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Directors' disqualification after the Insolvency Act 2000: the new regime

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****Insolv. L. 86*** Introduction: disqualification law and company law

Whether we like it or not and whether we actually think it works or not, the Company Directors' Disqualification Act 1986 (CDDA) has proved to be a significant measure in political, cultural and legal terms. Since publication of a National Audit Office Report in 1993 critical of the Insolvency Service's enforcement efforts, there has been a dramatic increase in the volume of disqualification proceedings. The number of disqualification orders made by the courts in disqualification proceedings is now running at in excess of 1,000 per annum.¹ A sharpening of rhetoric has accompanied this increase in activity. The Department of Trade and Industry's (DTI) press releases from the last five years or so use colourful and vigorous language. Here are just a few examples: "Dodgy Directors Top of Insolvency Service's Hitlist" (August 15, 1995), "78% More 'Bad Bosses' Banned by Insolvency Service" (February 20, 1996), "Unfit Directors of 'Phoenix' Companies Grounded as Disqualification Orders Soar" (November 12, 1996), "Griffiths Goes Gunning Against Cowboy Directors" (June 5, 1997), "Griffiths Promises No Let Up in Campaign to Ban Rogue Directors" (April 30, 1998), "Insolvency Service is Winning Battle in Clamp Down on Dodgy Directors" (November 30, 1999), "Clamp Down on Dodgy Directors Continues" (April 18, 2000). All of this suggests that there remains a strong political commitment to the disqualification regime and a determination in official circles to foster the general perception that disqualified directors, whatever their conduct, are no better than "crooks".

At the same time, the DTI is doing its best to sustain a parallel discourse of entrepreneurship, competitiveness and enterprise² and to promote a culture altogether more forgiving (and more "American") in its attitude towards business failure.³ As in all things, there remains a recognition that a balance needs to be struck and that too much "freedom" may lead to "abuse". Old liberal ideologies are being repackaged and updated to take account of globalisation and the arrival of the information age. Company law retains its regulatory agenda alongside its facilitative agenda, a point made clear by the Steering Committee of the DTI Company Law Review. However, those responsible for the reform of mainstream or "core" company law often lose sight of the structural importance of insolvency law (and here I am thinking in particular of CDDA, s.6) within the overall scheme of corporate regulation.

It is accepted wisdom that insolvency law plays a part in striking the balance between enterprise and abuse of limited liability. In his well-known text, Sir Roy Goode suggests that one of the overriding objectives of corporate insolvency law is "to provide a mechanism by which the causes of failure can be identified and those guilty of mismanagement brought to book and, where appropriate, deprived of the right to be involved in the management of other companies".⁴ A similar view was expressed in the Cork Report.⁵ However, the disqualification regime in CDDA, ss.6-7 purports to be more than merely pathological. The strong consensus emerging from the case law is that the CDDA is concerned with protecting the public from "rogue" directors and that protection is achieved in three ways:

- (a) by keeping the errant director "off the road";
- (b) by deterring him from "misbehaving" in the future (individual deterrence); and

****Insolv. L. 87*** (c) through general deterrence, *i.e.* by encouraging other directors to behave properly.⁶

Whether the CDDA *does* have a deterrent effect is open to doubt but we should not lose sight of the

claim being made about the disqualification regime here. Disqualification proceedings under CDDA, ss.6-8 are brought in the public interest and purport, through notions of individual and general deterrence, to be concerned with the upholding and advancement of public standards of commercial morality. Thus, through the mechanism of CDDA, s.6, as interpreted by the courts, the remit of insolvency law has arguably widened. Not only is it concerned with bringing wrongdoers to book, it also purports to lay down *ex post*, on a case by case basis, what amount to general standards of governance for directors of struggling companies. As well as being a source of new standards, it is arguable that disqualification is now the principal means by which the general law of directors' obligations is moulded and enforced. The best illustration so far is the *Barings* case.⁷ The immediate question there was whether the conduct of the Barings executives made them unfit to be concerned in the management of a company under CDDA, s.6(1). In analysing this question, the court drew on modern Australian and American authorities to reformulate the duties of care, skill and diligence laying particular emphasis on the supervisory responsibilities of directors.⁸ Thus, the impact of the CDDA in creating a modern discourse of commercial morality within company law has been quite considerable. However, this is generally overlooked and an artificial division is maintained between so-called "core" company law and insolvency law when we should perhaps be asking questions about the relationship between the two. As a consequence, the reforms of the CDDA discussed in the rest of this article have, by and large, slipped unnoticed onto the statute book: a seemingly uncontroversial "add-on" to an Insolvency Bill. There is a case for saying that 15 years on from the enactment of the CDDA, we should be conducting a fuller assessment of its place in the regulatory scheme, especially when a full-scale review of company law is already in train.⁹ It is perhaps ironic that the principal change brought about by the Insolvency Act 2000, the advent of disqualification undertakings (discussed below), may serve to reduce the visibility of the CDDA still further and reinforce **Insolv. L. 88* the existing tendency to treat disqualification as a thing apart from company law.¹⁰

Disqualification undertakings: origins and purpose

The law on undertakings pre-Insolvency Act 2000

The most important substantive reform to the CDDA is contained in Insolvency Act 2000, s.6. This inserts a new section 1A into the CDDA providing a means by which disqualification can be achieved administratively without the involvement of the court. Under this "fast-track" system, the Secretary of State will be empowered to accept undertakings equivalent in effect to a disqualification order in cases where the director consents to being disqualified and the parties can reach agreement on the period of disqualification. Broadly speaking, prior to the amendment, it was not possible for disqualification cases to be compromised in this way. In the leading case of *Re Blackspur Group plc, Secretary of State for Trade and Industry v. Davies*,¹¹ the Court of Appeal held that the Secretary of State's decision to continue disqualification proceedings against the defendant, despite an offer of undertakings, was not open to review. In the court's view, the Secretary of State was entitled to refuse an offer of undertakings for the following reasons:

