

# The UK's Insolvency Service Reports on Recent Director Disqualification Enforcement Activity

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## Introduction

On 18 April 2023, the UK's Insolvency Service ("TIS") published statistics on its enforcement activities and outcomes during the last financial year (the "**Report**").<sup>1</sup> The Report describes TIS's enforcement activities in the areas of director disqualifications, company enforcement actions, bankruptcy and debt relief matters, and criminal prosecutions.

In addition to general insights into TIS's wider enforcement outcomes, the Report illustrates certain enforcement trends in director disqualifications.

In this Client Alert, we:

- highlight three trends in director disqualification enforcement which emerge from the Report;
- suggest factors that may have contributed to these trends; and
- discuss whether these trends are likely to continue.

We also provide some insights on contested disqualification proceedings from recent cases.

It is important to note that the UK's director disqualification regime applies to members of UK limited liability partnerships ("**LLPs**") in the same manner as it does to company directors. The Report does not distinguish between enforcement activity against LLP members relative to company directors. For ease of reference, this Client Alert uses the term "*director*" to apply to all individuals who may be subject to the disqualification regime.

## Disqualification Trends Highlighted in the Report

The Report covers TIS's enforcement activity between 1 April 2022 and 31 March 2023 (the "**22/23 Year**").<sup>2</sup>

Three noteworthy trends in director disqualification enforcement which emerge from the Report are:

- an overall increase in the number of disqualifications, as compared with previous years;
- a focus by TIS on the abuse of Covid-19 financial support schemes; and

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<sup>1</sup> See the Report [here](#).

<sup>2</sup> *Ibid*, paragraph 2.

- an increase in the average length of disqualifications.

### *Trend 1: An Overall Increase in the Number of Disqualifications*

The number of disqualifications obtained in the 22/23 Year was higher than in previous years. In the 22/23 Year, 932 individuals were disqualified, compared with 804 in 2021/22.<sup>3</sup> Of the 932 disqualifications secured in the 22/23 Year, 893 (i.e., 96%) were obtained through Section 6 of the Company Director Disqualification Act 1986 ("**Section 6**"). Pursuant to Section 6, TIS may pursue disqualification where it considers that a director has acted in a way that makes them "*unfit*" to be concerned in the management of a company.<sup>4</sup>

The 932 disqualifications secured by TIS during the 22/23 Year were obtained as follows:

- 812 (i.e., 87%) were obtained by undertaking, whereby upon the initiation of disqualification proceedings by TIS, the director voluntarily agrees to a specified period of disqualification; and
- 120 (i.e., 13%) were obtained by a Court order following contested proceedings.<sup>5</sup>

It is possible that several factors contributed to the overall increase in disqualifications:

- TIS has recently obtained a wider jurisdictional reach. As reported in our previous [Client Alert](#), in 2022, TIS obtained, for the first time, powers to investigate and pursue disqualification proceedings against directors of dissolved entities. These enhanced enforcement powers entered into force shortly before the beginning of the 22/23 Year. The Report notes that TIS's first use of these powers was in June 2022 and that there were 25 such disqualifications obtained during the 22/23 Year.<sup>6</sup>
- Corporate insolvencies during 2022 reached the highest levels for several years.<sup>7</sup> TIS's power to disqualify a director under Section 6 arises where a company is dissolved, or enters insolvency through administration, liquidation, or receivership. An increase in corporate insolvencies increases the number of companies whose current and former directors become susceptible to disqualification under Section 6.
- The 22/23 Year marked the first full financial year following the phased termination of temporary measures to protect businesses from insolvency and creditor action during the Covid-19 pandemic. The Report acknowledges that the lower levels of corporate insolvency in the previous three years (particularly during the pandemic) is likely to have contributed to lower levels of enforcement activity in these years.<sup>8</sup>

### *Trend 2: The Majority of Disqualifications Concerned the Misuse of Covid-19 Financial Support*

The Report highlights that the most common allegation made by TIS in disqualifications obtained under Section 6 was the misuse of Covid-19 financial support schemes introduced by the UK Government (e.g.,

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<sup>3</sup> *Ibid*, paragraph 3.1.

<sup>4</sup> *Ibid*.

<sup>5</sup> *Ibid*.

<sup>6</sup> *Ibid*.

