

Although in most instances these applications would previously have been made to the court identified in the new rule, this has now been codified. The Practice Direction on Insolvency Proceedings [2007] BCC 842 provides (para. 5.1(3)) that applications to restrain the presentation or advertisement of a winding-up petition must be made direct to the judge and, unless otherwise ordered, must be heard in public. Rule 4.6A does not appear to have had any impact on this provision.

Verifying the petition

Before 6 April 2010, rule 7.57(5) of the Rules provided that (with limited exceptions) where the Rules provided for the use of an affidavit, a witness statement verified by a statement of truth could be used as an alternative. This rule was revoked by the 2010 Rules but several specific amendments make it clear that affidavits are seldom now required.

The amended rule 4.7(1) provides that a winding-up petition may be verified by a statement of truth instead of an affidavit. Extensive amendment has also been made to rule 4.12. It appears that verification of the petition no longer needs to take the form of a separate document and may instead be contained in or endorsed upon the petition which it verifies. But if that is not done, the statement must adequately identify the petition.

Proof of service

A new rule 4.9A has been inserted which provides that service of the petition must be proved by a certificate of service and not, as before under the old rule 4.9, by filing an affidavit (or witness statement) verifying service.

Rule 4.9A(2) stipulates that the certificate of service must adequately identify the petition served and must specify:

- > the name and registered number of the company;
- > the address of the registered office of the company;
- > the name of the petitioner;

- > the court in which the petition was filed and the court reference number;
- > the date of the petition;
- > whether the copy served was a sealed copy;
- > the date on which service was effected; and
- > the manner in which service was effected.

Where an order for substituted service has been made, the certificate of service must have attached to it a sealed copy of the order.

The certificate of service must be filed in court as soon as reasonably practicable after service and in any event not less than 5 business days before the hearing of the petition. The effect of CPR rule 2.8(2) (reckoning time), which applies to the Insolvency Rules (see rule 7.51A(2)), is that in the High Court, where winding-up petitions are heard each Wednesday, a certificate of service will need to be filed by Tuesday of the previous week in order to comply with rule 4.9A.

It remains to be seen how flexible the court will be in applying this rule (and there is unlikely to be a uniform approach across all insolvency courts). Rule 7.55 provides that *'no insolvency proceedings shall be invalidated by any formal defect or by any irregularity ...'* The High Court will normally allow one or two days' grace in complying with a rule as to the filing of a document. The real difficulty, however, is that the Companies Court in particular processes so many petitions that there is a risk that a late certificate of service will not make its way onto the court file in time for the hearing at all.

Notice of adjournment

The new rule 4.18A provides that where the court adjourns the hearing of the petition *'unless the court otherwise directs, the petitioning creditor must forthwith send (a) to the company, and (b) where any creditor has given notice under rule 4.16 but was not present at the hearing, to that creditor, notice of the making of the order of adjournment. The notice must state the venue for the adjourned hearing.'*

It has long been a requirement to serve a notice of adjournment in the case of a bankruptcy petition (see rule 6.29 and form 6.24), but until the insertion of rule 4.18A no parallel provision existed in winding-up proceedings. The new rule 4.18A does not specify whether service on the company's solicitors is sufficient (where the company is represented) or give any indication of the circumstances in which the court may *'otherwise direct'* that a notice of adjournment is not required. Service on the company's solicitors should surely be sufficient, given that it will fulfil what is doubtless the purpose of the notice: to notify the company of the adjourned hearing date.

Practitioners might expect the court to be willing to dispense with the need for such notice where the company is represented at the hearing of the petition which leads to the adjournment; the wording of the rule, however, suggests otherwise, as sub-rule (b) makes it clear that notice of adjournment need be served on an opposing or supporting creditor only when the creditor was not present at the hearing, but no such qualification is attached to the requirement to send notice to the debtor company. It remains to be seen how strictly new rule 4.18A will be enforced by the court.

Nicola Allsop has a commercial chancery practice with particular experience in corporate and personal insolvency, company law and professional negligence. She regularly appears in the Companies Court in winding-up petitions and in applications for injunctions restraining the presentation or advertisement of petitions or for validation orders.