- (1) Once proceedings were on foot, it was for the court and not for the parties to decide whether or not a disqualification order should be made. Under CDDA, ss.6(1) and 8(2), the court could only make a disqualification order if it was "satisfied" that the director's conduct made him unfit. As the court was required to be "satisfied" of the director's unfitness, the judge could not be asked to make a disqualification order by consent of the parties without first forming a view on the underlying merits.¹²
- (2) The means by which protection of the public was to be achieved was embodied in a detailed legislative scheme which did not provide for the disposal of proceedings on the basis of undertakings. The Secretary of State was entitled to adhere to that statutory scheme in the interests of good regulation.
- (3) Moreover, the undertakings offered, even though they were expressed to be permanent in duration, did not provide the public with the same level of protection as that afforded by a disqualification order. There were three reasons why an undertaking not to act as a director or in any other prohibited capacity was not identical in effect to a disqualification order made by the court. First, breach of undertaking would not automatically give rise to the statutory consequences for contravention of a disqualification order in CDDA, ss.13-15. Secondly, there was no statutory procedure governing the grant of leave to act under an undertaking. Thirdly, there was no scope for undertakings to be entered on the register of disqualification orders which the Secretary of State is required to maintain under CDDA, s.18(2).

In the earlier cases of *Re Homes Assured Corporation plc*¹³ and *Re Company X*,¹⁴ the court did stay disqualification proceedings where undertakings acceptable to the Secretary of State had been offered. However, the true rationale of these cases may lie in the court's jurisdiction to dismiss proceedings as an abuse of process in circumstances where there are doubts about whether the defendant will receive a fair trial. For example, in *Homes Assured*, the court was satisfied on medical evidence that it would have been "hazardous and difficult" to embark on a lengthy trial in which the defendant would be giving evidence and acting in his own defence. There is a third case in which proceedings were stayed on the basis that undertakings had been offered.¹⁵ However, this case is hard to reconcile with *Blackspur*. These exceptional cases aside, the prevailing view, epitomised by the decision in *Blackspur*, was that legislative intervention was required to make it ***Insolv. L. 89** permissible for disqualification cases to be compromised on undertakings without court involvement.

Carecraft disposals

It was possible under the old law for civil disqualification proceedings to be disposed of on a summary basis using a procedure sanctioned by Ferris J. in *Re Carecraft Construction Co. Ltd*¹⁶ and approved by the Court of Appeal in *Secretary of State for Trade and Industry v. Rogers*.¹⁷ Under the *Carecraft* procedure, the parties can put a statement of agreed or non-contested facts before the court and invite the court to make a disqualification order for a specified period or a period within an agreed range of years. Thus, the parties negotiate and agree a basis on which the court is then asked to dispose of the matter without the need for a full hearing. It is the essence of *Carecraft* that the court is not strictly bound by the agreement reached by the parties. The court must make its own findings based on the statement. In theory, the court could hold that the conduct described in the agreed statement is of insufficient gravity to merit a finding of unfitness. Equally, the court might be satisfied that the agreed conduct makes the director unfit but disagree with the parties' assessment of the appropriate period. If the court disagrees with the parties on either question, the case is adjourned to a full hearing with both sides able to adduce evidence in the normal way. The *Carecraft* procedure has proved something of a success and is used widely in CDDA, s.6 cases.¹⁸ Although, in practice, the judge rarely disagrees with the parties' assessment, the court remains the ultimate arbiter and a summary disposal results in the making of a disqualification order. As we saw above, it is the absence of precisely these features which led the Court of Appeal to conclude in *Blackspur* that the Secretary of State was entitled to reject an offer of undertakings and proceed to trial.

Reform

Despite the relative success of *Carecraft*, support grew in the second half of the 1990s for the idea that the CDDA should be amended to enable the Secretary of State to settle disqualification cases in a way that achieved the same legal effect as a disqualification order without the court having to hear the matter at all, even on a summary basis. The first public call for reform was made by the then Vice-Chancellor, Sir Richard Scott in December 1995. In a Practice Direction¹⁹ aimed in part at streamlining *Carecraft*, he made the following observations and recommendation:

"Under the 1986 Act, there is no alternative but for all applications for disqualification orders, no matter what state of agreement there may be between the parties, to be processed through the court machinery and made by a judge or registrar after a court hearing. I regard this as unnecessary and avoidable. I would recommend, accordingly, that the Secretary of State give consideration to the possibility of introducing amending legislation, under which an agreement between a director and the Secretary of State, or the Official Receiver, as to the disqualification period to be applied to the director, be given the same effect as a court order imposing the disqualification period. If the director is willing to bar himself from acting as a director for a period that the Secretary of State, or Official Receiver regards as being sufficient to protect the public interest, I do not see why time and money should be expended by insistence on bringing the case before the court."

Similar judicial recommendations were made in the course of subsequent *Carecraft* cases²⁰ and were echoed by the Court of Appeal in *Blackspur*.²¹ There can be little doubt that this growth in judicial support for a statutory system of undertakings was a reflection of the increasing pressure that disqualification cases were bringing to bear on court resources. In particular, there was a strong feeling that *Carecraft* was little more than a rubber-stamping exercise that did not merit the amount of court time devoted to it. The government's response to these calls for reform is enshrined in section 6 of the Insolvency Act 2000.

