Department for Business, Innovation & Skills

Final Stage Impact Assessments to Part B of the Transparency and Trust Proposals (Director Disqualification Regime)

Contents

Title: Matters to be taken into account by the Court when determining that a person is unfit to act as a company director **IA No:** BIS INSS005 **Lead department or agency:** The Insolvency Service **Other departments or agencies:** Department for Business, Innovation & Skills	Impact Assessment (IA) **Date: Published 24 April 2014** **Stage: Final** **Source of intervention: Domestic** **Type of measure: Primary legislation** **Contact for enquiries:** Sarah O'Sullivan Tel: 020 7291 6766

Summary: Intervention and Options

RPC Opinion: Not Applicable

Cost of Preferred (or more likely) Option				
Total Net Present Value	**Business Net Present Value**	**Net cost to business per year** (EANCB on 2009 prices)	**In scope of One-In, Two-Out?**	**Measure qualifies as**
£3.18m	£0.0m	£0.0m	No	NA

What is the problem under consideration? Why is government intervention necessary?

The Company Directors Disqualification Act provides for the disqualification of directors. The effect is to bar an individual from acting in the management of a limited company for a period up to 15 years. When determining whether a director is unfit, the court or Secretary of State must take account of matters in Schedule 1 CDDA. Both legislation and case law have moved on since the enactment of the CDDA, but there have been no substantive amendments to Schedule 1; giving rise to the question as to whether it is now fit for purpose and, in particular, is transparent about the breadth of misconduct that might lead to disqualification, and to address perceptions that it does not take account of all matters of public interest.

What are the policy objectives and the intended effects?

The changes proposed aim to ensure that: Any party involved in disqualification proceedings, particularly directors of companies, are enabled to understand what conduct might result in director disqualifications, and: As a result, trust and confidence in the marketplace may be increased.
Government intervention is proposed to revise or rewrite Schedule 1 to render it fit for purpose for the present day, to make it clear to directors the wide range of misconduct that may lead to disqualification and to address perceptions that not all relevant matters of public interest are taken into account.

What policy options have been considered, including any alternatives to regulation? Please justify preferred option (further details in Evidence Base)

Do Nothing
Option 1: Amend and make public current guidance material
Option 2 (preferred option): Replace Schedule 1 CDDA with a broader outline of public interest factors to be taken into consideration

Will the policy be reviewed? It **will** be reviewed. **If applicable, set review date: 04/2020**

Does implementation go beyond minimum EU requirements?			N/A		
Are any of these organisations in scope? If Micros not exempted set out reason in Evidence Base.	**Micro No**	**< 20** No	**Small No**	**Medium No**	**Large No**
What is the CO_2 equivalent change in greenhouse gas emissions? (Million tonnes CO_2 equivalent)			**Traded: N/A**	**Non-traded: N/A**	

I have read the Impact Assessment and I am satisfied that (a) it represents a fair and reasonable view of the expected costs, benefits and impact of the policy, and (b) that the benefits justify the costs.

Signed by the responsible Minister: Jenny Willott Date: 5 March 2014

Summary: Analysis & Evidence Policy Option 1

Description: Amend and make public current guidance material

FULL ECONOMIC ASSESSMENT

Price Base Year 2013	PV Base Year 2013	Time Period Years 10	Net Benefit (Present Value (PV)) (£m)		
			Low: -1.32	**High: -0.54**	**Best Estimate: -0.93**

COSTS (£m)	Total Transition (Constant Price)	Years	Average Annual (excl. Transition) (Constant Price)	Total Cost (Present Value)
Low	£0.5m	1	N/A	**£0.5m**
High	£1.3m		N/A	**£1.3m**
Best Estimate	£0.9m		£0	**£0.9m**

Description and scale of key monetised costs by 'main affected groups'

Transition costs to The Insolvency Service from producing the guidance, and to judges from reading it, are considered to be negligible. Familiarisation costs to Insolvency Practitioners are considered to be £507K to £1.01m, based on 1,352 IPs spending 1 to 2 hours reading the new guidance at an hourly rate of £375. Familiarisation costs to lawyers are expected to be in the range of £31K to 307K, based on 210-375 lawyers spending 1 to 2 hours and an hourly rate between £146 and £409.

