DIRECTOR'S DISQUALIFICATION FOR COVID-19 FRAUD

Authored by: Alice Court (Solicitor) - Irwin Mitchell and Jessica Powers (Barrister) - New Square Chambers

The COVID-19 pandemic is something that the majority of us want to forget. However, three years on its repercussions for families, businesses and the economy continue to be felt.

In particular, concerns about the level of abuse of the financial support schemes implemented during the pandemic continue to make the headlines.

In the last few months, HMRC put a final estimate on the amounts lost to error and fraud. That figure is a shocking £5bn.

The last two years have seen a steady ramping up of disqualification proceedings against directors accused of dishonestly applying for, and misappropriating financial support.

As of April 2023, more than 450 directors have been disqualified for abuse of the financial support schemes, with the average period of disqualification exceeding seven years.

The disqualification of directors who wrongly caused companies to apply for Bounce Back Loans ("BBL") appears to be the latest trend.

Disqualification

In Secretary of State for Business, Energy and Industrial Strategy v Deea Construct Ltd [2023] EWHC 2084 (Ch) the director, Marian Ghimpu, was accused of providing false or inaccurate information when applying for a BBL, which enabled Deea Construct Ltd to secure a larger loan than it was entitled to, and then using the monies for his own benefit. When the loan was due to be repaid, Mr Ghimpu put the company into CVL.

Chief ICC Judge Briggs had no hesitation in finding that Mr Ghimpu's conduct fell below the expected standards of probity and competence. He noted that Mr Ghimpu had either been incompetent, or deceitful, and that his false representation was particularly heinous because it was made at a time when the Government had placed trust and confidence in directors to honestly represent the financial status of companies when seeking financial support for their maintenance and survival. The Judge was assisted by comments made in R v Dagistan [2023] EWCA Crim 636 to the effect that exploitation of the BBL scheme (described as an "exceptionally vulnerable target at a time of national emergency") increased the level of a director's culpability.

The period of disqualification imposed was lengthy: 13 years. The Judge observed that Mr Ghimpu's breaches of commercial probity were particularly serious, and that a long period ought to be imposed if the disqualification regime is to have any teeth.

Compensation orders

Mr Ghimpu was also the unfortunate recipient of a sizeable compensation order.

The Court can make a compensation order where a person is disqualified by Court order, and the conduct for which they were disqualified has caused loss to a creditor of an insolvent company of which they have at any time been a director. As noted by ICC Judge Prentis in Re Noble Vintners Ltd [2019] EWHC 2806 (Ch), the intention behind the compensation order regime is to "[…] enhance in the public interest the protective aspect of the disqualification regime by giving monetary redress to creditors financially affected by the misconduct, thereby giving the regime as a whole more 'bite' […]".

The Court's power to make compensation orders was introduced in 2015. However, that power has been rarely employed: the Secretary of State has only made two applications, with the first in 2019, and the order against Mr Ghimpu was the first obtained by the Insolvency Service.

The potential difficulties facing office-holders in bringing misfeasance proceedings for abuse of the COVID-19 financial support schemes, particularly where the director did not personally benefit, coupled with the political pressure to recoup the billions lost, mean that compensation orders could become much more common.

Advising directors

It is important for directors facing allegations of financial abuse to obtain legal advice at the earliest opportunity for a host of reasons. In particular, any responses submitted during a disqualification investigation are often used against directors to form the basis of the allegations of unfitness, and it may be in the director's interest to head off proceedings early by agreeing a disqualification undertaking.

A disqualification undertaking is essentially an agreement reached between the director and the Secretary of State that the individual will not be a director, or concerned in the promotion, formation or management of a company for an agreed period.

Agreeing a disqualification undertaking avoids the significant time and costs involved with proceedings, and provides certainty. Historically, it was often possible to agree reduced periods of disqualification, especially if mitigating factors were advanced. Relevant mitigating factors might include reliance upon independent professional advice, being a first-time offender, the absence of any allegations of fraud or dishonesty, and the director not having received a personal benefit as a result of their misconduct. However, the Insolvency Service is currently reluctant to agree to significantly reduced periods of disqualification, and, in practice, it is rare to obtain a reduction of more than one year. Of course, even a minimal reduction could bring the period down from the top, most serious band, to the middle band of disqualification periods, which may assist in making an application for permission to act.

Applications for permission to act

Directors faced with incontrovertible allegations of misconduct, or who have no appetite for fighting a disqualification case to trial often elect to agree a disqualification undertaking and then apply for the Court's permission to act as a director of other companies.

A disqualification undertaking ordinarily comes into effect 21 days after signature. It is therefore important that any permission to act application is prepared well in advance and issued in good time. It may also be necessary to seek interim relief, pending final determination.

The Court will take into account a number of factors when exercising its discretion to award permission to act.

Most notably, an application must demonstrate that it is important that the applicant (as opposed to anyone else) be a director, and that sufficient controls are in place to prevent the misconduct in question from re-occurring, so as to protect the public.

Naturally, directors with higher periods of disqualification, and those who are found to have acted dishonestly or fraudulently will find it more difficult to persuade the Court to grant leave. The Court is likely to have concerns about granting permission to act where a director has been disqualified because of abuse of COVID-19 financial support schemes, even if they have not directly been accused of fraud or dishonesty.

If the Court does grant permission to act in a financial support scheme abuse case, that permission is likely to come with the imposition of stringent conditions. For example, the director might be prohibited from entering into loan agreements on behalf of the company, or might be prohibited from paying money to themselves unless all other creditors are paid. It is always helpful to try and negotiate the conditions with the Insolvency Service in advance.