The political justification for the new undertakings regime appears to rest on the following four factors:

***Insolv. L. 90** (1) *Reduced cost to the taxpayer.* It was suggested during the parliamentary debate on the Insolvency Bill that undertakings will save the DTI an estimated £300,000 per annum.²² While there was praise for *Carecraft*, it was felt that the procedure still involved unnecessary costs such as the costs of negotiating the statement of agreed facts and attending court.²³

(2) *Better regulation.* Where disqualification proceedings are pending, the defendant director is not legally prohibited from acting as a director or from being concerned or taking part in the management of a company. So, for example, in a CDDA, s.6 case, the director remains at large from the moment the relevant company becomes insolvent within the meaning of section 6(2) right up to the point that a disqualification order is made either at trial or on a *Carecraft* disposal. During that period, (which could be as long as three or four years bearing in mind that the Secretary of State has two years in which to commence proceedings under section 7(2)), the public are not legally protected. The new regime is touted as a “fast-track” procedure that will improve regulation. The hope is that it will allow more directors to be processed more quickly and thus result in earlier protection for the public.²⁴

(3) *Savings in court resources.* It is clear that a major aim of the undertakings regime is to reduce pressure on court resources. As we will see below, the Secretary of State is able to accept undertakings and dispose of cases even before formal proceedings are commenced. Cases dealt with in this way will be taken out of the court system altogether. The House was told that, on current figures, only 10 per cent of disqualification proceedings are contested and go to a full trial. Of the remainder, 30 per cent are disposed of by agreement (presumably using *Carecraft*), while 60 per cent are simply uncontested.²⁵ It appears that the Government sees undertakings as a means of reducing court time spent hearing *Carecraft* cases and dealing with uncontested applications. In this sense, the new regime can also be seen as a response to the considerable expansion of directors' disqualification touched upon in the opening section. Since the early 1990s, the CDDA has grown from a cottage industry into a significant and sizeable legal enterprise. The need for undertakings suggests that disqualification has become a victim of the *relative* success it has enjoyed over the last decade.

(4) *Benefit to directors.* Undertakings appear to have some benefits for directors though these were not strongly emphasised by the Government. First, directors who are prepared to give undertakings at an early stage will presumably save themselves costs. Secondly, undertakings should make the position of directors more certain. Although directors are free to act until a disqualification order is made, it is difficult for them to make any forward plans while proceedings are pending. For those wishing to return to company management in the future, undertakings also offer the prospect of a quicker turnaround.

The new provisions introduced by section 6 of the Insolvency Act 2000 are now considered in detail.

The basic scope of the undertakings regime

The key features of the new regime²⁶ are as follows:

(1) Undertakings are only available in “unfitness” cases, *i.e.* cases falling within CDDA, ss.6 or 8. There is no logical reason why undertakings should not be made available in other forms of civil disqualification proceeding, *i.e.* cases under CDDA, ss.2, 3 and 4. However, the majority of cases are brought under sections 6-8 and so the decision to concentrate on “unfitness” cases probably reflects the relative weight of numbers.²⁷

(2) The decision to accept an undertaking is exclusively within the discretion of the Secretary of State. Hitherto, the Secretary of State's discretion has been merely prosecutorial. Proceedings can only be commenced “if it ***Insolv. L. 91** appears to the Secretary of State that it is expedient in the public interest that a disqualification order should be made” (CDDA, ss.7(1) and 8(1)). Under the new regime, the Secretary of State enjoys a wider discretion. Before the Secretary of State can accept an undertaking, two criteria must be applied. First, the Secretary of State must assess whether the conditions in CDDA, ss.6(1) or 8(1) (as appropriate) are satisfied, *i.e.* it must appear to the Secretary of State from the material available that the director's conduct makes him unfit. It follows that the question of “unfitness” is no longer exclusively a matter for the court. Secondly, the Secretary of State must consider that it is expedient in the public interest to accept an undertaking (instead of applying, or proceeding with an application, for a disqualification order) (CDDA, ss.7(2A) and 8(2A)). Subject to agreement between the parties, the upshot is that a director can be disqualified exclusively by administrative means. Clearly, the Secretary of State's decision to accept or refuse an undertaking is justiciable.²⁸ A decision to refuse an undertaking is susceptible to judicial review in the normal way

and, as in the *Blackspur* case, an application for review can be made in the main disqualification proceedings. In cases where undertakings are accepted, CDDA, s.8A builds a supervisory jurisdiction into the machinery of the Act. Under section 8A, the court has the power to vary an undertaking by reducing the period for which it is to be in force or it can discharge an undertaking altogether. Quite how section 8A will operate in practice is a point taken up further below.

(3) The Secretary of State can accept undertakings either *before* or *during* proceedings. This is clear from the wording of CDDA, ss.7(2A) and 8(2A) which expressly provide that undertakings can be accepted as an alternative to “applying, or proceeding with an application, for a disqualification order”. An offer of undertakings is unlikely to be considered before the point at which the Secretary of State would ordinarily decide to bring proceedings. This is because the Secretary of State is required by CDDA, ss.7(2A) and 8(2A) to form a view on the merits.²⁹ It is anticipated that the normal reporting and pre-action investigative procedures will be allowed to run their course. The likelihood is that the director will be formally advised of the possibility of undertakings in the letter before action that the Secretary of State is required to send in order to comply with CDDA, s.16(1).³⁰ It follows that a director will not be able to offer undertakings e.g. within a couple of weeks of his company going into liquidation and before the office holder has had the opportunity to compile a “D” report.³¹

(4) An undertaking will have exactly the same legal effect as a disqualification order. The prohibition must be drawn in the same terms as an order (compare CDDA, s.1A(1) and s.1(1) as amended by Insolvency Act 2000, s.5(1)). A period of disqualification falling within the statutory boundaries must be specified (CDDA, ss.1A(1)-(2)). Sanctions for breach of an undertaking are identical to those for breach of an order (CDDA, ss.13-15, as amended by Insolvency Act 2000, Sched. 4, Pt. I, paras. 8-10). Provision is made for the court to grant leave to act (CDDA, ss.1A(1) and 17(3), as substituted by Insolvency Act 2000, Sched. 4, Pt. I, para. 12). The framework is also in place for particulars of undertakings to be entered on the register of disqualification orders (CDDA, s.18 as amended by Insolvency Act 2000, Sched. 4, Pt. I, para. 13). These amendments meet the objections raised in the *Blackspur* case.

Practical implications

This section of the article discusses practical issues and assesses the likely overall impact of disqualification undertakings.

