Director disqualification proceedings explained

Elliot Green explains how the process works, and why it's vital a director facing disqualification should seek expert advice

Director disqualification proceedings arise from an adversarial process enabled by the Company Directors Disqualification Act 1986 ("the Act"). In the blue corner is the Secretary of State. In the red corner is the director(s) against whom allegations of unfitness will have been levied.

It is a trial of the evidence and the burden is on the Secretary of State of the Department for Business, Energy & Industrial Strategy to prove its case. The Secretary of State will typically delegate its role to the Insolvency Service.

The outcome is no forgone conclusion. However, if the Secretary of State is successful then the Court will grant a director disqualification order which prevents the relevant director(s) from embarking upon activities involved in the promotion, formation or management of a limited company for a period of time which ranges from two to 15 years.

The utility of the director disqualification regime

Company directors cannot expect to enjoy the fruits of limited liability if they do not have proper regard for their fiduciary duties to act bona fide with a proper purpose. Being true and fair is an ingredient of good director behaviour. Directors should conduct themselves in an appropriate manner, be consistent in promoting the prosperity of the company and adequately disclose conflicts of interest. Failure to do so puts them at risk of being struck off, particularly if creditors suffer avoidable losses.

The gateway for the Secretary of State to take a director "off the road" is set out in the following provisions of the Act:

Section 2 of the Act can be utilised against a person where he or she is convicted of an indictable offence in connection with the promotion, formation, management of a company.

Section 6 of the Act is by far the most common mechanism deployed for director disqualification and arises when a director has a company that has become insolvent and he or she engaged in unfit conduct.

Section 8 is used when there is a public interest reason for disqualifying a director.

The company director disqualification regime exists with the noble aim to protect the public. Mere mismanagement will not typically cause a disqualification order to be made; there usually has to be something more. It is often promoted as a scheme that is not penal in character. However, the Court of Appeal in the matter of the Secretary Of State For Trade & Industry v Griffiths & Ors [1997] EWCA Civ 3013 recognised that if the Secretary of State

succeeds on an application for a disqualification order what follows is akin to a sentencing exercise. The period of disqualification is linked to the gravity of the deemed unfit conduct.

Director disqualification undertakings

As an alternative to Court proceedings there is a procedure referred to as a director disqualification undertaking. It is permitted by the Act and enables the Secretary of State and the relevant director(s) to dispose of matters by consent.

If one were to train their sights on Insolvency Service data for the past 10 years or so, looking at the method deployed by the Secretary of State to disqualify directors, it is notable how disqualification undertakings outstrip disqualification orders at the rate of more than four to one. One can guess that pressure on the public purse might be responsible for this state of affairs. In more recent years such as 2019/2020 it reached a ratio of around seven undertakings for each order.

Instead of being locked down in a legal process occasioned by substantial costs and delays the undertaking routine enables the Secretary of State to conceivably streamline its procedures.

It is unsurprising that many directors may with alacrity grab the opportunity with both hands to avoid a long drawn out legal battle and try to negotiate a 'deal' by way of an undertaking. It may be possible to negotiate reductions to the period of disqualification as a result.

Defending director disqualification proceedings

In cases where a consensual disposal by way of undertaking is not possible matters will typically follow a pattern common to much litigation before the Courts. The burden in litigation is with the applicant, who in disqualification proceedings will be the Secretary of State. It will need to plead a case alleging unfitness and assemble evidence it considers proves that position on the balance of probabilities.

As with all litigation both sides are at real risk of losing. The Court is not there to rubber stamp the views of the Secretary of State. There have been instances of high-profile director disqualification proceedings that the Court found unconvincing. For example, in the case of the Kids Company the Court was unimpressed by the case put forward by the Secretary of State. It said: "The public need no protection from these Trustees."

A pleaded case for director disqualification will typically look to rely upon one or more of the matters of unfit conduct suggested in Schedule 1 of the Act as follows:

- The extent to which the person was responsible for the causes of any material contravention of regulations.
- The extent to which the person was responsible for the causes of insolvency.
- The frequency of the conduct.
- The nature and extent of any loss or harm caused.
- Any misfeasance or breach of any fiduciary duty by the director in relation to a company or overseas company.

Once the case is assembled, someone on behalf of the Secretary of State has to stand up and be counted by putting forward a positive case for the allegations of misconduct and then be prepared to go into the witness box. Here they can anticipate having their evidence and assumptions tested forensically by a director's barrister. The witness box can be an unforgiving place, particularly if you go into it without a strong case or not knowing your way around the evidence. It is not a test per se but good preparation is important.

Whilst the Secretary of State comes to matters as a relative stranger having had no prior involvement in the relevant company's affairs, the same cannot be said about a director who was there at the time. This can potentially be an advantage, particularly if the Secretary of State's evidence is occasioned by assumptions or involves asking the Court to draw inferences. The words of the late Christopher Hitchens still appear to ring true: "That which can be asserted without evidence, can be dismissed without evidence."

There appears therefore scope for a director to negotiate. This can have a knock-on effect on the length of any ban. However, unlike a commercial litigant the Secretary of State can have policy considerations to take into account that may constrain their approach.

Some of the matters considered above relate to the technical nature of such litigation. However, perhaps a reasonable starting point is first and foremost to grapple with the merits of the case promoted by the Secretary of State for disqualification. This will enable a director (perhaps with the benefit of legal advice) to gauge their best approach.

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