

How directors' claims as employees could affect insolvency compliance

In the light of the recent article by IPA Member Caroline Clark which appeared in the IPA Newsletter Feb 19 and has subsequently been posted on the R3 website Redundancy Claims UK ("RCUK") would like to formally respond. Whilst we acknowledge that Ms Clark confirmed that the views expressed in the article were her own and do not necessarily reflect those of the IPA, there are inaccuracies within the article that we believe should be brought to the attention of members. We would like, therefore in response, to make the following comments (in italics) as set out below.

Before addressing the article in detail it is important to state that RCUK welcome any articles which highlight the importance of compliance and a company's adherence to their codes of ethics. This can only improve the service to clients and the industry's reputation as a whole. Like IP's who have their own regulation RCUK are regulated by the Claims Management Regulator ("CMR") (part of the Ministry of Justice). In addition to this RCUK have also been subject to an audit by the Redundancy Payments Service. The importance of the CMR in regulating RCUK's business, the RPS audit and the resulting benefits of this to both Directors, the Redundancy Payments Service and IP's is set out within this response.

RCUK would like to thank Tim Kenward, employment barrister and Helena Beare from Miller Beare Compliance Consultants for assisting with this response.

The Article below is drafted by IPA Member Caroline Clark

It is always useful for an insolvency practitioner to review the law concerning whether or when a director is an employee of a company.

Ultimately, the issue as to whether a director is also an employee is a legal issue which is determined by the Redundancy Payments Service ("RPS") on application from a director to the RPS for a payment. The success of such an application will be determined by the information provided by the director and the information provided by the IP. As such, the role of the IP is simply to provide the information required by the RPS not to determine whether the director can demonstrate employee status.

Directors who are not employees have no legal rights as employees and this could affect the payment of any claims that the directors might have against a company subject to an insolvency procedure.

A director may have legal rights against the company concerned without being an employee, but the right to a payment from the RPS will depend upon the director being deemed by the RPS to be both a director and an employee.

The legal status of a director of a company, without any further contract or agreement, is that the director is not an employee. Being a director is an office Service and this does not automatically

result in the director being an employee. If, however the director enters into a contract of employment for the provision of services to the company, this would probably result in the director becoming an employee and having the same legal rights as any other employee, such as the right to the minimum wage, notice of redundancy and rights under the Employment Protection Act 1996 (EPA 1996) should the company that is the employer enter into a formal insolvency procedure.

If the director has entered into a contract of employment, either written or implied based on documentary evidence the director will be deemed to be an employee, and will have statutory employment rights under the Employment Rights Act 1996. These rights include the right to a redundancy payment. It is important to note that, for these purposes, there does not have to be a written contract of employment.

The Employment Rights Act 1996 states that an “employee” is “an individual who has entered into or works under (or, where the employment has ceased, worked under) a contract of employment”, with a “contract of employment” being, in turn, defined as “a contract of service ... whether express or implied, and (if it is express) whether oral or in writing”. Thus, it will be sufficient that the circumstances are such as to give rise to a contractual employment relationship.

A director who does not have a contract of employment may claim to be owed arrears of pay and this claim against the company, however categorised, may be valid. Without a contract of employment however the director could not make a valid claim to be paid the arrears of pay by the Redundancy Payments Office under the EPA 1996. The director's claim for arrears of pay would be included with any credit balance on a director's loan account as a claim against the company as an unsecured creditor. The director's claim would rank for dividend equally with that of other unsecured creditors.

If there is deemed to be no contract of employment in existence whether written or implied which meets the definition in the Employment Rights Act 1996 then the director has no statutory right to payment by the RPS. Any claim they may have would be contractual rights against the company.

Employees between 18 and 24 years old are entitled to receive the national minimum wage and employees who are older than 25 are entitled to receive the national living wage which is currently £7.83 an hour, due to be increased to £8.21 an hour in April 2019. If a director has a contract of employment and is an employee then the director is also entitled to receive the national minimum or living wage, although some directors waive this right whilst working for the company.