Impact on Carecraft

Where the director is minded to accept disqualification and the parties can agree both the conduct and the period of disqualification, the case can now be settled on **Insolv. L. 92* undertakings. This suggests that the *Carecraft* procedure is now surplus to requirements. Indeed, it is arguable that one of the underlying objects of the new regime is to eliminate the need for *Carecraft* and, accordingly, save court time spent on *Carecraft* cases. A director who does not contest the case appears to have nothing to gain by insisting on the full rigours of *Carecraft*. However, there are two circumstances in which it is conceivable that *Carecraft* could still be used from time to time. First, there are cases where the parties agree the conduct but disagree on the appropriate period of disqualification. It is possible that the court could be asked to determine the period having regard to the agreed conduct.³² Secondly, *Carecraft* could presumably be used in civil disqualification proceedings under CDDA, ss.2-4 where undertakings are not available.

Statements of fact

As we have seen, the Secretary of State must form a view on the underlying merits when considering whether to accept an undertaking. It is clear that, in contrast to *Carecraft*, the parties are not formally required to agree a statement of facts. However, for both practical and philosophical reasons, there appears to be a need for at least some formal record of the conduct underlying the Secretary of State's decision. First, there is the question of future proceedings by the director either for leave to act while disqualified under CDDA, s.17 or to have the undertaking varied or discharged under CDDA, s.8A. In such proceedings, the court will need to be given a clear idea as to the factual basis of the disqualification. This is particularly important on an application for leave where the nature and seriousness of the applicant's previous conduct is highly material.³³ Secondly, there are questions of publicity and transparency. Disqualification of directors is justified on a rationale of public protection (including protection through general deterrence) and the Secretary of State is required, in deciding whether to accept an undertaking, to consider the public interest. In keeping with that rationale, there

is a strong case for saying that details of the conduct forming the basis for disqualification in the individual case should be a matter of public record. Disqualification orders and undertakings differ in terms of public accessibility. An order is made on the basis of a judgment given in open court. The reasons for the disqualification are readily accessible. Similarly, in *Carecraft* proceedings, a judgment is given and it is standard practice for the agreed statement of facts to be annexed to the order.³⁴ However, in the absence of a statement of facts that could be publicised, for example, by means of press release, the factual basis of a disqualification undertaking may not obviously be within the public domain.

Both these issues were raised during the passage of the Insolvency Bill through Parliament. The Trade and Industry Select Committee formed the view that there could usefully be express legislative provision for a statement of facts on which the undertaking was based so as to assist the court in future proceedings.³⁵ Concerns about lack of transparency and publicity were also aired.³⁶ However, the Government was unconvinced. Its formal response to the Select Committee stated that, “we are mindful ... of the danger of placing too much emphasis on the form of the procedure (statement of unfitted conduct) rather than on the substance of the underlying legislation (early provision of the protection for business and for the public generally which the CDDA is intended to provide)”.³⁷ In the Government's view, there was a risk that a mandatory requirement for an agreed statement of facts would end up reintroducing cost and delay.³⁸ Thus, it is theoretically possible for the Secretary of State to accept an undertaking offered by a director who disputes some or all of the allegations of unfit conduct. Equally, however, it is anticipated that, in practice, the Secretary of State will try to agree the unfit conduct and incorporate any agreement in a statement of facts, albeit in much shorter form than a *Carecraft* statement. It is current practice for the Secretary of State to include a schedule of unfit conduct in summary form in the CDDA, s.16 letter. It is likely that this will provide the basis for any short-form statement of facts.³⁹

Plea-bargaining

The Institute of Directors, among others, is concerned that directors offered the option of an undertaking will be put under undue pressure to accept it, rather than having their day in court. Their fear is that a plea-bargaining culture could **Insolv. L. 93* develop along the lines of, “accept a three-year disqualification undertaking, or else we will go to court and press for five years”.⁴⁰ One would have thought that some degree of plea-bargaining is inevitable especially as negotiations will presumably be conducted “without prejudice”. However, the Secretary of State is constrained to accept undertakings only if it appears to him that it is expedient in the public interest that he should do so. This suggests that an undertaking will only be accepted if the period approximates to that which, in the Secretary of State's assessment, the court would order in disqualification proceedings.⁴¹ It follows that there may be scope for plea-bargaining *within* a particular *Sevenoaks* bracket. However, there does not appear to be much scope for the Secretary of State to engage in drastic plea-bargaining *across* the *Sevenoaks* brackets (e.g. by accepting an undertaking for two years in a case that he considers falls squarely within the middle bracket of six to 10 years).⁴² One assumes that the “culture” will not be far removed from that which has developed in relation to *Carecraft*. Ultimately, it is clear that the Secretary of State could ask the court to make a disqualification order for a different period than that on offer via an undertaking. This seems fair enough bearing in mind that the evidence before the court in contested proceedings may differ in scope from the material available to the Secretary of State at the time the undertaking was under contemplation.

Ironically (in light of the concern expressed by the Institute of Directors), there may be scope for the Secretary of State to offer limited discounts as an incentive to early settlement. The reason for this is that the court's discretion in fixing the appropriate period does not correspond exactly with the Secretary of State's administrative discretion to accept an undertaking. While, in fixing the period of disqualification, the court acts with the broad scheme of the CDDA in mind, its primary focus is on the seriousness of the proven conduct.⁴³ By way of subtle contrast, the Secretary of State is required directly to consider the public interest. Bearing in mind the purposes of the undertakings regime, the public interest may be wide enough to justify some discount in order to secure the benefits of earlier protection and saving of cost.