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legal update

YOUR UPDATE OF
RECENT CHANCERY &
COMMERCIAL LAW

ARTICLE 1

Just get on with it –
lessons to be learned
from Welsh rugby

ARTICLE 2

Redundancy payments
for controlling
shareholders

ARTICLE 3

Recent changes to
the Insolvency Rules



Robin Hollington QC

Just get on with it – lessons to be learned from Welsh rugby

The case in question was *Re Neath Rugby Ltd, Hawkes v Cuddy* [2008] BCC 390 (Lewison J), on appeal at [2009] 2 BCLC 427 (CA). What remedy should the court grant in a company petition seeking an order on the unfair prejudice ground, now in ss 994-996 of the Companies Act 2006?

The facts

The two main protagonists were successful local entrepreneurs, Mr Cuddy and Mr Hawkes. Both were involved in the affairs of Neath RFC, a long-established rugby union club in South Wales. Welsh Rugby was in a state of flux at the time. The Welsh Rugby Union conceived the idea of encouraging its main clubs like Neath to pool their resources so as to create and act as feeder clubs for “super-teams” who could compete in the premier division with the big English, French and Irish clubs like Leicester and Toulouse.

This led to Mr Cuddy entering into talks with Neath’s rival, the neighbouring club Swansea RFC, for Neath and Swansea to pool their resources and form a new super-team to be called the Ospreys. Mr Hawkes came into the picture when Mr Cuddy approached him with a view to the two of them taking over and refinancing Neath, with Mr Hawkes

running Neath, and Mr Cuddy being Neath’s nominee on the board of the Ospreys.

There was one particular feature about the case, which in retrospect may be seen to have caused the ruinous litigation that eventually ensued. The joint venture was set up with built-in deadlock in the new Neath company if Mr Hawkes and Mr Cuddy fell out; and the same applied in the Ospreys if Neath and Swansea fell out. To make matters worse, winding up the new Neath RFC company because of deadlock was not an option, because the WRU rules provided that its shareholding in the new joint venture with Swansea, ie the Ospreys, was forfeit to the WRU if Neath were wound up.

Fall-out

Mr Hawkes and Mr Cuddy in due course fell out because Mr Hawkes felt that Mr Cuddy was not standing up for the interests of Neath on the board of the Ospreys. In particular, the Ospreys team played fewer and fewer games at Neath’s elderly ground, the Gnoll, and more and more games at the new Liberty Stadium in Swansea which was shared with the Swansea soccer club. Mr Hawkes felt that Mr Cuddy had become a Swansea man. Mr Hawkes tried to remove Mr Cuddy as the Neath-nominated director of the Ospreys but, given the deadlock in Neath, he was blocked by Mr Cuddy’s veto.

The remedy

Swansea RFC were not formal parties to the proceedings but were allowed to make submissions about the relief to be granted.

Section 994(1) provides a remedy for an aggrieved shareholder “on the ground that the company’s affairs are being or have been conducted in a manner which is unfairly prejudicial to the interests of its members”. Section 996(1) goes on to provide:

“If the court is satisfied that [the] petition ... is well founded, it may make such order as it thinks fit for giving relief in respect of the matters complained of.”

Section 996 appears to give the court *carte blanche* to grant whatever relief it wishes but the court does not have an unfettered discretion: it has to exercise its wide discretion according to the following principles:

- > The relief is prospective - its purpose is to cure for the future the unfair prejudice that has been established: *Re Bird Precision Bellows Ltd* [1986] Ch. 658, at pp 669-670; *Grace v Biagioli* [2006] BCC 83, at para 73.
- > The relief granted should be proportionate to the prejudice suffered by the petitioner: *Re Phoenix Office Supplies Ltd* [2003] 1 BCLC 76, at para 51.
- > In England, it has been said that there is much to be said in favour of a clean break, usually by way of a buy-out order: *Re Clearsprings (Management) Ltd* [2003] EWHC 2516 (Ch), at para. 29. In Australia, in contrast, it has been said that, before making a buy-out order, the court should first consider less intrusive relief regulating the company’s affairs for the future: *Fexuto Pty Ltd v Bosnjak Holdings* (1998) 28 ACSR 688, at 742.

Before any relief can be granted, the court has to be satisfied that the petitioner has made out a case of unfair prejudice – and the findings that are made in that context will control the relief to be granted, because the underlying purpose is to cure for the future the unfair prejudice that has occurred in the past and is otherwise likely to occur in the future.

