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How Will the UK Authorities Use New Director Disqualification Powers?

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On February 15, 2022, significant amendments to the regime for the disqualification of company directors entered into force.

The changes — introduced by the Rating (Coronavirus) and Directors Disqualification (Dissolved Companies) Act 2021 — provide for the first time the Secretary of State for Business, Energy, and Industrial Strategy (SOS) and its executive branch, the Insolvency Service (TIS), with powers to investigate and pursue disqualification proceedings against directors of dissolved companies.

Although the reforms significantly expand the number of companies whose current and former managers — including company directors and members of limited liability partnerships — may face disqualification proceedings, it remains to be seen how often the new powers will be used in practice. This article discusses the scope of the reforms and identifies factors that may affect how frequently the new powers will be exercised.

The Director Disqualification Regime

The Company Directors Disqualification Act 1986 prescribes circumstances in which the English court may impose a disqualification order on an individual. A disqualification order can be made in a range of circumstances including, in particular:

- Where the court is satisfied that an individual's conduct as a director makes them unfit to be concerned in the management of a company;[1] and
- Following more recent reforms, where the company of which the individual is a director has committed a breach of competition law, and the court considers that the individual's conduct as a director makes them unfit to be concerned in the management of a company.[2]

Although the 1986 Act is expressed to apply to an individual's conduct as a director, a disqualification order may, based on the same principles, also be imposed on a current or former member of a limited liability partnership.[3]

This article addresses the reforms from the perspective of their applicability to directors of limited companies, although the consequences of the reforms are also applicable to LLPs and their members.

Upon being made subject to a disqualification order, an individual may not, without permission of the court, be a director of any company or a member of an LLP, and may not be involved in the promotion, formation,

[1] Section 6(1) of the 1986 Act.
[2] Section 9A of the 1986 Act.
[3] Regulation 4(2) of the Limited Liability Partnership Regulations 2001.

or management of any company for the duration of the order.[4] Depending on its nature, a disqualification order may be made for a period of up to 15 years.

The imposition of a disqualification order has a substantial impact on an individual's livelihood and professional status. Given that the terms of any disqualification are a matter of public record, the public findings leading to disqualification order can also be the subject of an attempt by a company's creditors, liquidators or other stakeholders to bring follow-on claims against the individual in their personal capacity.

Company Dissolution

Relative to the liquidation process, the company dissolution process, which may be instigated where a company has not traded for at least three months, is a straightforward way to close a company. Broadly, to dissolve a company, the directors are required to send a completed form to the company register, pay a nominal fee, and publish a notice of proposed strike off in the official gazette.

Provided there are no objections to the proposed dissolution, the company is then dissolved. By contrast, the process of winding up a company through liquidation requires the appointment of a licensed insolvency practitioner (IP) who is required to assess the conduct of each of the company's directors and report the findings of these assessments to the SOS.[5]

Based on these reports, the SOS may decide to commence disqualification proceedings. The liquidation process, therefore, is more costly than dissolution and exposes current and former directors to greater scrutiny than would ordinarily otherwise be the case following dissolution.

There have for some time been concerns about the potential misuse of the company dissolution procedure, in particular regarding the practice of "phoenixism", i.e., the practice of dissolving a company to avoid its liabilities and then setting up a new company in its place to perform the same functions.[6]

More recently, concerns have been raised that the dissolution process has been used as a vehicle to fraudulently obtain, or avoid the repayment of, COVID-19 bounce-back loans, which were provided under a U.K. government scheme designed to provide businesses with quicker access to financing during the COVID-19 pandemic.[7]

In a recent report, the U.K.'s National Audit Office reported an estimate that, as of March 31, 2021, fraudulent U.K. bounce-back loans were valued at around £4.9 billion, or $6.6 billion.[8]

The 2021 Act

Prior to the reforms introduced by the 2021 Act, the SOS had no direct powers to pursue disqualification against former directors of dissolved companies that were not insolvent prior to dissolution. The 2021 Act gives, for the first time, the SOS jurisdiction to investigate and, if necessary, bring disqualification

[4] Section 1(1) of the 1986 Act.
[5] Section 7(A)(5) of the 1986 Act.
[6] https://www.gov.uk/government/publications/phoenix-companies-and-the-role-of-the-insolvency-service/phoenix-companies-and-the-role-of-the-insolvency-service.
[7] https://www.gov.uk/government/news/crackdown-on-directors-who-dissolve-companies-to-evade-debts.
[8] https://www.nao.org.uk/wp-content/uploads/2021/12/The-Bounce-Back-Loan-Scheme-an-update.pdf.

proceedings against directors of dissolved companies, even where the company was not insolvent prior to its dissolution.