<sup>7</sup> The Insolvency Service, [Commentary – Company Insolvency Statistics](#) dated 31 January 2023.

<sup>8</sup> *Supra* note 3.

Coronavirus Business Interruption Loans and Bounce Back Loans). Such allegations featured in 459 disqualification cases (i.e., 51% of all Section 6 disqualifications).<sup>9</sup>

There are numerous factors which may have reinforced TIS's focus on Covid-19 related allegations during the 22/23 Year:

- As the volatility caused by the pandemic has started to subside, there has been significant public focus on the extent of the fraudulent misuse of Covid-19 financial support schemes. In December 2021, it was estimated that, as of March 2021, around £4.9 billion of Covid-19 support loans had been obtained fraudulently.<sup>10</sup> As we noted in our previous [Client Alert](#), the apparent prevalence of the use of the company dissolution process as a vehicle to avoid liabilities to repay Covid-19 support loans was expressly cited as a reason to justify providing TIS with enhanced enforcement powers in respect of dissolved companies.
- As noted above, the 22/23 Year marked the first full financial year following the phased termination of temporary Covid-19 corporate insolvency protections. The termination of these measures is likely to have resulted in the insolvency of businesses that had previously relied upon the temporary Covid-19 insolvency protections. The current and former directors of such companies, upon the company's entry into insolvency, would become potentially subject to TIS's enforcement jurisdiction.
- In cases of alleged misuse of Covid-19 support loans, TIS may have had the opportunity to access material collected by, or otherwise obtain assistance from, third parties involved in administering and monitoring the Covid-19 support schemes. Such third-party assistance may have helped TIS to identify suitable cases for investigation and enforcement.

### ***Trend 3: An Increase in the Average Disqualification Period***

The length of each disqualification period was, on average, higher in the 22/23 Year than in the previous ten financial years. In the 22/23 Year, the average disqualification period was 7 years and 4 months. The equivalent figure for the previous ten financial years was between 5 years and 5 months, and 6 years.<sup>11</sup>

In this regard, the Report highlights that:

- the overall increase in disqualification period *"is linked to an increase in the number of disqualifications relating to Covid-19 financial support scheme abuse"*;
- the *"average length of disqualification[s] for these cases has been longer than for most other allegations"*; and
- *"nearly all such disqualifications have been [obtained by] undertakings rather than [Court] orders."*<sup>12</sup>

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<sup>9</sup> *Ibid*, paragraph 3.2,

<sup>10</sup> See National Audit Office, ['The Bounce Back Loan Scheme: an update'](#), 3 December 2021.

<sup>11</sup> *Supra* note 9.

<sup>12</sup> *Ibid*.

The Report highlights that, traditionally, the average disqualification term imposed by the Courts has been longer than the average disqualification term obtained by undertaking. However, in the 22/23 Year, the reverse was true, namely, the average period of disqualification obtained by undertaking (i.e. 7 years and 6 months) was larger than the average disqualification order imposed by the Courts (i.e. 6 years and 7 months).<sup>13</sup> The Report suggests that this trend reflects (i) the prevalence of Covid-19 allegations in disqualification cases during the 22/23 Year, for which TIS has sought comparatively higher periods of disqualification; and (ii) the fact that most Covid-19 related cases have been resolved by undertaking and not by Court order.

It is noteworthy that the prevalence of Covid-19 related allegations in disqualification cases - where such allegations have attracted higher periods of disqualification - is observed simultaneously with an overall increase in the average disqualification term. Given the Report's acknowledgement that "*almost all*" of the Covid-19 related disqualifications during the 22/23 Year were obtained by undertaking, the comparatively higher disqualification periods sought by TIS in Covid-19 related cases remain largely untested by the Courts.