Other key non-monetised costs by 'main affected groups'

No other wider costs are expected.

BENEFITS (£m)	Total Transition (Constant Price)	Years	Average Annual (excl. Transition) (Constant Price)	Total Benefit (Present Value)
Low	£0	N/A	unknown	**unknown**
High	£0		unknown	**unknown**
Best Estimate	£0		unknown	**unknown**

Description and scale of key monetised benefits by 'main affected groups'

No benefits have been monetised. Whilst it is possible that cost savings will come from directors giving earlier undertakings, as they will in option 2, stakeholders consider that option 1 does not go far enough and that its effects will be negligible. Its benefits have not therefore been costed.

Other key non-monetised benefits by 'main affected groups'

Wider benefits from this proposal might include increased clarity from stakeholders on what constitutes misconduct. This in turn can help to improve standards of company stewardship to the overall benefit of creditors, deter some directors from engaging in some misconduct and improve the perception in the enforcement regime.

Key assumptions/sensitivities/risks **Discount rate (%)** 3.5

The full extent of the benefits is unknown, but it is expected that this option will be less effective than Option 2 in achieving them. This option could help users better understand the current law but some stakeholders consider the law itself to be too opaque and therefore the benefits of any clear guidance would be limited.

BUSINESS ASSESSMENT (Option 1)

Direct impact on business (Equivalent Annual) £m:			In scope of OITO?	Measure qualifies as
Costs: 0.0	**Benefits: unknown**	**Net: 0.0**	No	NA

Summary: Analysis & Evidence Policy Option 2

Description: Replace Schedule 1 CDDA with a broader outline of public interest factors to be taken into consideration

FULL ECONOMIC ASSESSMENT

Price Base Year 2013	PV Base Year 2013	Time Period Years 10	Net Benefit (Present Value (PV)) (£m)		
			Low: -1.32	High: 7.52	Best Estimate: 3.18

COSTS (£m)	Total Transition (Constant Price)	Years	Average Annual (excl. Transition) (Constant Price)	Total Cost (Present Value)
Low	£0.5m	1	N/A	**£0.5m**
High	£1.3m		N/A	**£1.3m**
Best Estimate	£0.9m		N/A	**£0.9m**

Description and scale of key monetised costs by 'main affected groups'

Transitional cost to The Insolvency Service from producing the guidance, and to judges from reading it, are considered to be negligible. Familiarisation costs to Insolvency Practitioners are considered to be £507K to £1.01m, based on 1,352 IPs spending 1 to 2 hours reading the new guidance at an hourly rate of £375. Familiarisation costs to lawyers are expected to be in the range of £31K to 307K, based on 210-375 lawyers spending 1 to 2hours and an hourly rate between £146 and £409.

Other key non-monetised costs by 'main affected groups'

No other wider costs are expected.

BENEFITS (£m)	Total Transition (Constant Price)	Years	Average Annual (excl. Transition) (Constant Price)	Total Benefit (Present Value)
Low	£0	N/A	£0	**£0**
High	£0		£1.0m	**£8.1m**
Best Estimate	£0		£0.5m	**£4.1m**

Description and scale of key monetised benefits by 'main affected groups'

An additional 0 to 15 directors each year may choose to settle a disqualification case earlier, by undertaking before proceedings are issued at court, which would save The Insolvency Service from having to incur legal costs. Savings range from £0 to £0.69m. Further, with some disqualifications being brought more efficiently, resource will be freed up for additional investigations, preventing disqualified directors otherwise removing assets to an illegal market. Estimated benefit is £0 to £210K

Other key non-monetised benefits by 'main affected groups'

Increased clarity for stakeholders on what constitutes misconduct. This can help to improve standards of company stewardship to the overall benefit of creditors, deter some directors from engaging in some misconduct and improve the perception in the enforcement regime. Additionally the cost savings that lead to additional resource and an increase in disqualifications. Each disqualification impacts creditors by preventing future unfair transfers from them. See annex B.

