

Director Disqualification: Compensation Orders and Agreements

Compensation orders aim to make directors financially accountable for the consequences of their unfit conduct.

The Insolvency Service can apply to the court for a compensation order on behalf of the Secretary of State for Business, Energy & Industrial Strategy. The court can make a compensation order if the director is subject to a disqualification order or undertaking and their conduct has caused a quantifiable loss to one or more creditors of an insolvent company.

The Insolvency Service acts on behalf of the Secretary of State and decides whether it is in the public interest to seek a compensation order. The Secretary of State has two years from the date of the disqualification order or undertaking to apply for a compensation order. When added to the three-year time limit for disqualification, this is a lengthy period for directors to await their fate.

Alternatively, where directors accept their culpability a compensation undertaking can be entered into voluntarily without the need for court proceedings. Once accepted by the Secretary of State it has the same effect as a court order and can only be amended by the court. Such an offer may be refused if it is determined inappropriate based on the information held against the director.

When deciding the amount of compensation, it will be considered whether a director has made any other financial contribution in recompense for the conduct. This means a case for compensation will unlikely be made where:

- an insolvency practitioner has taken or is going to take civil recovery action against the director
- the director has made a contribution to the assets of the company

The principles considered when calculating loss include:

- whether the disqualification conduct caused an identifiable loss to one or more creditors
- the nature of the creditors and whether they have other forms of redress
- the ability to readily identify the creditors affected and quantify the loss to each creditor (or class of creditors)
- whether through the insolvency process, for example liquidation, there has been or predicted to be a (material) repayment to those creditors

Where the Insolvency Service is investigating the conduct of a director for a possible compensation order, best efforts will always be made to contact that individual as early as possible. If the director does not respond or a compensation undertaking cannot be agreed then proceedings will be started at court. At this stage, the director will be formally served with notice of the proceedings.

If a compensation order is granted or undertaking agreed, the compensation will be paid to the Secretary of State for distribution to a creditor or a class of creditors as a contribution to the assets of the company.

Please note that should your clients require any confidential advice regarding any insolvency matter they are welcome to contact one of our Partners. Initial advice is provided free of charge and without obligation. Also, if you or any of your colleagues require and clarification regarding insolvency law or procedure, please do not hesitate to contact us.