It was held in Mr Hawkes’ petition that in some relatively minor respects the affairs of Neath had been conducted in a manner that was unfairly prejudicial to Mr Hawkes. But it was held that Mr Cuddy’s misconduct had not been so serious that it justified the relief sought by Mr Hawkes, namely an order that he sell his shares to Mr Hawkes, particularly having regard to the fact that Swansea opposed such an order since they continued to have confidence in Mr Cuddy.

Article continued >



... the court did not order a clean break ...



Lewison J further held that Mr Cuddy had also made out a case of unfair prejudice, though this finding was reversed on appeal. But he was not prepared to order Mr Hawkes to sell his shares to Mr Cuddy, not least because of the uncertainty that this would have caused in the management of Neath RFC.

The judge held that the appropriate relief in all the circumstances was the relief eventually formulated by Mr Cuddy (with the co-operation of Swansea) shortly before the conclusion of the trial, namely preservation of the status quo but with deadlock-breaking provisions at Neath and Ospreys levels. In more detail:

- > There would be four members of the board of the Ospreys: two appointed by Swansea; one appointed by Mr Cuddy; one appointed by Mr Hawkes.
- > Mr Hawkes would have control at board level of Neath with a Cuddy nominee on the board holding only a watching brief.
- > The voting rights attaching to Neath's 50% shareholding in the Ospreys would be exercised by the members of Neath in general meeting. At general meetings of Neath, any deadlock would be resolved by an independent umpire.

The judge gave that relief on both Mr Hawkes' petition (although it was not relief for which Mr Hawkes asked at trial) and on Mr Cuddy's cross-petition. Though the Court of Appeal reversed the finding of unfair prejudice made against Mr Hawkes, it did not reverse Lewison J's order. It held that the court could grant the relief on Mr Hawkes' petition even though it had not been sought by Mr Hawkes at trial. So this was a very unusual case where the court did not order a clean break but, with the concurrence of the third part joint venturer (Swansea), regulated the affairs for the future of both the company and the joint venture between it and Swansea, ie the Ospreys. It illustrates the flexibility of the unfair prejudice jurisdiction.

Robin Hollington QC appeared in the Neath Rugby case, both at first instance and in the Court of Appeal. His general chancery practice has a particular

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Redundancy payments for controlling shareholders

When a company becomes insolvent its employees are entitled to redundancy payments out of the National Insurance Fund, under s 182 of the Employment Rights Act 1996.

Can a controlling shareholder and director of a company be an employee for that purpose?

The decision of the Court of Appeal in *Secretary of State for Business Enterprise and Regulatory Reform v Neufeld* [2009] 3 All ER 790 answered "yes" and finally laid to rest the Secretary of State's argument that he cannot.

The appeal was opened for the Secretary of State on the basis (para 7 of the judgment) that it was a matter of "considerable importance to him" as there had been 12,000 claims by directors on the National Insurance Fund, of which some 600 had gone or were expected to go to employment tribunals. The Secretary of State obtained permission to petition from the House of Lords

but decided not to pursue his cause and withdrew the petition. The matter is at an end insofar as the question of principle is concerned.

That is because the company is a separate entity and therefore there is no legal difficulty in its employing the person who is the controlling shareholder (whether as a director or not). The essential principles were stated by the Privy Council in *Lee v Lee's Air Farming Ltd* [1961] AC 12, where the issue was whether a controlling shareholder and director, who had died in a flying accident, could be an employed "worker" under a statutory scheme providing for compensation:

Held, that the deceased was a "worker" within the meaning of the Act. His position as sole governing director did not make it impossible for him to be a servant of the company in the capacity of chief pilot, for *he and the company were separate and distinct legal entities* which could enter, and had entered, into a *valid contractual relationship*, which was not invalidated by the circumstances that the deceased was sole governing director ... and also the controlling shareholder. *They were separate legal entities also so as to enable the company to give orders to the deceased.* ... (Emphasis supplied.)

There can be a contract of employment with a person who is a controlling shareholder even to act as a director provided that the contract is not a sham; it satisfies the requirements of an employment contract (ie the traditional three elements - work for a master for consideration; being subject to the master's control; and consistency of the other contractual terms with a contract of service); and it is performed accordingly. For the purposes of s 182 of the Act those requirements need to be satisfied at the date of the insolvency.

