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Lord Mendelsohn
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Dear Jon,

SMALL BUSINESS ENTERPRISE AND EMPLOYMENT BILL: DIRECTOR DISQUALIFICATION PROVISIONS – PART 9

During debate in Grand Committee of the Small Business, Enterprise and Employment Bill on Monday 19 January, I promised to write in response to points you raised about rogue directors and the position of non-executive directors in the context of the director disqualification measures in Part 9 of the Bill.

You made some good points about rogue traders and I agree it is important to ensure we have a robust regime to protect small businesses and consumers from that minority that breaks the rules. Our regime already provides considerable protection, and indeed we disqualify around 1,200 directors every year. The disqualification measures in Part 9 will further strengthen the provisions, with the intention of improving confidence within the business community that we can and will take effective action to deal with misconduct by directors.

You gave a few examples of the types of cases of particular concern to you, including alleged investment scams and unfit directors apparently operating through successive companies.

The Insolvency Service has successfully taken action against investment scams, such as wine, carbon credit and rare earth metal scams. These often target savings of older individuals. Since June 2007, 168 companies operating investment scams of this nature have been wound up in the public interest following investigations by the Insolvency Service. 62 directors have been disqualified for an average period of 10 years each. Some of those cases have also been referred to the relevant criminal prosecutor to be considered for prosecution. An annex to this letter sets out some examples of types of case in this area where we have successfully taken action.

Clause 104 of the Bill will modernise and streamline the reporting of director conduct where there has been a formal insolvency, enabling prompt action to be taken in appropriate cases. R3 (the body representing insolvency practitioners) and other stakeholders are supportive, recognising that there will be efficiencies from a new electronic reporting process. It will also speed up the reporting of misconduct in insolvency cases.

Clause 107 is intended as an additional tool to increase the likelihood of creditors being compensated where they have fallen victim to misconduct by directors. There are already legal remedies that liquidators and administrators can use to recover monies for creditors, but we do not believe these are used frequently. We recognise there is sometimes good reason for that, but this measure will enable the Insolvency Service to take action to help creditors get compensation where the conduct for which a director has been disqualified has caused identifiable loss to creditors of an insolvent company. This measure will only come into play where a director is disqualified and we would anticipate using it in a small proportion of those cases ever year.

When deciding whether to investigate a director, officials can already look in particular at those who have had a series of failures. The effect of clause 103 of the Bill will be to go one step further by requiring courts to pay specific regard to the frequency of a director's misconduct when considering a disqualification application.

Non-executive directors

You contrasted the role and function of directors of small private companies with those of directors of large listed companies and other entities and suggested that disqualification of non-executive directors, especially in the financial sector, should be treated and considered separately from other roles.

I agree with your comments about the importance of restoring public confidence in the banking sector. However, there is no legal distinction between an executive director and a non-executive director. As a consequence, non-executives have the same legal duties, responsibilities and potential liabilities as their executive counterparts. The level of involvement of a non-executive in any given company will differ based on the size, governance and circumstances of the company concerned. A court, in considering a disqualification application against a non-executive director, will take these factors into account alongside the particular skills and experience of the director.

The Company Director's Disqualification Act already applies to all directors, including shadow directors. Accordingly, if the actions (or indeed inaction) of any director, executive or not, show them to be unfit to run a company, and their behaviour has caused demonstrable loss for which they are culpable, it is right that they should be liable to be disqualified, and that the period for which they are disqualified should take account of the resulting loss to creditors. We are not attracted to the idea of providing for the disqualification of a person only as a non-executive director because it would depart from the principle that all directors have the same legal duties. Furthermore, once a person has been found unfit to act as a director as a result of conduct in whatever directorial capacity they have acted, there is a public interest in disqualifying them as a director generally for an appropriate period to protect the business community and consumers.