As a result of now being susceptible to disqualification, directors of dissolved companies may also, upon being made subject to a disqualification order, be made subject to a compensation order requiring them to pay damages representing losses caused to one or more of the company's creditors — where such creditors may include, for example, Her Majesty's Revenue and Customs.[9]

Further, the new powers have retrospective, as well as prospective, effect. They apply in relation to a director's conduct occurring, and in relation to companies that are dissolved, whether before or after the entry into force of the 2021 Act, subject to a requirement that the SOS must start any disqualification proceedings within three years of the date on which the company was dissolved.

The relevant reforms contained in the 2021 Act, which received Royal Assent on December 15, 2021, largely come into force on February 15, 2022, save for the SOS' powers to make compulsory information requests in respect of dissolved companies, which came into force on December 15.[10]

Possible Impact of the Reforms

Between 2020 and 2021, there were 437,790 company dissolutions in the U.K., a decrease of 18.5% from the previous year.[11] The reforms therefore significantly expand the number of companies whose current and former directors may potentially be investigated and subjected to disqualification proceedings.

Following the concerns raised about the misuse of COVID-19 bounce-back loans, TIS has recently announced several successful disqualification proceedings against company directors for inappropriate applications for, or misuse of, bounce-back loans.[12]

For several reasons, however, it remains to be seen how frequently the new powers will be used in practice.

First, unlike in respect of insolvent companies entering an insolvency process such as administration or liquidation, where an IP is required to report to the SOS on the conduct of each director to allow the SOS to consider whether any disqualification proceedings should be pursued, there is no automatic mechanism for the SOS to receive relevant information regarding dissolved companies.

It is possible that, in some cases, a live investigation into a company will be underway before it is dissolved, and therefore the company and its directors may already be the subject of investigation prior to the company's dissolution.

In most cases, however, it is likely that the SOS will only become aware of potentially improper conduct by directors of a dissolved company following a disclosure by a member of the public, such a whistleblower or an alleged creditor of the dissolved company. This may limit the number of investigations that are pursued in respect of dissolved companies.

[9] Section 15A of the 1986 Act.
[10] Section 4(5) of the 2021 Act.
[11] https://www.gov.uk/government/statistics/companies-register-activities-statistical-release-2020-to-2021/companies-register-activities-2020-to-2021.
[12] See, for example, https://www.gov.uk/government/news/insolvency-service-cracks-down-on-bounce-back-loan-abusers.

Second, given that, unlike for insolvent companies, there is no mandatory requirement for an independent officeholder — such as an IP — to be appointed in respect of a dissolved company, investigations concerning dissolved companies may be more difficult and time-consuming to conduct than investigations into companies that have entered administration or liquidation.

When conducting investigations into insolvent companies, it is common practice for the SOS or TIS to obtain company information and records from IPs, who are officers of the court, and who are required to take control of the company's books and records. In most cases, when conducting investigations into dissolved companies, the SOS will not have the benefit of an independent officeholder who has control of the company's records. This has the potential to introduce delays and obstacles into the investigation process.

Third, and related to the first and second reasons, the additional complexities, and potential burdens, of investigating conduct relating to a dissolved company may be increased by the requirement for any disqualification proceedings to be initiated within three years of the date of the company's dissolution.

Although the 1986 Act allows the court to grant permission for disqualification proceedings to be issued beyond the prescribed deadline,[13] such permission is only granted in exceptional circumstances.

Overall, the powers contained in the 2021 Act represent an extension of the SOS' jurisdiction to investigate and, if necessary, pursue disqualification proceedings against company directors.

Although it remains to be seen how frequently the powers will be used in practice, the reforms to the director disqualification regime, and the increase in the circumstances in which a company director may be subject to disqualification proceedings, will be of note to company directors and to providers of directors' and officers' liability insurance.

[13] Section 7(2) of the 1986 Act.

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