Steptoe

The Impact of UK Competition Law Director Disqualifications on the Role of the Non-Executive Director

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The goal of the Company Directors Disqualification Act 1986 ('CDDA') is to protect the public and to deter competition law breaches. This subjects director behaviour to close scrutiny by courts and regulators, whose public enforcement goals differ from those associated with general company law director duties. In recent years the risk of disqualification has also been heightened, with directors being disqualified from being involved in the management of companies for infringements of UK competition with increasing frequency, and for lengthening periods of disbarment.

As the UK Competition and Markets Authority ("CMA") ramps up its enforcement activity, in this article we summarise the key obligations imposed on directors under UK company law and compare these with the standards of review to which directors will be subject under the CDDA, in each case with particular refence to non-executive directors ('NEDs'). We also offer practical steps to avert the risk of a career-endangering disqualification order.

Recent developments

We outline below recent cases which provide a clear warning sign that executive directors and NEDs need to demonstrate an appropriate awareness of competition law and an effective degree of oversight at board level, in order to avoid disqualification.

In March 2021, two directors were disqualified by the CMA for periods of eleven and twelve years respectively, for their role in a cartel in which their company was involved in the precast concrete drainage products market. This followed the first contested court ruling in 2020 which determined the issue of director disqualification for a competition law breach, where a merely passive stance resulted in disqualification (*CMA v Martin*).

Most recently, following the CMA decision in the roofing materials cartel, three directors were disqualified under the CDDA for three, four and six and a half years, respectively, with effect from May 30, 2021. Two of the directors made a court application seeking permission to be allowed to continue acting as directors of certain companies. On May 13, 2021, the court granted permission, pending a full hearing, subject to strict conditions that not only outline necessary corrective steps but also place reliance on a NED's independent supervisory role:

- A named individual is to act as a NED of the companies, with his replacement requiring approval from the CMA.
- The NED will be responsible for supervising the companies and must report to the boards regarding competition law compliance.
- A named consultant is to be responsible for monitoring the performance of the corporate group and certain other named directors must remain on the board.
- All staff employed by and all directors of the relevant companies must engage in annual competition law compliance training.
- Each company's email servers will be subject to searches for terms indicative of possible competition law breaches.
- Competition law compliance matters must be considered and minuted at board meetings.

NED role and oversight

Consistent with the role of independent adviser or supervisor, a NED does not hold executive office but instead helps in the development of a company through external oversight and constructive challenge relying on their experience and expertise. This independent oversight and guidance is typically provided on a part-time basis (likely attending monthly or quarterly board meetings) and with limited exposure to the underlying daily operations of the company. NEDs are also not considered to be employees of the company.

English company law duties

English company law makes no explicit legal distinction between the legal responsibilities and duties applicable to full-time executive directors and a NED. Accordingly, NEDs face the same legal responsibilities and liabilities as the executive directors and are obliged to act within the terms of their powers, to promote the success and interests of the company (as they perceive it, acting in good faith), to exercise independent judgment, reasonable care, skill and diligence and to avoid (or, alternatively, declare and have approved) conflicts of interest. The discharge of the duty of care to the company is gauged having regard to the higher of two levels of knowledge, skill and experience, namely that which the director should have (given his role) and that actually possessed by the relevant director. For example, a NED who has had a career in the financial services industry is likely to be expected to have a higher degree of knowledge with regard to financial matters and will be expected to bring such knowledge to bear on matters involving, for example, accounting issues. The director is subject to the duty not to accept benefits from third parties and must also declare any interests in proposed transactions.

As with executive directors, NEDs may be held responsible if a loss should occur due to breaches of their assigned duties. Similarly, if a company's board becomes subject to an investigation by a law enforcement agency, such an investigation will likely include the actions or omissions of NEDs. By way of illustration, a 2010 consultation paper issued by the (then called) Financial Services Authority (FSA) stated that "*NEDs have a pivotal role to play in the active governance of firms. Where it appears to us that executives have persistently made poor decisions, we will look closely at NEDs' performance if we feel they have not intervened in a timely and sufficient way. We are concerned that the existing guidance could be misinterpreted and taken to mean that we would not hold NEDs responsible for, for example, failing to intervene and challenge the executive. This is not the case, as we see such challenge and intervention as a key part of any NED's responsibilities*".

