A sting in the tail

Michael Salter and **Chris Bryden** consider the problems left behind by insolvent employers

IN BRIEF

- The preferential debt status of employees means that in insolvency, if there is any money at all left over after paying holders of fixed charges, employees are entitled to another slice of what they are owed.
- In reality, however, after the payment of fixed charges there is likely to be little left, and any payment will be a small proportion of the entitlement.

It is estimated that every day in the UK 50 companies go out of business. Beyond the initial impact this will have on employees, who are likely to end up losing their jobs, there may also be a secondary sting in the tail when they find that money they are owed will not be as easy to obtain as they first thought.

Not only may this mean that wage payments due and owing are not made, it may also mean that there are difficulties in obtaining redundancy payments. Further, any claims currently pending in the employment tribunal or county court, or potential claims not yet issued, are likely to be affected by the employer's insolvency.

Various legal avenues exist to provide employees of insolvent employers with at least some recompense.

INSOLVENCY

The Insolvency Act 1986 (IA 1986) provides that an employee's claim for remuneration—which includes all wages and salary, whether for time or piece-work or earned wholly or partly by way of commission—up to a period of four months preceding the insolvency will be treated as a preferential debt up to £800 (IA 1986, s 386 and Sch 6). More money has been available to employees since the Enterprise Act 2002, s 251 stripped HM Revenue & Customs of its status as a preferential creditor.

NATIONAL INSURANCE FUND

Another remedy is to seek payment of money due out of the national insurance fund. The European Insolvency Protection Directive 2002/74/EC requires member states to guarantee payment of certain limited claims which employees have against their insolvent employers. The Directive has been implemented by Pt XII of the Employment Rights Act 1996 (ERA 1996), which deals with the recoverability of redundancy payments from insolvent employers.

PENSIONS

As far as pensions are concerned, the UK government has recently been found to be in breach of Art 8 of the insolvency Directive because of its failure to ensure that necessary measures are taken to protect the interests of employees, and of people who have already left the employer's undertaking or business at the date of the onset of the employer's insolvency (see *Robins and others v Secretary of State for Work and Pensions: C-278/05* [2007] All ER (EC) 648). It is hoped that the government will now bring the law into line following this ruling.

TUPE

Insolvency does not necessarily mean that an organisation's business does not continue. The effects of the Transfer of Undertakings (Protection of Employment) Regulations 2006 (SI 2006/246) (TUPE) are well known, and its engagement and effects heavily litigated. Obviously TUPE has the potential to affect insolvent companies. However, its effect is more complicated here than for solvent companies.

It is important to determine why the business has ceased trading. Regs 4 and 7, which provide that a transfer does not terminate employment and makes a dismissal unfair if the reason was the transfer, do not apply to bankruptcy proceedings, nor do they apply to compulsory liquidation as such proceedings are analogous to bankruptcy proceedings. In these circumstances the employees' contracts of employment will terminate and the employees will have to rely on ERA 1996, Pts XI and XII and claim from the fund. This should be compared to the voluntary liquidation by members. Here regs 4 and 7 do apply and therefore the claim is against the transferee and not the fund, whereas the Department of Trade and Industry feels transfers in accordance with a voluntary arrangement and administrative receivership are subject to regs 8(2) to (6), and so Pt XII liabilities will fall to be paid by the secretary of state.

PRACTICAL STEPS

What steps need to be taken on behalf of such employees to take advantage of the above provisions? The first and most obvious step to take on behalf of an employee is to facilitate a claim against the national insurance fund.

CLAIM FROM THE FUND

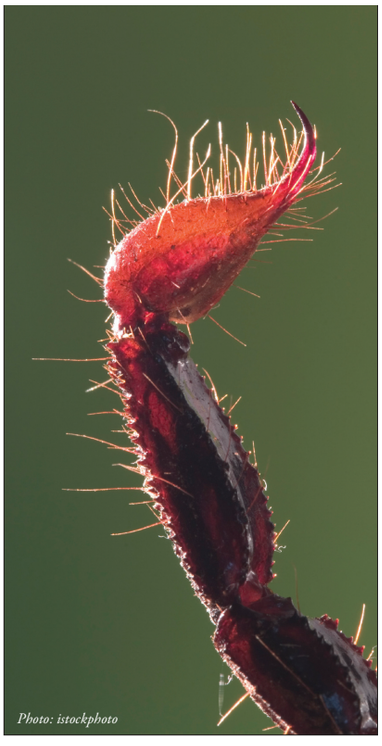
When a company becomes insolvent an insolvency practitioner (IP) is appointed. The IP should provide to employees details of the national insurance fund and the necessary forms required to make a claim. The standard form is the RP1 form which is used for claims for all types of claim from the fund. The form should be sent to the local redundancy payments office (RPO) or to the IP if so requested. The RPO will send out an acknowledgement form (RP5) and aims to pay most claims within six weeks.

