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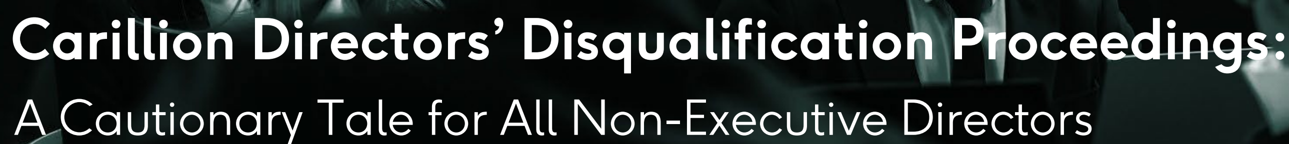

Carillion Directors' Disqualification Proceedings:
A Cautionary Tale for All Non-Executive Directors

Nearly six years after the collapse of Carillion in January 2018 with debts in the region of £7 billion, the trial of its five non-executive directors (and one executive director) under the Company Directors Disqualification Act (CDDA) in proceedings brought against them by the Insolvency Service was finally due to get underway today but was dropped by the Insolvency Service at the 11th hour on the basis that it would not have been in the public interest to continue. If the claim had succeeded, the individuals could have been disqualified from serving as directors for up to 15 years. They (and their executive colleagues) have already faced a series of enquiries and investigations. What was the nature of the case they were facing and to what extent were any liability protections which may have been in place prior to Carillion's collapse apt to protect them? Finally, what lessons, if any, are there here for non-executive directors of other publicly listed UK companies?

How Did We Get Here?

At yearend 2016, Carillion plc was one of the leading construction and integrated support service companies in the UK. Its business was divided into three limbs: (1) building and infrastructure support services; (2) project finance; and (3) construction services. The company had projects in the UK, Canada, and Middle East with revenues of over £5bn and a market cap. of just over £2bn. Carillion had grown quickly since its birth in 1999, subsuming competitors. It took over, for example, Mowlem plc and Alfred McAlpine.

A report issued in May 2108 by a joint parliamentary committee of the Work and Pensions Committee and the Business, Energy and Industrial Committee of the UK Parliament which was formed to investigate the circumstances of the collapse, summed up its findings thus:

> *"Carillion's rise and spectacular fall was a story of recklessness, hubris and greed. Its business model was a relentless dash for cash, driven by acquisitions, rising debt, expansion into new markets and exploitation of suppliers. It presented accounts that misrepresented the reality of the business, and increased its dividend every year, come what may. Long term obligations, such as adequately funding its pension schemes, were treated with contempt. Even as the company very publicly began to unravel, the board was concerned with increasing and protecting generous executive bonuses. Carillion was unsustainable. The mystery is not that it collapsed, but that it lasted so long."*

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It went on to conclude that:

> *"Carillion's board are both responsible and culpable for the company's failure."* And that: *"The company's non-executive directors failed to scrutinize or challenge reckless executives."*

The committee, to which members of the Carillion board had been required to testify, recommended that:

> *"….the Insolvency Service, in its investigation into the conduct of former directors of Carillion, includes careful consideration of potential breaches of duties under the Companies Act, as part of their assessment of whether to take action for those breaches or to recommend to the Secretary of State action for disqualification as a director."*

Three years later in January 2021, the Insolvency Service began disqualification proceedings against eight former directors. Two executive directors have recently entered into settlements under which they voluntarily agreed to disqualifications of 11 and 12 years respectively. The trial in proceedings against the remaining executive director and all five non-executive directors was due to commence on 16th October before it was dropped by the Insolvency Service at the last minute.

In the meantime, and separately, both the Financial Reporting Council (FRC) and the Financial Conduct Authority (FCA) have each also commenced their own investigations. The FRC investigated Carillion's auditors, KPMG, and its two finance directors over whom it had jurisdiction based on the fact that they were professionally qualified accountants. There is, as yet, no published decision against them, but we know the auditors accepted fines totalling £21 million for misconduct, including deliberate breaches of the fundamental principle of integrity. An action in negligence brought against the auditors also settled earlier this year for an undisclosed amount.

In July 2022, the FCA published provisional decision notices against three of Carillion's executive directors fining them for being knowingly concerned in breaches by Carillion of UK listing Rules and the Market Abuse Regulation. In a press release it stated that:

> *"In the view of the FCA, Carillion's systems, procedures and controls were not sufficiently robust to ensure that contract accounting judgments made in its UK construction business were appropriately made, recorded and reported internally to the Board and the Audit Committee."*

These findings were appealed by the directors concerned. Thes appeals to the FCA Upper Tribunal are still pending.

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What was the case in the CDDA proceedings against the Non-Executive Directors?