NEDs should have a proper understanding of the company's business and show diligence in attending board meetings including by insisting on receiving high-quality information sufficiently in advance of meetings to allow them to make a meaningful contribution. They must take reasonable steps to ensure that they guide and monitor the management of the company and provide constructive and robust challenge to the board, and contribute to the development of strategy, bringing their experience and expertise to bear. Directors (including NEDs) cannot evade their duties by leaving decisions to others, nor should they allow one director to dominate the board. Directors, acting as a board, can delegate executive responsibilities and particular functions to individual directors and to those operating at other levels of management. They can also reasonably assume that those to whom executive tasks have been entrusted will display competence and integrity. However, a director is not relieved from the duty to supervise the discharge of those delegated powers.

There is no universal rule that can be applied in determining whether directors' duties have been performed and any assessment will be fact-dependent. For instance, whether a NED reasonably relied on the executive directors and management to perform delegated duties honestly and diligently will include an assessment of the degree to which the NED has shown independence of judgment and an appropriate level of supervision.

However, under the UK director disqualification laws, the consequences of poor oversight can be career-endangering and bring about liability, ultimately both criminal and civil. In particular:

- Section 13 CDDA provides that it is a criminal offence for any person to act in contravention of a company director disqualification order or undertaking;
- Section 15 CDDA provides that when a person is in contravention of either they become personally liable for all the debts and liabilities of the company incurred during the period that they were involved in the management of the company.

Powers under the Company Directors Disqualification Act 1986

Under the CDDA, a court has wide powers to make a disqualification order against a person, prohibiting him from acting as a director and from being concerned, directly or indirectly, in the promotion, formation or management, of an English company for a period of up to 15 years. Originally these disqualification powers related to a director's role in a corporate insolvency. They also arose where serious or persistent

breaches of English company law had occurred or if directors were convicted of certain offences. Director disqualification undertakings could also be sought from individuals by the Secretary of State.

Since the advent of the Enterprise Act 2002, it has been possible for the UK competition authority and also for certain regulators with concurrent enforcement powers (in the financial services, health, water, telecommunications, energy, rail and aviation sectors) to apply to the court for a director disqualification order.

The court must make a disqualification order against a person if two conditions are satisfied. The first is that the company of which he is a director has committed certain breaches of UK competition law. The second condition is that the court considers that his conduct as a director makes him unfit to be concerned in the management of a company.

Procedural issues

Section 9B of the CDDA empowers the CMA (or relevant regulator) to seek a disqualification undertaking from a director if the CMA "thinks" that a company has committed a relevant competition law infringement and that a director's conduct renders him unfit. If the director refrains from offering an undertaking when requested to do so, and if the CMA proceeds to issue a formal notice that it intends to apply to the court for a disqualification order, the CMA can be expected to seek a longer period of disqualification than that offered by means of a director undertaking if the matter is adjudicated in the CMA's favour. This raises an issue of procedural fairness that was considered by the court in *CMA v Martin*. However, the court felt it was appropriate to make a seven-year disqualification order. This was a period around double in length to that imposed on other directors involved in the same competition law infringement, who had accepted disqualification undertakings.

Unfitness

In considering whether an individual's conduct makes him unfit to be concerned in the management of a company, under sub-sections 9(A)(6) and (7) CDDA, a court's decision will include an assessment of whether:

1. The director's conduct contributed to the breach of competition law. It is not necessary or relevant that the director actually knew that the conduct of the undertaking constituted a breach of competition law.
2. The director's conduct did not contribute to the breach, but he had reasonable grounds to suspect that the conduct of the relevant company constituted a breach of competition law and he did not take any steps to prevent it.
3. The director did not know, but ought to have known, that the company's conduct constituted a breach of competition law.

The court may also have regard to the director's conduct as a director of other companies relating to any other breach of competition law. If the court is satisfied that the conduct of a director renders that director unfit, it must make a disqualification order. A disqualification order can last for up to 15 years.

The application of the CDDA to competition law breaches is intended to reinforce and enhance boardroom compliance with the requirements of competition law and to deter behaviour harmful to the public, both generally and specifically in relation to all those directors whose conduct has fallen short. It is also intended to maintain and improve the standards of corporate management. The CDDA power of disqualification for competition law infringements has been used increasingly frequently and with ever-greater impact. *CMA v Martin*, the first contested case in which a court has made competition law disqualification order, provides strong judicial support for disqualification and a broad approach to section 9(A) of the CDDA.

