Director disqualification in the UK: Discipline and punish?

Frances Coulson examines the policy and the working of the Company Directors Disqualification Act 1986 (introduced at the same time as the Insolvency Act 1986)

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"Discipline and Punish", the title of the English translation of Michel Foucault's seminal study of the nature and purpose of imprisonment and control and power relations in our public institutions, could equally apply to the UK regime governing the disqualification of company directors.

Discipline, in the sense of maintaining proper standards of corporate governance; and punish, in that disqualification prevents its subject from trading with the privilege and protection of limited liability, as well as having other effects in terms of the offices he or she can fill. Although a person can be disqualified in criminal proceedings, disqualification is a civil law remedy to which the civil burden of proof applies.

The main aims of the regime have been expressed to be the protection of the public through the denial of the privilege of limited liability to those who have shown themselves to have fallen below required standards, the encouragement of good practice on the part of company directors, and the punishment of wrongdoing. Those considerations permeate the case law. Thus, in *Rwamba v Secretary of State for Business Energy and Industrial Strategy* [2021] BCC 184 Miles J said:

> *"The authorities show that the public protection policy underlying disqualification orders has two strands or aspects. One is removing the risk of the disqualified person harming the public through the repetition of the corporate misconduct or abuse which led to the order. It does so by taking him or her off the road for the duration of the order. The second aspect is deterrence. Directors may be expected to maintain higher standards of corporate conduct if they potentially face disqualification for falling below them."*

The "public" has been held to include "all relevant interest groups such as shareholders, employees, customers, lenders and other creditors" (*per* Peter Gibson LJ in *Secretary of State for Trade and Industry v Collins* [2000] BCC 998).

Director disqualification has a longer history than is generally appreciated. It can be traced back to the Companies Act 1928, since when it has been on the statute book in various incarnations, culminating in the Company Directors Disqualification Act 1986 (CDDA 1986), the act now in force. Although it is not, properly speaking, part of UK insolvency law, it is no coincidence that it was passed in the same year as the Insolvency Act 1986, the Act that consolidated and codified English corporate and individual insolvency for the first time and which remains in force today, albeit in much amended form. The overwhelming majority of disqualification orders are made following the insolvency of one or more companies in the form of liquidation or administration.

Proceedings may only be brought by the Secretary of State for Business and Trade or the Official Receiver, i.e., by government. They may not be brought by an insolvency office-holder, creditor or member of the public.

The CDDA 1986 allows the court, indeed imposes a duty on the court in certain circumstances, (for example where there has been a breach of competition law and the director is found to be unfit), to make a disqualification order against a person who is unfit and who has been a director of a company for up to 15 years (in the majority of cases there is a minimum period of two years). The primary disqualification is from being a director, but it includes a prohibition on being concerned directly or indirectly in the promotion, formation or management of a company. The term "company" has a wide meaning: it can include, for example, limited liability partnerships (LLPs), certain registered societies, charities and other broadly corporate entities. Similarly, the term "director" includes not just a person registered as such (a *de jure director*) but may apply to a *de facto* director (a person who assumes the role of a director without formal appointment) or "shadow director" (who exercise director-like control behind the scenes or "in the shadows").

The making of a disqualification order presupposes the unfitness of the person at whom it is directed to be a director. Section 6 CDDA 1986 provides that the court "shall make a disqualification order against a person" on an application where it is satisfied that:

(i) he/she is or has been a director of a company which has at any time become insolvent (including entering

liquidation at a time when its assets were insufficient for the payment of its debts, liabilities and expenses of the winding-up); and

(ii) his/her conduct as a director makes him/her "unfit to be concerned in the management of a company."

"Unfitness" is not defined. In *Re Bath Glass Ltd* [1988] 4 BCC 130 Peter Gibson J suggested it required the court to be satisfied that the director had been guilty of:

> *"a serious failure or serious failures, whether deliberately or through incompetence, to perform those duties of directors which are attendant on the privilege of trading through companies with limited liability."*

Its scope can, then, be wide. Want of commercial probity often features in the case law. "Ordinary commercial misjudgment", however, does not amount to unfitness, although "gross negligence or total incompetence" may (*Re Lo-Line Electric Motors Ltd* [1988] Ch 477). The majority of trials involve a factual inquiry, a decision as to whether the facts of the allegation(s) relied upon have been made out, and then consideration of whether the matters that have been proved amount to unfitness, so as to require the making of an order.

The court, when making an order, will do so by reference to three brackets laid down in Re Sevenoaks Stationers (Retail) Ltd [1991] Ch 164:

(i) a top bracket (over ten years) for particularly serious cases;

(ii) a minimum bracket (two to five years) where the case is, relatively, not very serious;

(iii) a middle bracket (six to ten years) for serious cases which do not merit the top bracket.

Amendments effected in 2000 introduced disqualification undertakings as an alternative to disqualification by court order. The advantage is the saving in the costs associated with legal action and trial. A disqualification undertaking has the same effect as a disqualification order. Defendants complain that they are effectively forced to give an undertaking because they cannot afford to defend proceedings which would otherwise ensue.

More recently, the Rating (Coronavirus) and Director Disqualification (Dissolved Companies) Act 2021 has enabled disqualification proceedings to be brought where a company has been dissolved as opposed to going into an insolvency procedure.

Arguably the most important recent reform has been that effected by the Small Business Enterprise and Employment Act 2015, which introduced a compensation regime enabling the court to make a compensation order alongside a disqualification order where the conduct of an individual has caused loss to one or more creditors of an insolvent company of which the person concerned was a director. This was slow to take off. The first case in which it was used was *Re Noble Vinters Ltd* [2019] EWHC 2806 Ch, but since then a number of cases have been reported. Most recently the power has been used to seek compensation in cases where government bounce back loans, designed to assist businesses recovering from the pandemic, were misused. Again, an undertaking to pay compensation may be given to avoid proceedings.

Fears that the power might cut across the ability of insolvency office-holders to make recoveries from former directors of insolvent companies have so far proved unfounded. The Insolvency Service said from inception that it did not anticipate a high number of compensation orders. Similarly, the power of the court to award compensation for the benefit of "a creditor or creditors specified in the order" or "a class or classes of creditors so specified", thus, potentially, overriding the *pari passu* principle and the usual statutory priorities has attracted little adverse comment. It remains to be seen how the jurisdiction will develop and whether fears that compensation will undermine the integrity of insolvency process will yet become a serious reality or adversely affect insolvency recoveries by more conventional routes.

The effectiveness of the disqualification regime in terms of improving standards of directors' behaviour and protecting the public is hard to measure. Many feel it has little impact. The ability to recover compensation may add strength, but it is too early to say. A greater number of prosecutions for breach of disqualification orders might give them more teeth. Plans to introduce training and education for company directors, currently under active consideration by the Insolvency Service, may prove to be more efficacious. A modest start has been made in the creation in 2023 of a "new director information hub … giving directors of companies clear, bitesize information to guide them through the lifecycle of their company", but it is a start and one to build upon. ■

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