Key assumptions/sensitivities/risks **Discount rate (%)** 3.5

The full extent of the benefits is unknown, but it is expected that this option will be more effective than Option 1 in achieving them as stakeholders consider the law opaque and this option would provide more clarity and certainty in how it might be applied. There are not expected to be any unintended consequences.

BUSINESS ASSESSMENT (Option 2)

Direct impact on business (Equivalent Annual) £m:			In scope of OIOO?	Measure qualifies as
Costs: 0.0	**Benefits: 0.0**	**Net: 0.0**	No	NA

Evidence Base (for summary sheets)

Introduction

The CDDA and Disqualification of Company Directors

The Company Directors Disqualification Act 1986 (CDDA) aims to maintain the integrity of the business environment. Those who become directors of limited companies should:

- Carry out their duties with responsibility; and
- Exercise adequate skill and care with proper regard to the interests of the company's creditors and employees.

The majority of directors do this effectively, but the CDDA is a powerful tool against those who abuse the privilege of limited liability. The CDDA applies not just to persons who are formally appointed as directors but to those who carry out the functions of directors.

If there is any unfit conduct in an insolvent company, then the liquidator, administrative receiver, administrator or official receiver has a duty to send the Secretary of State for Business, Innovation & Skills a report on the conduct of all directors who were in office in the last 3 years of the company's trading.

The Insolvency Service, on behalf of the Secretary of State has to decide whether it is in the public interest to seek a disqualification order against a director.

The proceedings are brought by The Insolvency Service on behalf of the Secretary of State for Business, Innovation & Skills or, usually in compulsory winding-up cases, by the official receiver at the direction of the Secretary of State. The matter is heard, and decided by the court, unless the Secretary of State accepts a disqualification undertaking from a director. An undertaking has the same legal effect as a court order, but negates the need to go to court.

The minimum period of disqualification is 2 years and the maximum 15 years.

If a company director is disqualified (by court order or by giving an undertaking), unless they have court permission, that person is disqualified for the period stated in the order or undertaking from:

- Being a director of a company;
- Acting as receiver of a company's property;
- Directly or indirectly being concerned or taking part in the promotion, formation or management of a company; or
- Being a member of or being concerned or taking part in the promotion, formation or management of a limited liability partnership.
- Acting as an insolvency practitioner (IP).

Problem under consideration

1. Under the provisions of Section 9(1) and (1A) of the CDDA, to decide whether a director is unfit, the Court and the Secretary of State must take account of matters set out in Schedule 1 (Sch1) to that Act (see **Annex A**).
2. Given that disqualification can have a major impact on the commercial freedoms of an individual, it is vital that directors should have a clear understanding of what they can be held accountable for,

particularly when their company encounters financial difficulties. Equally, such clarity is a vital element of trust in the marketplace.

3. The problem under consideration is that Sch1 as currently drafted, is both technically opaque and exclusive in approach. The list in Sch1 of matters the court should take into account in determining whether a company director is unfit defines some conduct matters by reference to breaches of specific sections of the Companies and Insolvency acts, whilst other matters are expressed in much broader terms. The very fact that there is a list gives rise to the perception that, if a matter is not explicitly included, it is not, or may not be, taken into account in determining whether a director is unfit.

4. Moreover, Sch1 does not spell out the public interest factors underpinning every disqualification action, with the consequence that this can give rise to a perception that public interest is fettered – in that, if a matter, such as a director's previous failures or the harm caused by their misconduct, is not explicitly listed in the schedule, the perception might be that it will not be taken into account in considering whether an individual is unfit.