While we have not had access to the detailed pleadings in the case brought by the Insolvency Service, there are some strong clues as to the general nature of that case to be found in a **judgment** by Mrs Justice Joanna Smith in April 2022 on a preliminary issue concerning the claim.

An application had been made on behalf of the non-executive directors complaining about the lack of clarity in the case they had to meet. That case as it stood fell into two limbs summarised by the judge as follows:

1) *"… by reason of the NEDs failure to discharge certain duties they owed as directors, they bear responsibility for the unfit conduct of the other directors which resulted in amongst other things material misstatements of profits in Carillion 's financial statements.*
2) *"….the NEDs caused Carillion to take certain steps in circumstances where they ought to have known such steps were inappropriate."*

Conspicuous by its absence in this summary of the allegations against them, is any specific allegation that the directors failed to discharge their duties under section 174 of the Companies Act to exercise reasonable skill and care in the discharge of their duties. Mrs Justice Smith agreed that there was a lack of clarity in the case brought by The Insolvency Service which needed to be remedied. What this appears to mean is that the Insolvency Service would have assumed the burden at trial of persuading the court that the conduct of the individuals (whilst not expressly in breach of their respective Section 174 duties to exercise reasonable skill and care) nevertheless fell below an acceptable standard of vigilance in respect of their fellow executive directors, implied by the "unfitness" threshold set in the CDDA itself. If that had been right, it would have represented a significant broadening of the jeopardy faced by non-executive directors on the boards of high-profile UK companies which fail.

How effective are any liability protections which the directors are likely to have had in place?

Given the nature and complexity of the various parliamentary, regulatory and judicial proceedings and enquiries brought against all eight former directors of Carillion over nearly six years, it seems inevitable that their collective defence and legal representation expenses will have run into many millions of pounds.

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The two key protections generally available to meet directors' legal fees are the company indemnity and any Directors' and Officers' liability insurance (D&O) which may have been purchased on their behalf. The particular peril for directors of insolvent companies, though, is that the first of these key protections automatically falls away at the point when the insolvency event occurs since the company is no longer able to honour any such indemnity. That leaves only the D&O insurance.

Whilst we have no knowledge (and can therefore only speculate as to the nature and extent) of any D&O insurance enjoyed by the Carillion directors, we set out below a checklist of potential coverage issues in this context which directors might wish to discuss with their advisers.

- Once the policy period has expired (and unless and to the extent that future claims have been validly notified as circumstances) the whole tower of insurance expires and the entire protection evaporates at that point. This is a function of the fact that D&O policies operate on an annually renewable claims made basis. *This risk can be mitigated by purchasing appropriate extended reporting periods built into the D&O programme.*

- Once the policy has expired (assuming the directors remain in office as is often the case during the insolvency process) there will be no ongoing cover for wrongful acts committed during this time. *Again, it is possible to buy such advance protection as part of the D&O programme.*

- The limit of liability under D&O policies is generally shared between all insured persons and (in certain circumstances) the company itself. Claims are generally paid on a first come first served basis. What this means is that the limit can be eroded and/or exhausted by prior competing claims. The risk is especially acute for non-executive directors who are often the last in line to face civil or regulatory claims or complaints. *Steps can be taken to preserve ring-fenced limits both for the main board in general and for non-executive directors in particular.*

- D&O cover is usually purchased by the company on behalf of its directors and officers on the working assumption that the company will manage the relationship with insurers and deal with any coverage issues which may arise. This assumption falls away in the context of an insolvency, leaving the directors to deal with insurers themselves. This can give rise to practical and financial difficulties in complying with policy terms, conditions and exclusions not specifically designed to deal with these circumstances, thus making it more difficult to collect insurance proceeds from the market to fund the ongoing defence of claims. *It is possible to purchase D&O insurance policies specifically tailored to address these insolvency related risks*

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Conclusion

For well capitalised companies with strong balance sheets the risk of insolvency may seem remote. That said, the standards of diligence and care expected of non-executive directors in the oversight of a company are high and often become the subject of intense scrutiny and controversy in protracted and expensive investigations and proceedings following collapse, as the Carillion case well demonstrates. What is more, problems can emerge quickly from a clear blue sky. Indeed, given the speed and growth of 24-hour news and media coverage, that risk is perhaps even greater now than it was six years ago when Carillion collapsed. Other more recent and sudden corporate collapses such as that of Silicon Valley bank, British Steel and Greensill Capital bear witness to this.

Arguably, the risk reward ratio for non-executive directors of public companies has become less attractive. This is perhaps especially so when the risk of unfunded legal representation costs are factored in, should the D&O policy should fail to respond for any reason. That being the case, there is much to be said for non-executive directors taking a lively and engaged interest in the protections which may be available to them in the event the worst happens.

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