The most recent Guidance on competition disqualification orders issued by the CMA (on 6th February 2019) indicates that when considering disqualification issues relating to a director, it will always consider the statutory factors listed in paragraphs 1 to 3 above. The CMA may take into account factors that include:

- the nature and seriousness of the infringement;
- the duration of the infringement;
- the impact, or potential impact, of the infringement on consumers;
- the conduct of the undertaking during the CMA's investigation; and
- any previous breaches of competition law committed by the 'undertaking' (broadly speaking the company and its corporate group).

The CMA will assess the nature and extent of the director's responsibility for, or involvement in, the competition law breach, when determining director unfitness.

The NED's role

The CDDA's requirements and CMA Guidance require NEDs to be aware of what constitutes a competition law breach. The CMA considers that company directors have a responsibility to remain well informed about their company's activities and to ensure that they comply with competition law. Whilst the skill and knowledge levels required under UK company law are those appropriate to a director's position and the activities of the company, a NED will be expected by the CMA to understand the most serious forms of infringement of competition law. The conditions (outlined earlier) attached to the interim order enabling directors who had accepted disqualification undertakings to continue to act plainly indicate heightened CMA expectations of NEDs in preventing further transgressions. It is very clear that adopting a merely passive role will not be acceptable.

In *CMA v Martin*, the defendant was not involved in day-to-day operations (including pricing or sales). He did not initiate, implement, or direct staff to participate in or approve the infringement, nor did he attend meetings at which estate agent commissions were fixed. He took no active steps with respect to the activities that constituted the breach and claimed that he tried to ensure a corporate culture of competitive pricing. However, the defendant saw emails referable to the cartel that the court decided fixed him with knowledge of it. The court held that, in taking no steps to prevent the implementation of the commission-fixing arrangement, he contributed to it. He would also have been caught by the third ground for a disqualification order, namely that he ought to have known that the emails and the meetings that

were being convened related to a cartel that constituted a breach of competition law, particularly since he professed to be aware of UK competition law. The court concluded that, since the inactivity of the defendant contributed to the breach, it did not need to determine this issue, but that it would "plainly" have been a ground for disqualification.

The section 9(A) CDDA basis for liability outlined above creates a net with a relatively fine mesh. Evading it will mean achieving a degree of familiarity with the following key provisions of the Competition Act 1998, the infringement of which can trigger a CDDA disqualification order. Although those breaches listed in paragraphs (v) to (viii) below are the usual ones that form the basis for a disqualification order, those in paragraphs (i) to (iv) are also regarded as serious violations that trigger an uplift in company fines and remain a potential ground for director disqualification.

Chapter I of the Competition Act 1998: prohibits anti-competitive agreements. Serious infringements in a supplier and reseller arrangement are:

(i) the conferral of absolute territorial exclusivity on a reseller (leaving no prospect of a reseller responding to passive or non-actively solicited enquiries from outside its territory);
(ii) resale price maintenance (imposing minimum or fixed resale prices on a reseller);
(iii) a ban on the use of the Internet by a reseller; and
(iv) prohibiting authorized distributors in a selective distribution network from selling to each other or (if active as retailers) to end users.

In an agreement between competitors, the following would be regarded as serious restrictions:

(v) price fixing;
(vi) output limitation (agreeing the volume of products to be put on the market and thereby restricting supply);
(vii) allocating markets or customers; or
(viii) an exchange of strategic information (which may result in a collusive outcome).

Chapter II of the Competition Act 1998: prohibits a 'dominant' undertaking from abusing that dominance. Abuses are broadly divisible into:

(i) exclusionary abuses that involve consolidating and/or reinforcing the dominant undertaking's strength in the market, e.g. a refusal to deal or to license, predatory pricing, exclusive dealing or engaging in market foreclosing rebates; and
(ii) exploitative abuses, where the dominant undertaking takes advantage of the fact that neither customers nor competitors are able to restrain its commercial behaviour, e.g. excessive pricing.