### Reflections on the Trends

The Report provides useful insight into TIS's enforcement priorities and activities. Whether the trends highlighted in the Report will continue in the current financial year, and beyond, remains to be seen and will depend on several factors, including the following:

- **Corporate insolvency trends.** Corporate insolvency statistics, published by TIS at the same time as the Report,<sup>14</sup> indicate that the number of registered corporate insolvencies in March 2023 was 16% higher than in the same month in 2022. To the extent that corporate insolvencies continue to rise, we are likely to see a corresponding increase in the number of Section 6 Disqualifications pursued and obtained by TIS.
- **The extent to which TIS utilizes its powers in respect of dissolved companies.** As we noted in our previous [Client Alert](#), the reforms introduced last year significantly expanded the number of companies whose current and former directors may theoretically be subject to disqualification. However, it remains to be seen how frequently the new powers will be used in practice.
- **Whether the alleged misuse of Covid-19 support schemes remains central to TIS's enforcement priorities.** Given the apparent scale of misconduct related to Covid-19 financial support schemes, it seems likely that these issues will remain a core part of TIS's enforcement strategy. In general, TIS has three years from the date of a company's dissolution, or entry into insolvency, in which to bring disqualification proceedings.
- **The availability, and affordability, of adequate D&O insurance.** Disqualification proceedings can be lengthy and complex. In addition to the damaging consequences of being disqualified, an individual will usually be liable for adverse costs if they are unsuccessful in defending a disqualification claim. Accordingly, individuals who are unsupported by adequate funding and adverse costs protection (whether through directors' and officers' liability ("D&O") insurance or otherwise) are often unable practically to defend a complex disqualification claim to trial. The

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<sup>13</sup> *Ibid.*

<sup>14</sup> The Insolvency Service, [Commentary – Monthly Insolvency Statistics March 2023](#).

reported volatilities in the D&O market in recent years<sup>15</sup> may have resulted in fewer directors being protected by D&O insurance, which may have led some directors facing disqualification proceedings to accept an undertaking at an early stage of proceedings instead of defending the case to trial.

## Insights on Contested Disqualification Cases

As the Report illustrates, TIS is obtaining an increasing number of disqualifications. Particularly when alleging misconduct related to Covid-19 support schemes, TIS is pursuing cases aggressively and seeking longer disqualification terms. In a reverse of a previous trend, the Report suggests that a disqualified director is on average likely to serve a longer disqualification term if they agree to an undertaking than if they lose the case in Court.

In recent years, the Courts have shown willingness to dismiss disqualification claims where TIS's investigative or enforcement processes have not met the requisite standards of fairness and proportionality. For example, in *Re Keeping Kids Company*<sup>16</sup>, Mrs Justice Falk dismissed the disqualification proceedings against the trustees of a well-known charity, noting that there had been an "insufficient appreciation of the importance of the duty to present the case in a balanced way", which may have reflected "a wider issue" within TIS.<sup>17</sup> Similarly, in August 2020, the High Court in *Secretary of State v Rahman*<sup>18</sup> dismissed a disqualification application made following what the Court referred to as a "superficial investigation" by TIS. The Court in *Rahman* was "struck" by the "rudimentary pieces of evidence" underpinning the investigation.

In a recent disqualification application following a three-year investigation by TIS, we acted for the former CEO of a high-profile business facing complex and wide-ranging allegations. We were able to secure the complete discontinuance of the case, before trial, following our identification of investigative deficiencies and significant disclosure errors by TIS. In that matter the former CEO had ensured that adequate D&O insurance policy was in place. That foresight allowed this firm to deploy a comprehensive resistance to the application involving substantial work.

The personal, professional and financial consequences of disqualification can be extremely damaging. Whilst the defence of disqualification proceedings can be a daunting, and potentially costly, endeavour, individuals facing disqualification proceedings who have the benefit of adequate funding and costs protection would be well-advised to carefully assess the allegations and investigations processes adopted by TIS and, where appropriate, to challenge in Court cases where TIS has not met the requisite standards of fairness and proportionality, or where appropriate investigative processes have not been followed.

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<sup>15</sup> For example, the effects of the Covid-19 pandemic and the global increase in interest rates. See The Financial Times, *Cost of insuring board directors from lawsuits doubles in Covid era*, 16 September 2020, and Allianz Global Corporate & Specialty, *Directors and Officers Insurance Insights 2023 Report*, December 2022.

<sup>16</sup> *Re Keeping Kids Co Official Receiver v Atkinson and others* [2021] EWHC 175 (Ch).

<sup>17</sup> *Ibid*, paragraph 900.

<sup>18</sup> *Secretary of State for Business, Energy, and Industrial Strategy v Luther Rahman* [2020] EWHC 2213 (Ch).

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