There can be difficult issues of fact to resolve. There will be cases where the parties in fact had the common intention that the contract should not create the legal rights and obligations it appeared to (ie the contract was a sham). There may be cases (albeit exceptional) where the corporate veil should be pierced and the company be treated as the *alter ego* of the controlling shareholder so that they should be treated as one. There may also be cases where the terms of the contract were never



... extensive amendments to the Insolvency Rules 1986 ...



put into practice. However, these will or should be unusual cases. The fact that someone is also a controlling shareholder will be relevant as “part of the backdrop” when investigating what was done in order to decide whether there was a valid contract of employment but it will not be a reason for deciding that someone was or was not an employee (*Neufeld* at para 86; see also *Ashby v Monterey Designs Ltd* [2009] UKEAT 0226_08_1812 in the EAT). In most cases, as indeed with Mr Neufeld, provided there is a contract of employment (oral or in writing), the claim should be accepted.

If there are to be disputes of fact, guidance for the purposes of assessing the true factual position can be found in *Clark v Clark Construction Initiatives Ltd* [2008] IRLR 364. The eight (non-exhaustive) factors set out in that decision are recorded in *Neufeld* and their “essence” approved subject to comments (paras 78, 88-90). Modified to give effect to the comments of the Court of Appeal, they are:

- > It will be for the putative employee to prove the existence of a contract but then the evidential burden will shift to the party seeking to deny its effect and that party will need to satisfy the court that it is not what it appears to be – all the more so where the claimant has paid national insurance and tax as an employee;
- > The mere fact of being a controlling shareholder, or of being in practice able to exercise real or sole control, does not preclude a contract of employment;
- > Nor will the fact that the claimant is an entrepreneur or built the company or profited from its success;
- > If the conduct of the parties was in accordance with the contract, that will be a strong pointer that it is valid and binding;
- > Conversely non-compliance with the terms of the contract may militate against a finding of the existence of a contract of employment;
- > If the contract is oral, that will be a relevant consideration but too much should not be made of that because the same test still applies, namely whether the putative employee can satisfy the tribunal that there was a true contract of employment;

- > In most cases the fact that the individual borrows from the company or guarantees its debts will be unlikely to carry weight, although it may be relevant when analysing exceptional cases;
- > Although a good rule is “never say never”, the fact that there is a controlling shareholding should not justify a finding that there was no contract in place.

As always, guidance can appear to add extra test layers to the law to be applied. That would be the wrong approach to adopt. The starting and end point is the statutory test and that is a straightforward one: was the claimant employed at the date of the insolvency? Now that the fact of being a controlling shareholder is clearly stated not to be definitive, in most cases the existence of the contract should be relatively easy to establish and the claim will succeed unless the contract is a sham or it was not performed or there are other exceptional circumstances.

The courts rightly emphasised in *Neufeld* that there was no suggestion that Mr Neufeld’s claim might be based upon a sham agreement or that it was made other than in good faith. He was a controlling shareholder and managing director but he had been employed as a salesman, worked as a salesman, and paid national insurance and tax as an employee. He was also an employee. Mr Neufeld had to wait a long time for his money but it was money to which he was entitled and (having paid national insurance and indeed tax as an employee) money which he deserved under the legislation.

Clive acted for the successful director-employee in *Neufeld*. Company and insolvency, advisory and litigation work form a core part of his practice and he is currently instructed in the *BTA Bank* litigation. He is a Deputy Bankruptcy Registrar and sits as a Deputy Registrar in the Companies Court. He is currently ranked in Legal 500 as a Leading Junior for Company, Insolvency and Partnership.

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Recent changes to the Insolvency Rules

Practitioners involved in the winding up of companies will need to master the extensive amendments to the Insolvency Rules 1986 made by the Insolvency (Amendment) Rules 2010 (SI 2010/686), which came into effect from 6 April 2010. The more important amendments include:

- > A new rule 4.6A, which specifies the appropriate court to which applications to restrain presentation of a petition or to restrain advertisement should be made;
- > The petition must now be verified by a statement of truth rather than by affidavit;
- > Proof of service of a winding-up petition is now by way of certificate and not affidavit or witness statement;
- > Where the court adjourns the hearing of a winding-up petition, a notice of adjournment must be served on the debtor company.

Restraining presentation or advertisement
Rule 4.6A provides that ‘an application by a company for an injunction restraining a creditor from (a) presenting a petition for the winding up of a company must be made to the court having jurisdiction to wind up the company and (b) advertising a petition for the winding up of a company must be made to the court in which the petition is pending.’

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