Costs

One factor that may encourage directors to agree to an undertaking is that of costs. The usual rule where the court makes a disqualification order in contested proceedings is that the Secretary of State is entitled to his costs on the “loser pays” principle. If an undertaking is offered and accepted without

proceedings having to be issued, the director will usually face no adverse costs consequences. Where undertakings are accepted during proceedings, the Secretary of State will have to discontinue the proceedings. The usual rule where proceedings are discontinued is that the claimant pays the defendant's costs. However, this rule is reversed by paragraph 28.1 of the reissued Practice Direction: Directors' Disqualification Proceedings which provides that the director will generally be required to pay the Secretary of State's costs where proceedings are discontinued because of acceptance of an undertaking. Thus, from the point of view of costs, directors are better off settling sooner rather than later.⁴⁴

One intriguing question is whether there is any scope for a director to make an offer of undertakings on a *Calderbank* basis, *i.e.* an offer "without prejudice save as to costs"⁴⁵ to the effect that he is prepared to accept a disqualification for, say, a fixed period of four years. *Calderbank* offers are commonly used in other types of civil proceeding to shift the risk of adverse costs. If the claimant wins at trial but does not beat the defendant's *Calderbank* offer, the court may deprive the claimant of all or part of his costs. Thus, in theory, if the court disqualified our *Calderbanking* director for only three years, the Secretary of State could arguably be at risk on costs. However, there is little correlation between disqualification proceedings and the types of proceedings in which *Calderbank* offers are typically made. In offering the undertaking, the director would have to identify clearly the factual basis on which it was being offered. In contested proceedings, the material before the court, which would include the defendant's affidavit evidence, might differ in a number of respects from the material underpinning the director's offer of undertakings. Moreover, as was argued above, there are subtle differences between the court's discretion in relation to the period of disqualification and the **Insolv. L. 94* Secretary of State's discretion to accept undertakings. For these reasons, *Calderbank* offers are unlikely to be widely used.

When does an undertaking come into force?

CDDA, s.1A makes no provision for when an undertaking is to come into force. This contrasts with the position under CDDA, s.1 (as amended by Insolvency Act 2000, s.5(2)). This provides, subject to contrary order of the court, that the period of disqualification does not start to run until 21 days have elapsed, counting from the date of the order. It follows that a disqualification order will not usually have immediate effect. The 21-day period of grace gives the disqualified person a useful period of breathing space during which he can re-arrange his affairs without being in breach of the disqualification order while he does so. Without it, a person who loses contested disqualification proceedings would be faced with considerable practical difficulties in respect of any current directorships. CDDA, s.1 (as amended) gives him a short time to resign those positions and, where necessary, take steps in conjunction with the relevant company or companies to appoint a replacement.⁴⁶ There seems no good reason why, in practice, the Secretary of State should not accept undertakings on a similar basis. However, the failure to make express provision in section 1A does cast doubt on the Secretary of State's power to allow the director a 21-day period of grace. The answer may be that the undertaking is essentially contractual in nature and that as long as its contents comply in all respects with CDDA, s.1A it will be open to the director to say, "I undertake not to act in a prohibited capacity for a period of x years beginning 21 days hence". If this course is not available and the Secretary of State is not prepared to delay acceptance of the undertaking, then, technically speaking, the director would need to apply to the court for a short period of leave to act.

Leave to act under disqualification undertakings

It is important to note that the Secretary of State has no power to grant a disqualified director leave to act. Thus, the Secretary of State cannot accept an undertaking on the footing that the director will have leave to act in relation to one or more specified companies. It is quite common for a director to make his application for leave in the main disqualification proceedings. Indeed, the practice is encouraged by the courts on the ground that it saves costs. However, a director who is prepared to accept an undertaking but wants leave, *e.g.* to continue in a current directorship must make a free standing application to the court. In the intervening period between acceptance of the undertaking and the hearing of his application for leave, the director will be unable to act. Moreover, subject to what was said above about the 21-day grace period, the Secretary of State has no power to grant interim leave pending the hearing of the director's application. The best the Secretary of State can do in this situation is to persuade the director to accept the undertaking on the footing that, subject to agreeable conditions, he will not oppose the application for leave. As the question of leave is entirely a matter for the court, the Secretary of State cannot guarantee any particular outcome, *e.g.* that leave will be granted subject to conditions x and y. The position is therefore no more attractive than that

facing a director in the same situation under *Carecraft*. There too, the director faces the prospect of uncertainty in the period between the *Carecraft* disposal and the hearing of his application for leave.⁴⁷ This is not to say that the Secretary of State *should* be given power to grant leave.⁴⁸ However, it is important that directors are advised (a) that leave to act can only be granted by the court, (b) that once an undertaking is accepted, they cannot act pending hearing of their application for leave unless the court grants them interim leave in the meantime, and (c) that the court is likely to order them to pay any costs incurred by the Secretary of State in connection with the hearing of their application.

Section 8A proceedings for variation or discharge of undertakings

There is little doubt that the immediate purpose of CDDA, s.8A is to demonstrate the compatibility of the undertakings regime with the European Convention on Human Rights. The Trade and Industry Select Committee were concerned that the new procedure would put the DTI in the position of investigator, prosecutor and **Insolv. L. 95* judge.⁴⁹ In empowering the court to vary or discharge undertakings, Parliament appears to have responded to this concern. It is not easy to predict the sort of grounds on which the court will be prepared to entertain a section 8A(1)(b) application.⁵⁰ It is anticipated that, initially at least, some directors will try their luck and apply to have their undertakings quashed on grounds that they were subjected to undue pressure or that the nature and effect of the undertaking was not fully explained to them. If fresh information comes to light casting doubt on the Secretary of State's view on the merits, that too may give grounds for review. Applications to reduce the period of an undertaking under section 8A(1)(a) will presumably be based on the ground that the period agreed is too long and that the public interest will be adequately served by a shorter period. It is submitted that the courts are likely to give the Secretary of State a wide margin of appreciation and deal robustly with applications under section 8A. Otherwise, the system, which is designed to achieve "fast-track" disqualifications, could become self-defeating. So, for example, on an application to vary the period, the court is likely to adopt a "broad-brush" approach and refuse to intervene where the period of the undertaking falls within a reasonable range.

