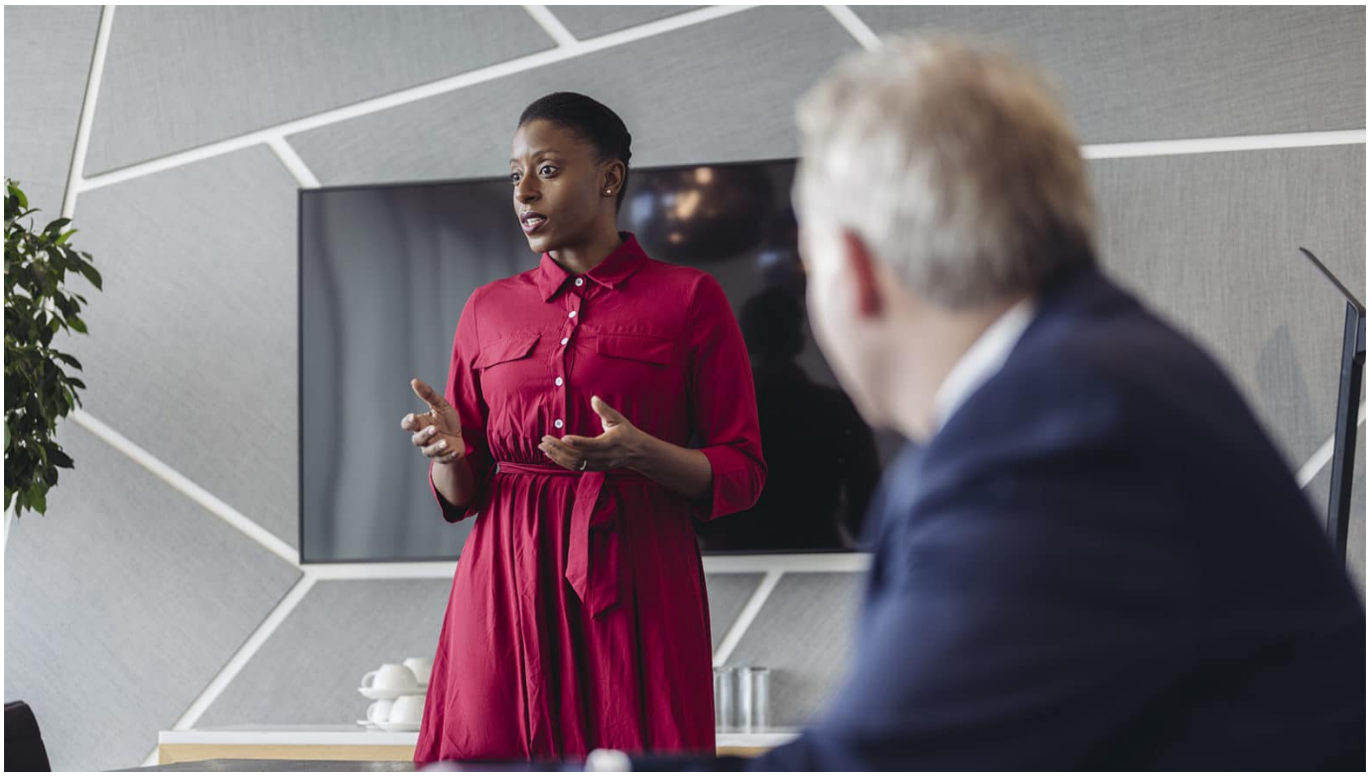
Rare relief: Compensation order made against disqualified director



The courts have recently ordered a disqualified director to pay compensation to creditors – only the second time that such an order has been made since they were introduced in 2015.

Cripps advised the Defendant, Mr Barnsby, in this case (*Secretary of State for Business and Trade v Barnsby* [2023] EWHC 2284 (Ch)). The Secretary of State (SoS) sought a disqualification order against our client under the Company Directors Disqualification Act 1986 (CDDA) together with a compensation order for the creditors' losses, being deposits from five creditors for holidays totalling £81,405. The SoS argued that Mr Barnsby had caused the creditors' losses by continuing to trade the package holiday company despite its ATOL having expired.

A disqualification order was made in April 2022 against Mr Barnsby for a period of seven years. At the hearing, directions were given in relation to the compensation claim including the listing of the claim with a time estimate of 3 days.

The Compensation Order was made on 20 September 2023, and requires Mr Barnsby to pay compensation for a sum equal to the amount of the deposits the creditors had paid to the company before it went insolvent, namely £81,405.

Before asking the Secretary of State to apply for a compensation order against a director, a person will need to show that various conditions set out in the CDDA are satisfied:

- the person is subject to a disqualification order and

- conduct for which the person has been disqualified caused loss to one or more creditors of an insolvent company

With that in mind, the court was invited to consider the following issues –

1. The conduct relied upon for the making of a compensation order.
2. Whether any such conduct caused loss to any creditors (and if so which creditors and in what sum).
3. Looking at all the circumstances of this case, whether it is appropriate for the court in the exercise of its discretion to make a compensation order.