5. Thus Sch1 does not always provide company directors with sufficient clarity regarding the broad spectrum of misconduct that might find them facing disqualification action. Nor does it spell out the public interest factors underpinning every disqualification action, hence may give rise to a lack of transparency as to all the factors that are considered in determining whether an individual is unfit.

6. There is limited evidence to suggest that Sch 1 CDDA is not fit for purpose and is a barrier to obtaining the disqualification of those who deserve such action. Over 80% (2012-13 86%, 2009-10 82%) of disqualifications are obtained by directors offering an undertaking not to act in the management of a company and a relatively small proportion of cases are either discontinued after proceedings have been issued[1] or are lost at Court. In 2011-12, three disqualification cases were lost at court and 43 were discontinued after proceedings had been issued. The Secretary of State only pursues cases where it is considered that there is a greater than 50% chance of obtaining a disqualification and the high success rate of cases reflects this approach. There is little to suggest that cases are not being targeted for enforcement action because of the iteration of Sch 1 – the test is one of wider public interest and allegations tend not to be expressed using the "labels" presented by Sch 1.

7. However as Sch1 does not clearly set out to directors and to the public what matters might be considered in pursuing disqualification action, there is a perception that not all public interest factors may be taken into account. This can negatively affect[2] stakeholder confidence in the enforcement regime, which will persist if no action is taken.

8. In addition, both legislation and case law have moved on since the enactment of the CDDA and, indeed, neither the allegations of misconduct included in affidavits supporting an application for the disqualification of an individual, or the disqualification undertaking that is signed by a director are cited in a manner that explicitly echo the Sch 1 list, rather they describe the nature of the action by the individual and the consequences (or harm) that resulted from them – in short, the public interest.

Rationale for intervention

9. Increasing transparency as to the conduct that might result in disqualification action will aid directors in making the right choices as to their action and conduct as a director of a company; particularly if that company encounters financial difficulties. It will also increase the probability of disqualification cases being settled by way of undertaking, without recourse to, often costly, court action, as directors might better understand what they can be held accountable for.

10. The general economic rationale for dealing with misconduct is to address the moral hazard[3] problem generated by perverse incentives created by limited liability[4]. That is, directors are more likely to engage in misconduct and or take more risks if they are not personally responsible for the

[1] E.g. if further information comes to light at a late stage

[2] R3, the trade association of Insolvency Practitioners, has made numerous adverse comments in the press to the effect that disqualification action is only targeted at "low hanging fruit on the basis, it is suspected, of an erroneous perception that Insolvency Service targets easier cases

[3] In economic theory, a moral hazard is a situation where a party will have a tendency to take risks because the costs that could incur will not be felt by the party taking the risk.

[4] Halpern et al. (1980) Limited Liability in corporate law

consequences of their actions[5]. Information asymmetries mean that directors have more information than creditors about their likely future behaviour. And high transaction costs (for example from trying to write the 'perfect contract') can prevent creditors from protecting themselves, inhibiting, in some instances investment from happening. Government action is therefore needed to minimise the unintended consequences of limited liability by achieving a better alignment of incentives and so discouraging directors from misconduct, hence enabling optimal levels of risk-taking and investment in the market.

11. Laws to address general director misconduct, primarily the Company Directors Disqualification Act (CDDA), are currently in place. But it is the transparent, fair and consistent application and enforcement of these laws that determines the effectiveness in aligning director's incentives.

12. Government intervention is necessary to help to address any regulatory failures associated with disqualification activities delivered by The Insolvency Service. In particular the proposals presented in this Impact Assessment are aimed at updating legislation so grounds for disqualification reflect current case law and are made clearer to directors.