Conclusion

The Disqualification Unit is likely to come under political pressure to make the new undertakings regime work and efficiency gains should result. Undertakings are likely to prove very useful in the case of individuals who no longer wish to be directors or who have no immediate plans to become involved again in the management of companies. For directors who want to return to managing companies in the future, there is some prospect of a quicker turnaround. Cases can now be resolved more quickly and at lower cost. A director who gives, say, a three-year disqualification undertaking will be back in the market place more quickly than a director who contests a similar case to trial and receives a three-year disqualification from the court. If the Secretary of State is able to offer some discount on period (as discussed above), then this combined with the adverse costs implications of proceedings should create sufficient incentive for directors to settle by resorting to undertakings. We should expect to see a sizeable reduction in the number of *Carecraft* cases. At the same time, there will always be directors who want to fight and the availability of undertakings will do nothing to deter them. It is also questionable whether undertakings will reduce the number of cases that come before the courts uncontested because the defendant simply chooses to ignore the proceedings. As mentioned above, there are one or two procedural issues that need ironing out. In particular, it will be interesting to see how practice develops with regard to statements of fact. We can also expect an initial surge of applications under section 8A. On balance, the advent of undertakings is likely to mean less rather than more work for lawyers arising out of the CDDA in the future.

The scope of the prohibition

Section 5(1) of the Insolvency Act 2000 amends CDDA, s.1 to make it clear that a disqualified person is absolutely prohibited from acting in any office that requires him to be qualified as an insolvency practitioner. Before the amendment, it appeared on the face of CDDA, s.1 that the court had jurisdiction to grant a disqualified person leave to act as a liquidator or administrator. This gave rise to an anomaly because the effect of Insolvency Act 1986, s.390(4)(b) is that any person made the subject of a CDDA disqualification order automatically loses their qualification to act as an insolvency practitioner. The better view was always that the absolute ban in section 390 overrode the qualified ban in CDDA, s.1. The amendment now makes this crystal clear.⁵¹

Jurisdictional issues

Schedule 4 to the Insolvency Act 2000 makes a series of minor amendments to the CDDA. Of these, the most important (apart from those already mentioned earlier **Insolv. L. 96* in parenthesis) are the amendments to CDDA, s.6(3). These resolve various problems of jurisdiction that defendants have sought to use to challenge the validity of proceedings.⁵² Section 6(3), as originally enacted, used the present tense to identify the court having jurisdiction. So, for example, in the case of a director of a company “which is being wound up”, the relevant court under former section 6(3)(a) is “the court by which the company is being wound up”. Two problems arose that had a particular impact on county court jurisdiction. First, did the court which had jurisdiction when proceedings were commenced cease to have jurisdiction once the winding-up process was completed and the company was no longer “being wound up”? Secondly, where the registered office of the company was changed (e.g. by the liquidator), was the relevant court the county court for the district of the new registered office or the county court for the district of the registered office as at the date of the winding-up? The courts decided pragmatically that jurisdiction should be tested by reference to the commencement of disqualification proceedings. Thus, on the first question, if the court had jurisdiction when proceedings were commenced, it did not lose it simply because the winding-up was completed while proceedings were still pending.⁵³ Similarly, proceedings were properly commenced in the county court for the district of the company's registered office as at the date of commencement.⁵⁴ The amendments make it clear (a) that the court retains jurisdiction even once the relevant insolvency process has come to an end, and (b) that the correct county court in which to bring proceedings is the court for the district of the company's registered office as at the commencement of the relevant insolvency process.⁵⁵ Significantly, new section 6(3B) of the CDDA expressly validates proceedings commenced in the wrong court and gives that court discretion to retain such proceedings. Thus, Parliament has followed the example of the courts by seeking to ensure that jurisdictional obstacles do not derail disqualification proceedings.

This article is an updated version of an address given by the writer to the Annual Conference of the Insolvency Lawyers' Association on March 10, 2001. The assistance of Malcolm Davis-White, 4 Stone Buildings, Lincoln's and Felicity Toube, 3-4 South Square, Grays Inn is gratefully acknowledged. Any errors remain the sole responsibility of the writer.

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1. More specifically, according to figures published by the Insolvency Service, there were 1,267 orders made under CDDA, s.6 in 1997-98, 1,284 orders in 1998-99 and 1,540 orders in 1999-2000, representing an increase of over 20% in three years. This compares with a figure of 339 orders in 1992-93 at around the time of the original National Audit Office Report. The National Audit Office commented favourably on the increase in the number of directors being processed through the courts in a follow-up report published in May 1999: see *Company Director Disqualification--A Follow-Up Report* (1998-99 HC 424).
 2. For example, through the ongoing Company Law Review.
 3. See e.g. *Bankruptcy: A Fresh Start--A Consultation on Possible Reform to the Law Relating to Personal Insolvency in England and Wales* (April 2000), a consultation document issued by the Insolvency Service. For a useful discussion of these attempts at cultural engineering locating modern developments within a wider historical context see S. Wilson and G. Wilson, “Responsible Risk Takers: Notions of Directorial Responsibility--Past, Present and Future” (forthcoming, *Journal of Corporate Law Studies*).
 4. *Principles of Corporate Insolvency Law* (2nd ed., 1997), p. 24.
 5. Report of the Insolvency Law Review Committee, *Insolvency Law and Practice*, Cmnd. 8558 (1982), para. 198.
 6. See e.g. *Re Swift 737 Ltd* [1993] B.C.L.C. 1, *Re Grayan Building Services Ltd* [1995] Ch. 241, *Re Westmid Packing Services Ltd* [1998] 2 All E.R. 124 and general discussion in Walters and Davis-White, *Directors' Disqualification: Law and Practice* (1999).
 7. *Re Barings (No. 5)* [1999] 1 B.C.L.C. 433 affd. [2000] 1 B.C.L.C. 523, CA.
 8. See further, A. Walters, “Directors' Duties: The Impact of the Company Directors' Disqualification Act 1986” (2000) 21 Co.Law. 110.
 9. There is uneasiness in some quarters about the *ex post* nature of the legal standards applied in disqualification cases: see e.g. views expressed extra-judicially by Lord Hoffmann in the fourth annual Leonard Sainer Lecture (1997) 18 Co.Law. 194. As such, it is arguable that the proposed Statutory Statement of Directors' Duties should, as an *ex ante* measure, contain some positive account of directors' obligations distilled from CDDA jurisprudence. A similar view is expressed by Professor Sealy in “Directors' Duties Revisited” (2001) 22