The main debts which can be recovered from the RPS are all entitlements which are calculated by reference to the director's remuneration, and for these purposes the RPS accepts that the statutory provisions in respect of the national minimum wage (“NMW”) or national living wage (“NLA”) give rise to a contractual entitlement for any pay owed to be calculated on the basis that the national living wage applied. For clarification an employee whether they be a director or not cannot lawfully waive their right to the NMW or the NLA. Any purported waiver will be treated as being void, and the legal requirements in respect of paying the national living wage can be enforced through both civil and criminal proceedings. As such any claim to the RPS will be on the basis of the director's statutory entitlement as governed by the NMW and NLA

If an employee who is paid less than the national minimum or living wage makes a claim against the Redundancy Payments Office then the claim will be increased by the Redundancy Payments Office to the level of the national minimum or living wage and this increased amount will be paid to the employee.

An employee is entitled to put his or her application to the RPS on the basis that the amounts being claimed take account of the rate which should have been paid had there been full compliance with the requirement to pay the NMW or NLS.

This all seems straightforward and insolvency practitioners will be used to explaining to directors the difference between a claim against the company as an unsecured creditor and a claim against the company as an employee that is then subrogated to the Redundancy Payments Office against the company.

As frequently happens in an insolvency situation, however, where money is short and professional fees still have to be paid, incorrect procedures may result in poor compliance and a risk of disciplinary action by the insolvency practitioner's RPB. There is substantially more to compliance regarding directors' claims as employees than establishing whether the director had a valid contract of employment.

It is agreed that this is a complex area and this the reason that an IP should not be advising directors on the validity and value of their claims. They should advise the directors to take specialist independent advice from regulated claims management companies or legal practitioners. It is a criminal offence under the Compensation Act 2006 for any organisation to provide advice and assistance in this field unless they are regulated by the Claims Management Regulator or are exempt from authorisation as set out in the Compensation (Exemptions) Order 2007.

It has been suggested to some insolvency practitioners that it might be possible to come to an agreement with directors that any claims that they might have against the Redundancy Payments Office should be paid to the insolvency practitioner as part of the pre-appointment or statement of affairs fee. Similarly, if directors are earning less than the national minimum or living wage it has been suggested that the insolvency practitioner changes the information provided to the Redundancy Payments Office regarding that director to show the national minimum or living wage.

Given that the RP14A requires information as to the amounts owed to the director then it is entirely proper for the entries for pay owed to be updated to the statutory minimum. Indeed, the version of the RP14A Form in use in Northern Ireland specifically provides for the entries to be provided as updated figures taking into account the applicable statutory minimum rates of pay.

The firm making these suggestions is understood to claim that it has been authorised by the Redundancy Payments Office and that its advice is therefore reliable.

For the avoidance of doubt RCUK has never advised that it is authorised by the RPS. RCUK has only ever stated that it has been audited by the RPS. The RPS does not authorise anyone. However, as stated above RCUK is authorised by the Claims Management Regulator and as such has had to undergo a stringent application process for authorisation. As an authorised business it must

adhere to a code of ethics set out in the Conduct of Authorised Persons Rules 2018 (“CAPR 2018”). This includes the requirements set out below.

- **General Rule 2 of CAPR 2018 requires that “a business shall conduct itself responsibly overall including, but not limited to, acting with professional diligence and carry out the following:**
 - take all reasonable steps to investigate the existence and merits of each element of a potential claim before presenting it to a third party.
 - make representations to a third party that substantiate and evidence the basis of the claim, are specific to each claim and are not fraudulent, false or misleading”.
- **General Rule 2(d) of CAPR 2018 further requires a business to “maintain appropriate records and audit trails”.**

The rules can be viewed at:

https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/691890/CMR - Conduct of Authorised Persons Rules 2018 web .pdf

RCUK have also engaged external independent auditors Miller Beare Compliance Consultants, who are assisting RCUK improve its compliance management ready for the transition of claims management services to the Financial Conduct Authority (“FCA”). Details of the comments set out in Miller Beare’s audit report are provided below.

