

## ITB15 Directors Part 3



# disqualification

## introduction

"Disqualification" is a word normally associated with alcohol and driving, or cheating in a competition. However, it can also be a process affecting company directors.

Directors are critical to the corporate governance process and therefore have a number of duties and responsibilities to all parties who are affected by the activities of their company by virtue of their own actions.

If they are in breach of their duties (see ITB14) and they have been sufficiently "naughty", they can be banned, or disqualified, from acting as a director for anything up to 15 years by the Insolvency Service. For some, this can be a life changing ban.

The legislation is primarily contained in the Company Directors Disqualification Act 1986 ("CDDA") and action will usually be taken following an "unfit conduct" report submitted to the Insolvency Service by an Insolvency Practitioner appointed to deal with the affairs of the insolvent company.

## unfit conduct

There are many areas of unfit conduct, but some of the more common ones are:

- continuing to trade when a director knew that the company was insolvent;
- causing an avoidable loss to creditors;
- failing to keep proper accounting records;
- using the company's funds or assets for personal benefit;
- any type of fraudulent activity;
- failing to pay company tax liabilities; and
- failure to assist the appointed insolvency practitioner.

I have not detailed anything further on areas of unfit conduct as this will depend upon the particular circumstances of each case.

## what happens?

Once an Insolvency Practitioner has been appointed, as a Liquidator, Administrator or Receiver, one of their duties

is to investigate the conduct of the director(s). The basic investigation requirements are set out in Statement of Insolvency Practice 2 (SIP2) which can be found [here](#). It is mandatory for the IP to undertake these investigations, even if there are no funds in the case to pay their costs for doing so.

All directors that have held office for the three years prior to the date of the insolvency (even if they have resigned before that date) will be investigated.

The IP then submits a conduct report to the Insolvency Service and, if unfit conduct has been identified, the Insolvency Service will investigate the affairs of the company and the relevant directors in a lot more detail to determine if they should be disqualified "in the public interest". Roughly translated, this means "will the director cause more loss if he's not disqualified?"

## prosecution or disqualification?

In severe cases, the Insolvency Service may decide that a criminal prosecution is warranted, e.g. for fraud. However, my experience is that unfit conduct has to be REALLY severe to result in a criminal prosecution.

More realistically, a civil disqualification action would be undertaken which, if successful, would result in a director being disqualified for between 2-15 years, depending on the severity of their conduct.

The disqualification would usually fall into a band of 2-5 years, 5-10 years or 10-15 years and would be put in place either through a Court action or by an agreed Undertaking with the director (without Court action).

## consequences

If a director is disqualified, the effects can be quite severe. For the length of the disqualification, they could not:

- be registered as a director;
- act in the promotion, formation or management of a company;
- instruct a third party or the other directors (i.e. act as a *shadow director* – see ITB13) to run the company;

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- act in any way that a normal company director would (e.g. hire/fire staff, sign contracts, be on the company bank mandate);
- be a member of certain professional bodies, e.g. accountant, solicitor, which would prevent them from practicing.

If there was a loss to creditors as a direct result of their misconduct, the Court may also order a compensatory award made against a disqualified director which would mean the director would have to pay money over to the IP for the benefit of the creditors. The most severe compensation award I have seen in recent years has been for in excess of £500,000!

If they also breached the disqualification, the individual would:

- be committing a **criminal** offence liable to up to 2 years imprisonment;
- become personally liable for the company debts incurred whilst acting as a director whilst they were disqualified;
- (if a third party acted for a disqualified director, that third party could also be liable...); and
- face a further, additional, disqualification period.

I haven't covered everything here, but I hope you get the picture!

It is possible to get the permission of the Court to act as a director whilst disqualified but it would be a permission that is quite specific and would detail exactly what was allowed. In practical terms, the Court rarely grants a leave to act that is of any use!



## public record

Every disqualification is made public and can be found at [Companies House](#) or through [gov.uk](#). Statistics on disqualifications are also available [here](#).

I have reproduced the latest statistics on the last page. For the period May 2009 – May 2019, there has been one director disqualified for every 15 insolvent companies!

## in summary

The assessment of whether or not a director's conduct has been unfit or they have breached any of their duties sufficiently to merit disqualification is a difficult one. From 2012 – 2016, the Insolvency Service suffered from a lack of resource to enable it to take action in every case it felt was "in the public interest". However, more resources have been allocated in the last few years so the number of disqualifications is beginning to rise, although the length of disqualifications have fallen.

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A director must also be able to demonstrate that they have acted to "exercise reasonable care, skill and diligence" in undertaking their duties and not fall foul of "unfit conduct".

You should therefore ask two questions:

- If a third party unaware of the circumstances of the company looked at what I am doing, would they think it was reasonable?
- Is what I am doing or proposing to do, going to cause (further) loss to creditors?

