

Controlling Shareholder Can Be an Employee

The Court of Appeal has confirmed that a shareholder and director of a company can also be an employee under a contract of employment with the company, even where that person has a controlling interest in, or even total control of, the company.

The ruling resulted from two cases arising from the insolvency of companies and hinged on whether or not each claimant had been an employee of the failed company. If so, he was entitled to the protection afforded by Section 182 of the Employment Rights Act 1996 (ERA) to those who are employees at the date when the employer company has become insolvent.

The facts of the first case were as follows. Mr Neufeld was managing director of A & N Communications in Print Ltd. (A&N) and held 90 per cent of the shares. The company went into insolvent liquidation. He first began working for Neufeld Press Ltd. in 1982 as a member of its sales team. In 1988 he became a shareholder and one of the company's three directors. In 2001, this undertaking was transferred to A&N. Mr Neufeld continued to work as part of the sales team, managed by the sales director, and worked a 60-hour week carrying out sales as well as management duties. He had loaned money to A&N as well as providing personal guarantees on the company's behalf. None of the three directors had a written contract of employment.

The Secretary of State had refused to meet Mr Neufeld's claim for redundancy money, notice money and holiday pay owing at the date of insolvency to be paid from the National Insurance Fund (NIF). His claim amounted to approximately £10,000.

Mr Neufeld brought a claim under Section 188 of the ERA and the Employment Tribunal (ET) dismissed his claim. It held that the fact that he had given personal guarantees on A&N's behalf, had lent money to the company and had control over it showed that in reality he was not an employee of the company when it became insolvent. In the ET's view, he was running his own business as a manager and major shareholder.

The Employment Appeal Tribunal (EAT) disagreed. In its view, the correct approach was to focus on the conduct of the parties in carrying out the 'purported' contract of employment. Other factors were only relevant in so far as they reflected upon that conduct. The EAT held that the ET judge had erred in law in taking into account irrelevant matters.

The Secretary of State appealed to the Court of Appeal. The appeal was heard at the same time as the other case because a salient factor in each was that the claimant was a controlling shareholder and a director of the company. The Secretary of State asked the Court of Appeal to clarify the approach to be adopted by the ET in these circumstances.

The Court of Appeal dismissed both appeals. In giving its judgment, Rimer LJ analysed the previous case law and authorities governing this question. In the

Court's view, the correct approach is to first determine whether the putative contract is genuine or a 'sham'. If it is genuine, is it a contract of employment rather than, for example, a contract for services? As the critical question in such cases is whether or not the putative employee was an employee at the time of the company's insolvency, it may be necessary to examine what has been done under the claimed contract, particularly where this is not in writing. The fact of a person's control over the company will form a 'backdrop' against which the assessment of the conduct under the contract will be made, but will not ordinarily be of any special relevance in deciding whether or not that person has a valid contract of employment. Nor will the fact that they have share capital invested in the company or have made loans to it or given personal guarantees on its behalf. Such considerations will ordinarily be irrelevant in determining whether or not a valid contract has been created. They show an owner acting as an owner. They do not show that the owner cannot also be an employee.

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