Co.Law. 79. The Steering Committee of the Company Law Review accepts that the statement should make it clear that directors are under an overriding obligation to have regard to the interests of creditors when the company is insolvent or threatened by insolvency: see *Completing the Structure* (November 2000), para. 3.12. Any more detailed prescription is rejected as undesirable on the ground that "the law [governing directors' duties in an insolvency situation] is developing and there is already a carefully balanced statutory provision, which operates *ex post* in a liquidation, in the Insolvency Act 1986, s.214 (wrongful trading)". There is no mention of the CDDA even though, through the volume of reported cases alone, the impact of disqualification law on directors' obligations has been far more visible than that of s.214.

10. It is interesting to note that the few academics that have written on *Barings (No. 5)* would probably hold themselves out as being insolvency lawyers rather than pure company lawyers (if there is such a thing). Company lawyers talk about *Re City Equitable Fire Insurance Co Ltd* [1925] Ch. 407 *ad nauseam*. The developments based around the Insolvency Act 1986, s.214(4) seen in cases like *Re D'Jan of London Ltd* [1994] 1 B.C.L.C. 561 have also been digested and are influencing the thinking of both the Law Commission and the Steering Committee. There has been hardly any academic comment from company lawyers on *Barings* which is surprising given Jonathan Parker J.'s clear reformulation of the *City Equitable* duties.
11. [1998] 1 W.L.R. 422.
12. As Ferris J. put it in *Re Carecraft Construction Co. Ltd* [1994] 1 W.L.R. 172 at 181: "In disqualification proceedings ... there is no scope for the parties to reach an agreement and then ask the court to embody their agreement in a consent order. The court itself has to be satisfied, after having regard to the prescribed matters and other facts which appear to be material, that the [director] is unfit to be concerned in the management of a company; and the court itself must decide the period of disqualification if it decides to make a disqualification order."
13. [1996] B.C.C. 297 (on which see further *EDC v. U.K.* [1998] B.C.C. 370).
14. February 1, 1996, Ch.D., unreported.
15. *Re Stormont Ltd, Secretary of State for Trade and Industry v. Cleland* [1997] 1 B.C.L.C. 437.
16. [1994] 1 W.L.R. 172.
17. [1996] 1 W.L.R. 1569. For a fuller account of *Carecraft* procedure than that provided here see Walters and Davis-White, *op. cit.*, Chap. 8.
18. It is also used in CDDA, s.8 cases: see *e.g. Re Aldermanbury Trust plc* [1993] B.C.C. 598. Moreover, there is no reason in principle why it could not be used in civil disqualification proceedings brought under ss.2-4.
19. *Practice Note (Chancery Division: Directors' disqualification applications)* [1996] 1 All E.R. 442.
20. See *Secretary of State for Trade and Industry v. Rogers* [1996] 1 W.L.R. 1569 at 1574; *Official Receiver v. Cooper* [1999] B.C.C. 115 at 119.
21. [1998] 1 W.L.R. 422 at 429.
22. See report of proceedings in House of Commons Standing Committee B (5th sitting, November 7, 2000). The figure of £300,000 derives from the Government's regulatory impact assessment. The financial memorandum accompanying the Bill stated that there would be no net benefit to the taxpayer. This suggests that any saving will be ploughed back in with a view to achieving efficiency gains: *i.e.* further increases in the numbers of directors being processed on roughly the same budget.
23. See *e.g.* Trade and Industry Select Committee, Second Report, *Draft Insolvency Bill* (December 20, 1999), para. 40.
24. *ibid.* See also "New Insolvency Act Receives Royal Assent" (DTI Press Release P/2000/808, December 1, 2000).
25. *Hansard*, H.L., col. 1251, April 4, 2000; *Hansard*, H.C., col. 166, October 24, 2000.
26. All statutory references in this section of the article are to the CDDA, as amended by Insolvency Act 2000, s.6. The provisions came into force on April 2, 2001: see Insolvency Act 2000 (Commencement No. 1 and Transitional Provisions) Order 2001 (S.I. 2001 No. 766).
27. If undertakings were to be extended to CDDA, ss.2-4 cases, s.16 would need to be amended so that *locus standi* in such cases could only vest in the Secretary of State or official receiver. As it stands, it is open to a liquidator or creditor of the relevant company to commence proceedings under ss.2-4. This seems to be incompatible with the executive nature of the undertakings regime which rests exclusively on the discretion of the Secretary of State.
28. As is the case with the existing discretion to commence and/or continue proceedings: see *e.g. Re Blackspur Group plc* [1998] 1 W.L.R.

422; *R. v. Secretary of State for Trade and Industry, ex p. Lonhro* [1992] B.C.C. 325.