That being said, there is already some degree of flexibility in relation to the directors of companies operating in certain regulated sectors, such as banking, where an individual may become subject to a sectoral ban (from any role, not just as a director) if the Prudential Regulation Authority or the Financial Conduct Authority considers that the individual is not a fit and proper person to perform functions in relation to a regulated activity. This does not preclude the individual from acting as a director of any company outside that sector. As you are aware, only persons approved by the financial services regulators may perform certain functions (such as being a director) in authorised financial services firms. The Government is also strengthening the regulatory oversight of senior bankers through its measures in the Financial Services (Banking Reform) Act 2013, to implement reforms recommended by the Parliamentary Commission on Banking Standards.

In instances where the sectoral regulator considers conduct leading to a sectoral ban was of such seriousness as to merit a wider ban, the matter can be referred to the Insolvency Service to consider taking disqualification action. In this respect, we are also working to better integrate sectoral regulation and the director disqualification regime. We are committed to further improving co-operation between sectoral regulators, particularly in key sectors, and the Insolvency Service are taking steps to remove barriers to efficient investigation. Clause 106 of the Bill will help by removing legislative barriers to the types of investigative material, including from sectoral regulators, that can be used in deciding whether or not to bring disqualification proceedings against a director.

I hope you find these comments helpful and I am placing a copy of this letter in the House libraries.

Warm regards

Lucy

BARONESS NEVILLE-ROLFE DBE CMG

ANNEX: Investigation and Enforcement Actions

Enforcement actions taken by the Insolvency Service against rogue directors

Land Banking Investments

- 111 companies have been wound up in the public interest since 2007.
- These companies had taken almost £98 million from at least 2,000 investors.
- 49 directors disqualified for a total of 488.5 years (average period of 10yrs).

Carbon Credit Investments

- 42 companies have been wound up in the public interest since June 2012.
- These companies had taken over £51 million from nearly 2,000 investors.

Wine Investments

- 8 Companies have been wound up in the public interest since January 2010.
- These companies had taken over £82 million from nearly 970 investors.
- 6 directors have been disqualified for a total of 59 years.

Rare Earth Elements

- 4 Companies have been wound up in the public interest since March 2014.
- These companies had taken almost £7 million from at least 400 investors.

Investigation and Enforcement Case Studies – The Insolvency Service

Case Study 1: Carbon Credit company - Eco-Synergies Ltd

In May 2014, a web of 13 companies involved in a scheme to sell carbon credits to the public for investment was wound up in the High Court on public interest grounds, following an investigation by the Insolvency Service. Eco-Synergies Ltd, a wholesaler of Voluntary Emission Reduction carbon credits, was at the centre of and controlled this web of companies.

Over £19m of investments were sold to the public using false claims contained in slick brochures, among other marketing methods. Investors, including vulnerable individuals and often repeat victims, were urged to buy more and more credits and have lost their money.

The credits were sold at such inflated prices that an unnatural increase in value would be required before investors could break even let alone see a return on their investment.

The investigation uncovered that carbon credits sourced by Eco-Synergies Ltd for an average of 65p per credit were then sold to investors over the internet of ostensibly unrelated companies at an overall mark-up of up to 869%.

Case Study 2: Land Banking – Eren Metcalfe

A director who ran an extensive land banking scam through his three companies that misled members of the public into investing at least £1.7 million in small plots of land of little value was disqualified from being a company director for 14 years.

Eren Metcalfe, formerly known as Eren Cemal Ibrahim, was the sole director of Natural Wealth Solutions Ltd, Proctor Capital Ltd and Land Security Management Ltd, three companies that were wound up in 2013 in the public interest after an investigation carried out by the Insolvency Service, following complaints by members of the public.

The companies marketed the plots as being suitable for development but there was no realistic prospect of planning permission being secured. The land sold to customers had little, if any, value for development purposes and was sold at a mark up of between 18 and 63 times the purchase price per acre. Neither Mr Metcalfe nor his staff had any expertise in assessing land and made no enquiries as to the likelihood of planning permission being granted before marketing the investment.

In common with other land banking scams, these companies brought misery to unsuspecting members of the public, who were persuaded to part with their savings in exchange for virtually worthless plots of land. Every customer lost their investment due to the way in which these companies sold it. There was no exit strategy for investors.