Where an insolvency payment is not made from the fund, or the payment is less than the amount that the employee considers should have been paid, the employee has the right to complain to an employment tribunal against the decision of the secretary of state (ERA 1996, s 188). The respondent in such a claim will be the secretary of state for business, enterprise and regulatory reform and any other appropriate respondent, such as, for example, a transferee if there has been a TUPE transfer.

Where there is the possibility of a TUPE transfer, a payment is unlikely to be made from the fund and tribunal proceedings are likely to be required.

INSOLVENCY PROCEEDINGS

The existence of the fund provides a minimum payment to employees who would otherwise have to wait a significant period of time to get any payment at all as creditors in insolvency proceedings. It is important to bear in mind that the amount payable from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the fund may be far less than the employee is otherwise entitled to. If this is the case the remainder of the monies owed must be claimed by the employee as a creditor. This process can take some time and there is no guarantee that the employee will receive all, or indeed any, of the outstanding money owed.

Certain debts are given priority in insolvency. Employees have priority claims for:

- All holiday pay.
- Wages up to £800 in the four months immediately before the insolvency date.
- Some pension contributions and contributions deducted from pay.

Included in the preferential debt status is the claim by the secretary of state for the amounts paid out from the fund. Before September 2003 this claim had what was known as "super preference" status and ranked in priority to other claims of employees. However, since then this status has been removed. More recently, the Chancery Division spelt out that there is no priority given to damages for wrongful dismissal (see *In Re Leeds United Association Football Club Ltd* [2007] EWHC 1761 (Ch), [2007] All ER (D) 385 (Jul)).

The preferential debt status of employees means that in the insolvency, if there is any money at all left over after paying holders of fixed charges (such as mortgage companies or other secure creditors) and their preferential debt, employees are entitled to another slice of what they are owed. In reality, however, after the payment of fixed charges there is likely to be little left and any payment will be a small proportion of the entitlement. It goes without saying, therefore, that any other amounts owed by the company to employees are unlikely to be recovered at all.

A further line of attack on behalf of an employee is to bring a claim against a director personally. This is an option where a going concern has simply ceased to trade but the person behind it is not bankrupt. In such circumstances it is the individual trader who is liable. However, where a company has been wound up it is far more difficult to successfully bring a claim against a director of that company, due to the nature of limited liability.

However, there are certain powers contained in IA 1986 which may in limited circumstances be of assistance. Section 212 provides that, on the application of the official receiver, liquidator, or any creditor or contributory, a hearing may be ordered to examine the conduct of an officer of the company who may be compelled to repay, restore or account for any assets which have been misapplied or retained, or become accountable for money or property of the company. The same applies where he has committed misfeasance or breach of fiduciary or other duty. Further a sum in compensation to the company can also be ordered to be paid.

Clearly this power is limited to particular circumstances where the assets of a company have been plundered. It will be difficult to demonstrate this. Further, the operation of the section does not provide that the employee will receive the repayment of the money or other property—it all goes into the pot which is to be distributed to the creditors. However, if there is evidence of such action, or if the employee is the only creditor, or one of few, it may be worth considering applying for an examination under s 212.

Further, where a company goes into liquidation and resurrects itself as a phoenix company—where the company is put into liquidation owing large sums to creditors and is sold as a going concern at a knock-down price to a new company incorporated by the former controllers of the insolvent company—by using a prohibited name (defined in s 216 as one the liquidating company was known by within 12 months or is so similar it suggests an association with it), relevant considerations apply. If a person is a director of any other company known by a prohibited name, within five years of the liquidation, he will become personally responsible for the debts of the company. However, the circumstances in which an employee could avail himself of this provision are likely to be quite rare.

TRIBUNAL PROCEEDINGS

With regards to any Pt XI payment, where there is a question about liability or the quantum of the redundancy payment, there shall be a referral to the employment tribunal by virtue of ERA 1996.

The employee can appeal against a refusal of the secretary of state to make a payment under s 182. This appeal lies to an employment tribunal, by virtue of s 188. The application must be presented within three months of the date of communication of the secretary of state's decision, or such other period as is reasonable, if it was not reasonably practicable to have presented the complaint within the three-month limitation period.

> "A further line of attack on behalf of an employee is to bring a claim against a director personally"

However, it must not simply be assumed that the case will be automatically won. The claimant needs to produce a witness statement dealing with issues of liability and will be required to attend a final hearing at a tribunal where it must be demonstrated that he is entitled to a Pt XI payment. In practice, however, where there are employers in administration the secretary of state may leave the matter up to the tribunal to decide, without the attendance of a representative. In such cases the tribunal is likely to do everything it can to ensure that the employee is entitled to an award from the fund.

EMPLOYERS' LIABILITY INSURANCE

One further potential avenue to be explored is the existence of any insurance policies that the employer may have had. It is possible that such policies cover the claims brought by the employee and pay out even where the employer is insolvent—as often the relevant date for such insurance is the date of the insurable act, rather than the date of the claim. It is worth attempting to discover whether any such policy was in existence and would operate to cover such a claim, as an employee may receive more by this route than from the fund.

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