



Can controlling shareholders also be employees?

Introduction

For some time there has been uncertainty surrounding the issue of whether controlling shareholders and directors can be employees. Guidance previously given by the Court of Appeal in 1999 indicated that controlling shareholders could not be employees because, as controlling shareholders, they could determine the future of the company and therefore were not under sufficient control of the company.

This meant that these individuals could not benefit from the protection afforded to employees under the Employment Rights Act 1996 which provides that in the event a company becomes insolvent employees are entitled to receive payment for any debt owed to them by their employer e.g. unpaid holiday pay, out of the National Insurance Fund.

However, in a recent decision of the Court of Appeal in Secretary of State for Business Enterprise and Regulatory Reform v Neufeld and anor, it has been determined that controlling shareholders can in fact also be employees.

Facts of the case

Mr Neufeld was the controlling shareholder and director of A and N Communications in Print Limited. He had received a salary and had paid tax and national insurance contributions as an employed person and purportedly had an oral contract of employment. Mr Neufeld had also given personal guarantees and made a personal loan to the company.

Mr Howe was the sole shareholder and director of Track Records Music Limited. He received a salary and paid tax and national insurance contributions and also gave personal guarantees.

Both companies subsequently went in to liquidation and Mr Neufeld and Mr Howe sought to claim redundancy pay, notice pay and holiday pay owing to them at the date of the insolvency of the companies from the National Insurance Fund.

Mr Neufeld

The Employment Tribunal held that Mr Neufeld was not an employee of the company. Whilst he appeared to work under a contract of employment he gave personal guarantees on the company's behalf, lent the company money and had the controlling shareholding.

Mr Neufeld appealed to the Employment Appeal Tribunal who found that the Tribunal had incorrectly considered factors which did not reflect the parties conduct when performing the contract and as such determined that he was an employee. The Secretary of State appealed this decision to the Court of Appeal.

Mr Howe

The Employment Tribunal determined that Mr Howe was an employee and that the purported contract of employment between Mr Howe and the company was genuine.

The Secretary of State appealed this decision to the Employment Appeal Tribunal who dismissed the appeal so that Mr Howe's case could be heard together with Mr Neufeld at the Court of Appeal.

Court of Appeal's decision

The Court of Appeal held that it was a question of fact to be determined by the tribunal but that there was no reason in principle why a controlling shareholder and director of a company could not also be an employee. The court rejected the assertion that there would be insufficient control exerted on the individual by the company. The question of employment status however must be determined at the date when the company becomes insolvent.

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The court also laid down some useful guidance for Tribunals to apply when determining such matters which included:-

- The starting point is to consider whether any contract of employment is genuine or a sham, the burden of proof being on the party denying the existence of an employment contract.
- The fact an individual is a controlling shareholder or exercises control over a company's affairs does not immediately preclude an employment contract from existing.
- The absence of a written contract of employment will be treated as strong evidence of a sham. Where a written contract of employment is in existence, provided the parties acted in accordance with its terms, this will provide a strong indication that a genuine employment relationship was in existence.
- Features of ownership, for example, share capital, taking loans from a company or guaranteeing its debts are not relevant to the issue of employee status except in exceptional circumstances.
- Simply because an individual has a controlling shareholding does not in itself mean that person cannot be an employee. As a controlling shareholder can benefit from the success of a company through dividends employees are also capable of doing so through share options.

Conclusion

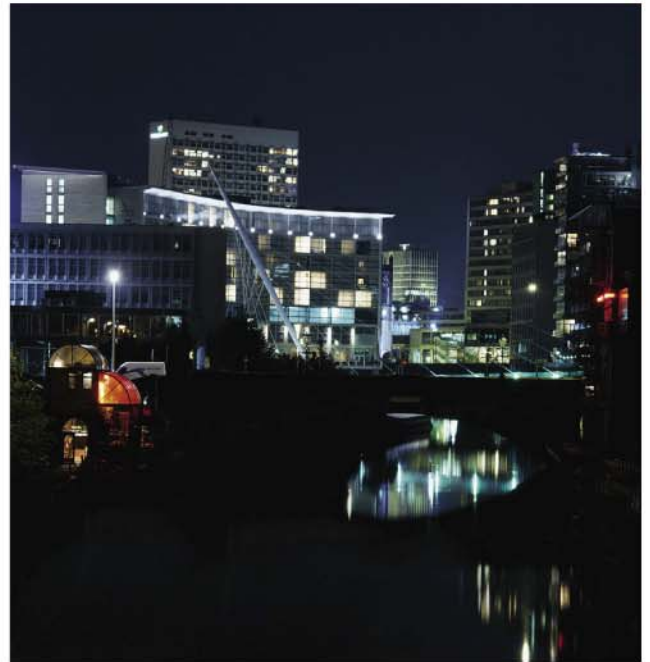
As a result of the Court of Appeal's judgment there is now useful guidance which allows parties to determine whether controlling shareholders can also benefit from the protection of employee status. Clearly, however, each case will need to be judged upon its own circumstances applying the factors referred to above.

If you would like to receive more information regarding the contents of this newsletter or information on any other employment law related matters then please contact **Russell Brown** at Glaisyers Solicitors LLP, One St James's Square, Manchester M2 6DN. Tel: 0161 832 4666; Fax: 0161 832 1981; Email: rwb@glaisyers.com

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