“From the review of the systems provided we are satisfied RCUK conducts itself responsibly from the initial assessment of individual claims for clients, to the collating of relevant evidence to completing the RP forms, to seeking guidance from the RPS and utilising the specialist services of a barrister, Tim Kenward.

The software is designed with built in prompts which ensures that all actions are dealt with expediently.

We were given a detailed demonstration of the case management system and viewed the processes for monitoring timelines and proceeding with claims. This is an area where RCUK excels. It operates a case management system where all communications made and received are recorded and relevant prompts are built in to ensure that deadlines are met and claims handled in an efficient manner”.

The Claims Management Regulator who recently completed an audit of RCUK equally found no issues with case values claimed, evidence collated per case, progression and submission. We also work closely with Tim Kenward a leading barrister in his field to ensure that all claims made to the RPS can be supported in law.

A spokesperson from the Redundancy Payments Office advised at an insolvency conference last year that the Redundancy Payments Office does not authorise anyone and that the claims of any employee, regardless of whether or not they were a director, should be paid directly to that employee.

The RPS is aware that RCUK operate client accounts. RCUK asked the RPS for guidance before implementing this system. The RPS has agreed that a client account may be used as long as the director signs a letter of authority. The RPS accordingly pays the amount assessed as due to the director to the account specified.

RCUK operates client accounts for the purposes of ensuring that RCUK's fees are paid. Once RCUK fees are paid, the director concerned is asked to confirm where and to whom the balance should be paid. Any money held in a client account is the property of the director concerned. Thus, RCUK only pay a director's funds to a third party with his or her express written consent. Once the RPS has paid the funds to the client account, the funds become the funds of the director to use as he or she wishes. The Claims Management Regulator operates stringent rules on the use of client accounts as set out in the Client Account Rules 2006 which includes an annual independent accountancy audit. The rules can be viewed at:

https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/313457/Claims-management-companies-client-account-rules.pdf

Information provided to the Redundancy Payments Office about employees' wages and other aspects of their employment should be correct and verifiable from the company's records and if an employee is earning less than the national minimum or living wage then this will be identified by the Redundancy Payments Office which will deal with the claim appropriately.

RCUK fully understand that there is nothing more important for an IP than being compliant and adhering to the prevailing statutory framework, the statements of insolvency practice and the fundamental principles embodied in the insolvency code of ethics. RCUK has continually strived to introduce standards and welcomes regulation in its own industry. The objective of mirroring the key ethical standards of the IP profession in relation to integrity, objectivity, professional competence, due care, confidentiality and professional behaviour is a top priority for RCUK and its directors.

RCUK work under the regulatory standards of the Claims Management Regulator and through establishing agreed and documented standards with the Redundancy Payments Service, following a full audit process, RCUK's standard working practices can assist the IP to remain compliant. A good example of this is supporting the IP in compliance with SIP2; that it has the appropriate books and records required to support the submission of the RP14 and RP14A.

Contained within SIP2 is the requirement to obtain a company's books (including the statutory books and minutes), records and other accounting information (including computerised records. There have been recent examples of sanctions being imposed on insolvency practitioners who have submitted the RP14 / RP14A to the RPS without first obtaining and checking appropriate company books and records.

How can RCUK help?

RCUK has been audited by the Redundancy Payments Service. What was established in this audit with regards to directors' redundancy claims was as follows:

- ***dividends would not be accepted as salary despite the Morgan case law***

- *directors' fees would not be considered as salary*
- *the national living wage / minimum wage should be used if a director's pay is established to be lower than the statutory minimum*
- *uplifting a claim to the statutory minimum may give rise to a substantial arrears of pay claim which can be maximised using accepted case law as the employee can choose the eight weeks most favourable (in other words with least pay) and any pay received in the eight weeks chosen is discounted if there are earlier arrears as the pay in those eight weeks is assigned (or rolled back) to the earlier arrears first .*

RCUK is pleased to see the issue of claims being approved by the Redundancy Payments Service at national living wage / minimum wage levels has now been communicated to insolvency practitioners in the Dear IP issue 82 November 2018.