29. In evidence to the Select Committee, Desmond Flynn of the Insolvency Service said: "We propose if this measure is adopted by Parliament that we will pursue our investigations in exactly the same way as we do now and take them up to the point where under our current rubric we would be issuing proceedings. At that point when we have fully worked up a case with fully displayed grounds of what we think is unfit conduct we will then do a smart side step to the right and say, 'This is our case. We think this represents a seven-year disqualification, what the court would order if we take proceedings against you. You now have the opportunity to give us an undertaking and unless that undertaking is forthcoming in more or less those terms, related to what we think is the degree of unfitness, we will proceed to court proceedings.'" (Trade and Industry Select Committee, Second Report, *Draft Insolvency Bill* (December 20, 1999), Minutes of Evidence, Q172).
30. s.16(1) provides that the Secretary of State must give the director not less than 10 days' notice of his intention to commence proceedings. See generally, Walters and Davis-White, *op.cit.* paras. 6.27-6.30.
31. As required by CDDA, s.7(3). See generally, Walters and Davis-White, *op.cit.* paras. 3.02-3.08.
32. The question of period is not usually left at large in the *Carecraft* statement, *i.e.* the parties customarily specify either a fixed period or an agreed band of years, *e.g.* 3-5 years. However, there have been unreported cases where the point was left entirely to the judge.
33. See generally, Walters and Davis-White, *op. cit.* Chap. 13. A related point is that a statement might reduce or eliminate the prospect of subsequent disputes about the underlying factual basis of the disqualification.
34. *ibid.* paras. 8.18-8.19.
35. Trade and Industry Select Committee, Second Report, *Draft Insolvency Bill* (December 20, 1999), para. 40. The recommendation appears to stem from a memorandum submitted to the Select Committee by the Law Society. Christopher Chope M.P. suggested that a statement of facts could also assist professional bodies in dealing with any consequential disciplinary matters: see report of proceedings in House of Commons Standing Committee B (5th sitting, November 7, 2000).
36. *ibid.*
37. Hansard, H.C., cols. 186-187, October 24, 2000.
38. See report of proceedings in House of Commons Standing Committee B (5th sitting, November 7, 2000); Hansard, H.C., col. 192, October 24, 2000. There was cross-bench support for the Government line in the Lords.
39. In *Re Blackspur Group plc*, May 23, 2001, Ch.D., unreported, the first case decided under the new regime, it was held that the Secretary of State does have the power to request and insist on a statement of grounds as part of the process of accepting a disqualification undertaking. It is understood that the decision is currently under appeal.
40. Hansard, H.C., col. 187, October 24, 2000.
41. It is current practice for the Secretary of State to give some indication of the period of disqualification he might expect the court to impose in the CDDA, s.16 letter before action.
42. The reference here is to the well-established division of the disqualification period into three brackets (a top bracket of over 10 years reserved for "particularly serious cases", a middle bracket of between six and 10 years for serious cases not meriting the top bracket and a minimum bracket of up to five years for less serious cases) first endorsed by Dillon L.J. in *Re Sevenoaks Stationers (Retail) Ltd* [1991] Ch. 164.
43. See generally, Walters and Davis-White, *op. cit.* paras. 5.67-5.74.
44. The issue of costs is becoming increasingly controversial. One concern is that the Secretary of State can use the "loser pays" principle effectively to browbeat a less well-resourced opponent into accepting disqualification even though there may be substantial grounds for contesting proceedings. The former Vice-Chancellor, Lord Scott, has gone so far as to suggest that the costs rules applicable in civil disqualification proceedings should be brought into line with the practice of the criminal courts, a point echoed in the parliamentary debate on the Insolvency Bill: see Hansard, H.L., cols. 1266, 1272, April 4, 2000. It is hardly surprising that the Government has not taken this suggestion on board. A criminal costs regime could give directors an incentive to fight cases that might otherwise be settled thus undermining the policy of "fast-track" disqualification.
45. See *Calderbank v. Calderbank* [1976] Fam. 93. Strictly speaking, the offer would now be made under Part 36 of the Civil Procedure Rules.
46. Before CDDA, s.1 was amended, the period of disqualification ran from the date of the order but the court had power to suspend the operation of the order for 21 days under the Insolvent Companies (Disqualification of Unfit Directors) Proceedings Rules 1987 (S.I. 1987

No. 2023), r. 9: see *Secretary of State for Trade and Industry v. Edwards* [1997] B.C.C. 222; *Re Cannonquest Ltd, Official Receiver v. Hannan* [1997] 2 B.C.L.C. 473. In the light of the 2000 amendments, r. 9 has now been revoked: see the Insolvent Companies (Disqualification of Unfit Directors) Proceedings (Amendment) Rules 2001 (S.I. 2001 No. 765).

- [47.](#) The Secretary of State cannot guarantee the *Carecrafting* director that the court will give him interim leave pending the full hearing of his application for leave. The position in relation to undertakings seems marginally worse as there is no prospect of the director obtaining even interim leave without an application to the court. The best one can say to the director is that he should get his application in as soon as possible after having his undertaking accepted. On interim leave generally, see Walters and Davis-White, *op. cit.* para. 13.54.
- [48.](#) Though the Law Society did suggest that the Secretary of State should have such power in its memorandum to the Trade and Industry Select Committee: see Second Report, *Draft Insolvency Bill* (December 20, 1999).
- [49.](#) *ibid.* para. 42.
- [50.](#) The Government indicated unhelpfully that factors other than a material change in circumstances might be sufficient to persuade the court to make an order. However, no examples were given: see Hansard, H.C., cols. 1113, 1120, November 16, 2000.
- [51.](#) The court can still grant a disqualified person leave to act as a receiver and manager (not being an administrative receiver). This reflects the fact that a person can act as a receiver and manager without being a qualified insolvency practitioner. The new legislation relaxes the qualification requirements for nominees and supervisors of voluntary arrangements. Nevertheless, a person made subject to a disqualification order or undertaking loses their authorisation to act in those capacities: see Insolvency Act 1986, s.389A, as inserted by Insolvency Act 2000, s.4(4).
- [52.](#) There was considerable incentive for directors to mount technical challenges to the validity of proceedings under CDDA, ss.6-7 as, more often than not, the two-year time limit in s.7(2) for the commencement of fresh proceedings would have long since expired.
- [53.](#) *Re The Working Project Ltd* [1995] 1 B.C.L.C. 226.
- [54.](#) *Re Lichfield Freight Terminal Ltd* [1997] 2 B.C.L.C. 109.
- [55.](#) Thus reversing *Lichfield Freight*.