Company directors should have an understanding of their product and geographic markets (as determined by reference to product substitution and homogeneous conditions of competition respectively). A market share of 50% plus is indicative of dominance but other factors, such as barriers to entry and countervailing buyer power are also relevant. It is only when armed with this knowledge that a NED can have an appreciation of whether the Chapter II prohibition might be being infringed by a particular commercial practice being proposed to the board.

Under the Enterprise Act 2002, as amended by the Enterprise and Regulatory Reform Act 2013, there is the possibility of individuals being criminally prosecuted for hardcore cartels, such as price-fixing or bid-rigging between competitors. This is potentially a ground for disqualification as an indictable offence if a

conviction occurs or (which is far more likely), if it is also a breach of the Chapter I Prohibition. The lack of convictions under the Enterprise Act 2002 is notable (they have only occurred where the executive has pleaded guilty). This has spurred the CMA to make far greater use of director disqualifications as a means of deterring individuals from breaching UK competition law and punishing those who do.

The above legal framework will be relevant in determining whether a NED:

- may have contributed to a breach (irrespective of actual NED awareness);
- had reasonable grounds to suspect that the company's conduct constituted a breach of competition law (when he should be taking the necessary steps to prevent it); or
- ought to have known that the company's conduct constituted a breach of competition law.

The first of these disqualification grounds is probably most applicable to an executive director. Nevertheless, a number of relevant decisions may require authorisation at board level and will be subject to NED scrutiny. Without an adequate and up to date knowledge of competition law, coupled with a degree of diligence that potentially exceeds that required of him under company law, a NED may find that he has approved a misstep that contributes unwittingly to an infringement.

The existence of reasonable grounds for suspecting a breach will be judged objectively by reference to emails, company records, circumstantial evidence and oral statements. The paper trail, when examined after the event, may not make for comfortable reading if the NED was not knowledgeable and alert to the potential danger signs when they arose. If the NED should reasonably have suspected a breach, his obligations go beyond those of mere inquiry; his subsequent actions should avert the infringement or mitigate any breach that has occurred. An appreciation of the necessary actions, in the form of obtaining privileged legal advice, engaging in further due diligence and possibly submitting a CMA leniency application, will be critical.

The final, broadly expressed, pitfall is the issue of whether a NED 'ought to have known' of any violation. This critical question will be assessed subjectively by reference to the level of awareness a director should have possessed, given his role and experience.

Conclusion

The CMA considers that company directors have a special responsibility to maintain adequate levels of competition law knowledge and a suitable awareness of their company's activities, NEDs will need to apply both in order to ward off threats to competition law compliance and their boardroom roles.

The ruling in *CMA v Martin* is clearly favourable to the CMA (or any relevant regulator) seeking to obtain a disqualification order or undertaking. It takes a broad view of how passive behaviour can amount to a contribution to an infringement that will trigger liability and acknowledges the relative ease with which the final additional ground for liability can arise, when a director ought to have been aware that that corporate conduct constitutes a competition law infringement.

The CMA takes a case-by-case approach to director disqualification and the OFT guidance issued in 2010 has been withdrawn to enable this further. However, the 2010 OFT Guidance helpfully highlights some pitfalls that directors should avoid:

- planning, devising, approving or encouraging the infringement;
- attending meetings, ordering or inducing employees to participate (directly or indirectly);
- authorizing activity referable to the breach (with knowledge or reasonable grounds for suspecting the violation)
- once apprised of facts that constitute knowledge or reasonable grounds for suspicion of a breach, failing to take active steps or to demonstrate a response aimed at preventing it or mitigating the breach once it has occurred, including raising the matter with external lawyers in order to determine how best to reduce the risks to the company and to consumers (this may entail an approach to the CMA or relevant regulator)

Directors should be aware that each of them will be attributed with the knowledge he ought to have had, given the role he occupied (including that of a NED), and accordingly each should demonstrate active oversight and supervision, remaining alert to company activities that might call for further inquiry.

In light of the increasing vulnerability of all directors to disqualification, NEDs that remain in doubt whether a competition law breach is in train should consider obtaining legal advice (potentially at the expense of the company) if they consider it necessary to discharge their responsibilities as directors and to protect their reputations.

Contact us

For further information please get in touch with the authors, or your usual Steptoe contacts.

Paul Hughes
Of Counsel
phughes@steptoe.com

Charles Whiddington
Partner
cwhiddington@steptoe.com

Zoe Osborne
Partner
zosborne@steptoe.com