As well as agreeing a sensible approach to the construction of directors' redundancy claims based on the Employment Rights Act 1996 and subsequent case law, RCUK also established a new working process with the Redundancy Payments Service which involves providing all the documents and records requested to allow the Redundancy Payments Service to assess an application. Exactly what documents and records were required was formalised in the full audit process.

On every claim RCUK submit on behalf of a director all supporting documents and records are submitted when the RP3 is submitted. No claim will be paid without them.

Before finalising a claim prior to submission RCUK always inform the IP exactly what it is intended to claim on behalf of the director concerned and RCUK shares with the IP all supporting documents and records to be submitted to the Redundancy Payments Service.

By sharing this information RCUK can ensure that the IP will have the appropriate books and records to assist the IP to comply with SIP2 and submit the RP14 / RP14A.

There are a number of excellent firms providing professional services to administer the claims of employees of insolvent companies against the Redundancy Payments Service and they are very definitely not involved in the matters mentioned by the spokesperson from the Redundancy Payments Service. Service holding insolvency practitioners can subcontract the management and administration of employees' claims to these firms in confidence that they will receive a high quality and good value service.

RCUK only represent directors (rather than other employees) which avoids the potential conflict which may arise when a firm is subcontracted by an IP to manage and administer the RP14/14A on their behalf and yet at the same time represent the director and submit his or her claim.

By only representing the director RCUK is in a position to ensure that directors claim the maximum they can within the legal framework of the Employment Rights Act 1996 and subsequent case law. This is a valid and important service for directors who do not always understand the claims process or exactly what they are entitled to.

If IP's are unsure and wish to avoid potential conflict issues they should make sure that they subcontract firms to manage and administer their ERA work who do not also represent directors and they should only refer directors to authorised firms who only represent directors and do not undertake outsourced ERA services on behalf of IP's.

In the IPA's January newsletter Michelle Thorp, the CEO of the IPA, advised that the IPA is coming to the end of its review of governance and regulation and she has since given more information about the results of the review to members of the IPA. In the future the IPA will be ensuring that the monitoring visit and reporting process will be swifter and more efficient, operated with integrity and targeting important issues not bureaucratic mistakes when carrying out the regulation of Service holding insolvency practitioners. The inappropriate use of funds payable by the Redundancy Payments Service to an employee of a company subject to a formal insolvency procedure would surely be seen as important. The Ethics Code and SIP 1 both mean that compliance includes all aspects of an insolvency practitioner's work, not just case administration.

There is no difficulty for insolvency practitioners where:

- ***a claim is submitted by RCUK to the RPS with full supporting evidence and the RPS has everything required to assess the claim correctly;***
- ***the same supporting evidence is supplied by RCUK to the IP to complement or complete existing books and records in order for the RP14 to be submitted correctly, this ensuring compliance with SIP 1 and 2;***
- ***the director's claim is submitted within the legal framework which allows him / her legitimately to maximise his / her claim***
- ***the funds are paid to the account the director has instructed the RPS to pay the funds – this could be a third party directly or RCUK's client account, and, if the latter, the director can decide to whom the funds from the client account are then paid;***
- ***if a director chooses to pay the Statement of Affairs fee from a legitimate RPS claim, this is simply the prerogative of the director to spend his / her funds as he or she thinks fit.***

RCUK has a regulatory obligation not to place insolvency practitioners in a position where they breach their regulatory codes or are placed in a position to breach their regulatory codes.

RCUK is confident that its services meet the requirements set out by the Claims Management Regulator and the RPS. RCUK also strongly believes that its services assist insolvency practitioners meet their regulatory requirements.

To download this article as a PDF document please click [here](#).

If you would like to know more about how our regulation and processes can help you stay compliant or understand more about how we work please contact Gary Addison at rcuk@redundancy-claims.co.uk or 01625 462587.