The court then went on to consider the only other claim where a compensation order had been made (*Re Noble Vintners Ltd* [2019] EWHC 2806 (Ch)) which found that causation should be assessed: "*using hindsight and common sense but without considering foreseeability the court must be satisfied that the misconduct has caused loss within the meaning of the Act to a creditor of a relevant insolvent company*".

The judge in this case commented that, on the facts of *Re Noble*, it was entirely unsurprising that the court adopted such an approach but queried whether the same approach on causation was appropriate in all directors' disqualification compensation cases. The judge concluded that where, for example, the ground of unfitness is based on negligence or, to use a phrase often seen in disqualification cases, 'incompetence to a marked degree', it is difficult to see why foreseeability should not play a role when considering the issue of causation. Having regard to the detailed findings in the 2022 judgment, the judge accepted it was clear that the loss suffered by the customers had only one cause, '*it was entirely down to [the Defendant] and his conduct*'.

It is also helpful to note the judge's comments on the matter of Mr Barnaby's impecuniosity when considering the exercise of her discretion to grant a compensation order. Specifically that whilst, in principle, a director's resources (or lack thereof) may be a factor to take into account *"…impecuniosity, without more, will very rarely weigh heavily in the balance when the court considers, in the exercise of its discretion, whether and if so in what sum to grant a compensation award."* In fact, the judge concluded that *"the court should be slow to allow mere impecuniosity, of itself, to dictate the outcome of a s15A application; particularly where, as here, that impecuniosity is, in part at least, a result of lifestyle choices freely adopted.*

Such an approach would risk undermining the policy objectives underpinning s.15A…Given the Defendant's age and abilities, it cannot be said that a compensation award would serve no purpose in this case. There is scope for recovery on the award. The Defendant has been sole director of a company and running a travel agency; it is entirely possible that he will take up full time employment again at some point in the future. Even if the Defendant were to declare himself bankrupt as he has indicated, it would be open to his trustee in bankruptcy to seek an income payments order".

Observations and commentary

Since the relevant legislation was introduced in 2015, compensation orders and undertakings have been a little-used means of enabling creditors of companies that have entered formal insolvency proceedings to recover compensation from those companies' directors possibly because up until just before COVID, there was more of a propensity on the part of office holders to take proceedings against directors for wrongful trading and misfeasance. According to an Insolvency Service response to a Freedom of Information request, in the period 1 November 2019 – 24 February 2023 only one compensation order was made and 29 compensation undertakings offered by directors were accepted by the Secretary of State.

Given the difficulties that liquidators and administrators now face in bringing successful wrongful trading claims against directors, many practitioners predict that the CDDA compensation regime will become more commonly used in their place.

Unlike claims under the Insolvency Act 1986, which can be brought by a liquidator or administrator, only the Secretary of State can apply to court for a compensation order or request a compensation undertaking.

However, as the two cases so far on compensation orders show, it is a potentially useful remedy for creditors where a liquidation or administration yields little in the way of recovery and creditors remain uncompensated. However, to do so, creditors will need to persuade the Insolvency Service to take the case. The Insolvency Service is unlikely to do this if an insolvency practitioner is already taking action against the director in respect of the same conduct, or if the director has already contributed to the company's assets in insolvency proceedings to compensate for their conduct.

The CDDA compensation regime also offers creditors another important advantage – directors can be required to compensate *individual creditors directly*. By contrast, where a liquidator or administrator successfully pursues a claim under the Insolvency Act 1986, the proceeds of that claim are required to be divided among all unpaid creditors.

In summary, going forward, it does look like compensation orders will become more commonplace especially in cases where there is little or no appetite (or funding) on the part of the office holder to pursue the director. An office holder will also look at the prospects of recovery at the outset as a key consideration and this will dictate his or her next steps. In this case, however, where there was a question mark as to whether there will be any recovery to speak of due to Mr Barnsby's financial circumstances, the Insolvency Service were nevertheless not deterred from proceeding with its compensation claim.

We explained to the Insolvency Service that it was an unfortunate fact that Mr Barnsby's financial circumstances were perilous and had, in fact, informed them of his lack of means at an early stage in the proceedings. Mr Barnsby completed the means questionnaire supplied by the Insolvency Service and confirmed that he did not own assets of any material value and that his limited income was insufficient to meet his liabilities and day-to-day (modest) expenditure. The Insolvency Service stated in pre-trial correspondence that the Defendant had *"chosen to prioritise paying other amounts owed over the amounts owed to the creditors in this instance"*. We considered this statement to be deeply misguided. The creditors in this case are creditors of Pure Zanzibar Ltd, to whom Mr Barnsby himself was not indebted. The reality is that he was and is liable to his own personal creditors and cannot be criticised for paying them above creditors of the insolvent company of which he is a director. Indeed, it would be bizarre for him to act otherwise.

The Insolvency Service confirmed it was *"still in the public interest to obtain a compensation order"*. We appreciated that this may well be the case if the intention was to obtain such an order regardless of recoverability and sought to explain to them that the debt would be discharged if Mr Barnsby was forced into bankruptcy (a real and possible consequence of a compensation order). As stated above, whereas recoverability is a key question to be considered by an officeholder, it appears to be a less important factor in compensation proceedings.

If you require any assistance with disqualification proceedings, applications for permission to act notwithstanding disqualification or compensation proceedings then please get in touch.

Tania Clench

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