## there is no substitute for expert advice

I have been advising individuals and businesses suffering financial distress since 1986, a substantial part of that time having been spent within the Insolvency and Business Recovery practices at two of the "Big Four" UK accountancy firms.

In that time, I have come across many instances where a particular insolvency process has proven to be a blessing in disguise for someone who may have no idea of what they can do. Early advice on insolvency could also prevent unfit conduct from being committed and avoid a disqualification.

As a Fellow of the Association of Business Recovery Professionals (also known as "R3" - Rescue, Recovery and Renewal) you can be assured that I am an expert in my field and will be able to help with an individual's needs.

## Get in touch



Please call me for further information or to arrange a free initial meeting.

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## disqualification

Director disqualification statistics for the period May 2009 – May 2019 (provisional).

Available at <https://www.gov.uk/government/collections/insolvency-service-enforcement-outcomes>. © Crown Copyright

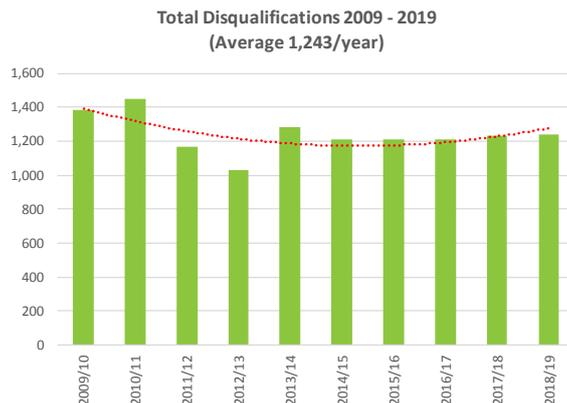
### 1. Director Disqualification Orders and Undertakings<sup>1</sup> Great Britain

Period	Total	Orders	Undertakings
2009/10	1,386	274	1,112
2010/11	1,453	288	1,165
2011/12	1,165	226	939
2012/13	1,034	193	841
2013/14	1,282	235	1,047
2014/15	1,210	226	984
2015/16	1,211	218	993
2016/17	1,214	200	1,014
2017/18	1,231	197	1,034
2018/19	1,242	215	1,027
2019/20 YTD p r	196	19	177
2019/20 Apr p	95	14	81
2019/20 May p	101	5	96
Total 2009 - 2019			12,428

p Provisional.  
r Revised

<sup>1</sup> Includes only those Section 2 disqualifications that are a result of referral or significant input from the Insolvency Service. More information can be found in the Notes and the *Guide to Insolvency Service Enforcement Outcomes*

Average 2009-19<sup>2</sup> 1,243



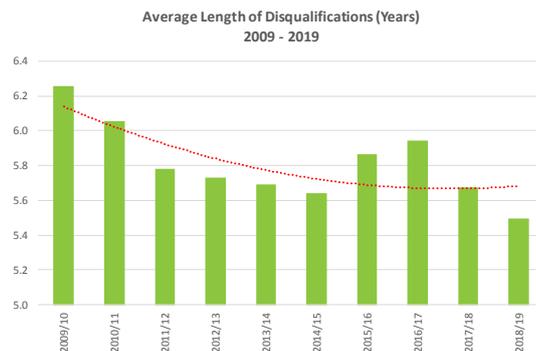
### 1b. Length of Director Disqualification Orders and Undertakings<sup>1</sup> Great Britain

Period	Average length (years)			Number of disqualifications by length band			Total disqualifications
	All disqualifications	Orders	Undertakings	2 to 5 years <sup>2</sup>	Over 5 to 10 years	Over 10 to 15 years	
2009/10	6.3	7.8	5.9	680	521	185	1,386
2010/11	6.1	7.6	5.7	745	556	152	1,453
2011/12	5.8	6.9	5.5	669	392	104	1,165
2012/13	5.7	7.0	5.4	634	289	111	1,034
2013/14	5.7	7.2	5.4	771	383	128	1,282
2014/15	5.6	7.5	5.2	740	352	118	1,210
2015/16	5.9	7.4	5.5	678	407	126	1,211
2016/17	5.9	7.5	5.6	641	434	139	1,214
2017/18	5.7	7.7	5.3	662	476	93	1,231
2018/19	5.5	6.8	5.2	726	432	84	1,242
2019/20 YTD p r	4.9	6.1	4.8	132	54	10	196
2019/20 Apr p	5.1	6.6	4.8	63	26	6	
2019/20 May p	4.8	4.8	4.8	69	28	4	

p Provisional.  
r Revised

<sup>1</sup> Includes only those Section 2 disqualifications that are a result of referral or significant input from the Insolvency Service. More information can be found in the Notes and the *Guide to Insolvency Service Enforcement Outcomes*  
<sup>2</sup> Includes a small number of orders of less than 2 years

Average 2009-19<sup>2</sup> 5.8 7.3 5.5 695 424 124



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