Caveat Entrepreneur

Paul Omar explains how foreign disqualification orders may lead to disqualification in the UK

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The Companies Act 2006, containing 1300 sections divided into 47 Parts, is one of the largest pieces of legislation ever enacted in the United Kingdom and will be brought into force in stages between 2007 and 2009. Entering into force on 1 October 2009, Part 40 of the Act is designed to enhance the disqualification regime under the Company Directors and Disqualification Act 1986, which ordinarily allows for disqualifications for company and insolvency law offences committed in relation to the management of United Kingdom companies. The disqualification regime will now be extended to permit disqualification orders to be made and undertakings received where the director concerned has been disqualified overseas.

Section 1184 of the Act allows for two procedures: automatic disqualification by the effect of an order made pursuant to regulations or following an application to court. The order or undertaking is made or obtained for the same period as the original disqualification and expires at the same time. Rules may be made under section 1185 of the Act on the basis of three factors, including the conduct giving rise to the foreign disqualification, the nature of the disqualification and the country or territory imposing them. The suggestion made in the literature is that the third factor will require courts to form "value judgments" about foreign companies' legislation and their enforcement regimes, a situation judges may not appreciate.[1] Under the same section, courts may then be required to have regard to other

factors, chiefly related to whether the conduct would attract a UK sanction or would be unlawful under UK law, when involvement with the UK began and whether the director intends to undertake activity overseas. Section 1186 of the Act makes it an offence for a person to act while so disqualified, while section 1187 of the Act imposes personal liability for the debts of the company for acting while disqualified. Further transparency in the process is also ensured in section 1189 by requiring a person who is disqualified under this part to notify the Secretary of State of any relaxation of the regime by a court. Even if a person is not disqualified in the UK, notification of any behaviour that would otherwise be a breach of a disqualification order must occur under section 1188. Under section 1190, notifications may also be made public and, underlining the seriousness of the sanction element, provision is made in section 1191 for criminal penalties in the event of failure to notify.

The cumulative result of these provisions, which are wholly new in the legislation, is to fill a lacuna in the previous law, which failed to deal adequately with an unintended consequence of the phenomenon of entrepreneurial migration relying on the four freedoms enshrined in the EC Treaty. In particular, this involved the use of Articles 43 and 48 of the EC Treaty by astute Continental entrepreneurs taking advantage of inexpensive and faster incorporation facilities in the UK. The fact that entrepreneurs were crossing borders to use UK incorporation facilities and then "export" these vehicles was first

revealed in the case of *Centros*,[2] where the desire to avoid certain domestic rules, in particular minimum capital requirements and stricter employee protection rules, led to entrepreneurs using the tactic, a strategy that has continued to the present day. In fact, a 2005 German survey suggests that the number of UK limited companies incorporated by German entrepreneurs rose, as a proportion of all incorporations, from 0.27 % in 2002 to 14.8 % in 2005.[3]

The possibility that rogue directors would take advantage of UK incorporation facilities is a natural consequence of the European Court of Justice's pronouncement in a number of cases, including *Centros*, that the freedom of establishment principle trumped these and other domestic rules which had the effect of preventing the conduct of business without compliance with those rules. It is interesting that the Explanatory Note accompanying the Act makes deliberate reference (in paragraph 1506) to the need to prevent persons disqualified elsewhere from forming and operating a company either in the UK or in the state where disqualified. In an environment where, following the accessions in 2004 and 2007, the European Union now has a membership of 27 countries, the probability of UK incorporations by European entrepreneurs increases and, with it, the possibility of misuse of the incorporated form. One difficulty that remains is how reliable information is to be obtained from foreign authorities, especially given potential human rights concerns over privacy, and whether the automatic disqualification procedure would infringe the right to a fair trial under Article 6 of the European Convention on Human Rights.

Although perhaps intended to deal with an intra-Community problem, because the Act does not have a specifically European focus, the same disqualification regime will affect directors from elsewhere in the world. At present, however, there are no reliable statistics of the numbers of incorporations by overseas entrepreneurs, whether from Europe or further afield. Nonetheless, the possibility of serial disqualification in a number of jurisdictions, including the UK, must remain, however rare statistically, one of the concerns facing directors who operate on a global basis.

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Footnotes

1. See A. O'Neill, "Part 40 of the Companies Act 2006: Disqualification Orders go Global" (2007) 18(5) *International Company and Commercial Law Review* 166 at 169.
2. *Centros Ltd v Erhvervs- og Selskabsstyrelsen* (C-212/97) [1999] ECR I-1459.
3. W. Niemeier, "GmbH und Limited im Markt der Unternehmensrechtsträger" (2006) 49 *Zeitschrift für Wirtschaftsrecht* 2237 at 2244.