of the Act. Overall, the tribunal's conclusion that the appellant was not an employee or worker was one of fact based on relevant factors and was not perverse.”

23. That was a case involving a claimant who had been a director and a 40% shareholder who was found to have been neither an employee nor a worker. The Claimant had drawn a ‘salary’ which was subject to PAYE and NI deductions, on the advice of the company accountants.

24. In *Secretary of State for Trade and Industry-v-Bottrill* [1999] ICR 592, CA, (as applied in *Sellars Arenascene Ltd-v-Connolly* [2001] ICR 760, CA) Lord Woolf MR suggested that Tribunal’s should consider the following questions:

(a) Was there a genuine contract between the business and the shareholder? One which was not a sham?;

(b) If so, did the contract actually create an employment relationship? Of the various factors which had to be considered, the degree of control is important. It was not just a case of looking at who had the controlling shareholding. A Tribunal had to consider where the real control lay; what role did any other directors/shareholders actually take?

25. In *Clark-v-Clark Construction Initiatives Ltd* [2008] ICR 635, EAT, the list was broadened to include some of the further following factors; Whether the individual was an entrepreneur and/or had built the company up and/or would profit from its success. It was also held that there were three sets of circumstances where it may be legitimate to not give effect to what is alleged to be a binding contract of employment: (1) where the company is a sham, (2) where the contract is entered into for some ulterior purpose, such as to secure some statutory payment from the secretary of state, and (3) the parties had not conducted their relationship in accordance with the contract.

26. In *Rajah v Secretary of State for Employment* EAT/125/95, it was held that the relevant date for the purposes of who the secretary of state is liable to make payments out of the National Insurance fund is the date when the company became insolvent and not the position it was two, five or ten years previously.

Respondent’s Submissions

27. The respondent submits that there are a number of features of the evidence which are contra-indications of employment status. It accepts that none are individually

determinative or conclusive but submits that when taken together they do not reveal a genuine employment relationship:

- i) The claimant never entered into a written contract of employment with the company, nor was there ever any written documentation setting out any of the terms of employment (See para 98(6) Clark) .
- ii) The claimant was paid a salary below national minimum wage rate. This is compatible and consistent with remuneration as an office holder, but not with genuine employment status. It is not open to an employer to pay, or an employee to agree to receive, less than the national minimum wage. However, it is always open to an office holder to agree to receive any amount of remuneration for holding the office and/or set their own rate of remuneration, which is the position in this case. The fact that the claimant agreed to receive less than the national minimum wage is therefore indicative of the fact that he was in reality an office holder and not an employee.
- iii) The claimant received no pay for the last two months of his employment. This was his decision and the claimant's acceptance of a zero pay arrangement is inconsistent with employment status.
- iv) The claimant was not in reality subject to any control as the sole shareholder and director.
- v) That as at the date of insolvency, and for some time prior to insolvency, the Director's Service Agreement did note claimant invested £18,700 of his own funds into the company to keep it afloat.

Claimant's Submissions

28. The claimant submits that :

- i) He must have genuinely been an employee as he was paid via PAYE and the amounts are accurately recorded in the payslips and P60's. Both his former and current accountants agree that he was an employee (for completeness sake there is no evidence before me of this but I have no reason to suppose that it is not true.)
- ii) The payment of salary as an employee at or about the income tax /NI threshold was standard and accepted practice.
- iii) In those circumstances the assertion that he was not an employee is "ludicrous".

Conclusions

29. As there is no written contract of employment the first question is whether the parties in reality ever entered into any verbal contract of employment. On the evidence, all that can be said in my view is that the claimant and the company, acting through the claimant on the advice of his accountant, agreed that he would receive part of his remuneration as salary and be paid that part via PAYE as an employee. That is, in my judgement, the only evidence that a contract of employment ever existed.
30. Insofar as this was the full extent of any agreement I accept the claimant's evidence, and I am satisfied that it was not a sham.
31. However, that does not in and of itself resolve the question of whether it was genuinely a contract of employment (see Bottrill - para 24 above).
32. As is set out above the irreducible minimum of a contract of service/employment contract are personal service, mutuality of obligation, and control.
33. In my judgment it is clear that:
- i) The contract required personal service in that the sole purpose of the company was supply his services;
 - ii) There was mutuality of obligation in that the claimant was obliged to supply his services and the respondent was required, insofar as it was able to, to provide him with work.
34. Whilst the element of control is necessarily somewhat artificial where the claimant is the sole shareholder and director; that does not in and of itself prevent it from being a contract of employment and will always be true of one man companies, particularly, as in this case, a company whose only purpose is the provision of the services of the individual. However, control is part of the test. As is set out above the claimant was the sole shareholder, sole director and sole employee. There was literally no one other than himself to exercise any control and it must follow, in my view and in reality that here was no control over him. However, I accept as set out above that this necessarily always true of one man companies, and that there is no principle of law or fact that that employees of one man companies cannot be genuinely employed. In the particular circumstances of this case this factor is not in and of itself determinative.
35. It follows that it is necessary to look at other factors to determine whether as it was operated in practice it was genuinely a contract of employment, and in particular whether that was true as at the date of insolvency. In my view there are two factors which militate against the conclusion that by the date of the insolvency that there was a genuine employment contract.
36. Firstly, for some two months prior to the insolvency the claimant chose not to pay himself a salary, and in his capacity as an employee to accept non-payment. In addition, this view is also reinforced by the fact that the claimant never received the

national minimum wage. If he were genuinely an employee R2 would have been bound to pay the national minimum wage. The fact that it did not is in my judgment clear evidence that this was not genuinely a contract of employment.

37. It follows that in my judgement the other factors are in my view inconsistent with a genuine employment relationship; and that taken together with the absence of any written contract of employment and the absence of control, that looked at overall I am not satisfied that the contract was a genuine contract of employment within the meaning of s230 ERA 1996.

38. It follows that the claimant has not established in principle that the SOS is liable to make the payments sought and his claims must be dismissed.

Employment Judge Cadney
Dated: 19th April 2024

Judgment sent to the parties on 10 May 2024

For the Tribunal Office