Policy objective

13. The policy objective is to increase transparency and the changes proposed aim to ensure that the matters to be taken into consideration by the Court or the Secretary of State when determining whether an individual is unfit to be concerned in the management of a limited company are iterated in terms that reflect public interest. And ensure that:

- Any party involved in disqualification proceedings, particularly directors of companies, are enabled to understand what conduct might result in director disqualifications, and:
- As a result, trust and confidence in the marketplace may be increased.

Description of options considered (including do nothing)

Extending the List of Matters of Unfitness in Sch1

14. This option was explored with stakeholders and discounted. This option was not supported as there was strong concern that to extend Sch1 would merely serve to compound rather than to address the problem under consideration and it has, therefore, been discounted.

15. The option of extending Schedule 1 of the CDDA to include the following matters was explored with stakeholders:

- Material breaches of sectoral regulation – whether the court should take account of the actions of a director who has materially breached specific sectoral regulations – such as a bank director who materially breaches financial services rules
- The wider societal impacts of the failed company - to ensure that the totality of any impact from the failures of individual firms can be duly reflected in the consequences felt by their directors;
- The nature of creditors and the degree of loss they have suffered - where a director's misconduct has resulted in losses to more vulnerable or less sophisticated creditors, should this be specifically taken into account; and
- The director's track record - whether an individual who has displayed a pattern of behaviour resulting in repeated company failure or creditor loss – perhaps due to simple incompetence - should be taken out of the marketplace**.**

[5] One of the consultation responses argued, that, although there is firm grounding in the literature that limited liability generates a moral hazard problem, there is little empirical evidence of the e*xtend* of this problem. The extent of the problem would determine the degree of regulatory action, rather than the need for regulatory action, which is the subject of discussion in this section.

16. Given the lack of support from stakeholders, this option has not been further explored or costed in this impact assessment.

Do Nothing

17. Sch1 as currently drafted is considered by stakeholders to be out of date and too prescriptive in its drafting. There is limited evidence to indicate that Sch1 is proving a barrier to successful disqualification proceedings and indeed, stakeholders consider that matters of public interest are taken into consideration by the Court and by the Secretary of State, whether or not they are explicitly included in Sch1. However one senior counsel who attended a stakeholder event[6] observed that Sch1 is more remarkable for what it includes rather than excludes.
18. Stakeholders who responded to the Transparency and Trust discussion document[7] expressed concern that prescription of the factors to be taken into should be avoided and instead courts should be allowed to make appropriate judgments; any proposed changes to Sch1 to the CDDA, should be made with caution. There were also concerns about the potentially exhaustive nature of Sch1 and whether it is necessary to entrench the proposed provisions into the CDDA rather than rely on the current existing regulatory frameworks that support business sectors.
19. Some concern was expressed that, were Sch1 to become an (apparently) exhaustive list, this might narrow the focus and exclude other matters of conduct. It is these arguments that can be brought to bear when considering whether the current, perceptually exhaustive, list is now fit for purpose.

Option 1: (Non Regulatory) Amend and make public current Guidance Material

20. In order to address the perception that Sch 1 fetters the Court and the Secretary of State with respect to public interest consideration, guidance material for officials and for the Courts could be updated on a collaborative basis. This would go some way towards obtaining a mutually agreed view of what should (and should not) be considered in determining that an individual should be disqualified in the public interest.

Cost and Benefits of Option 1

Costs

Costs to the public sector

21. Costs to the public sector are estimated to be mainly resource costs to The Insolvency Service for producing the guidance and publicising it, and familiarisation costs to the judiciary.

22. Additional resources costs to The Insolvency Service to produce the guidance are expected to be **negligible** as they will be incurred as part of business as usual (perhaps 1 or 2 people working on the project for a week). The new guidance will be publicised using The Insolvency Service's current channels, that is IP guidance material and changes to disqualification guidance on their website. The additional costs of these are also likely to be **negligible** as changes and updates are part of its 'business as usual' resourcing.
23. Familiarisation costs to the judiciary are unknown but they are also expected to be **negligible** given the fact that judges are used to considering new published guidance on a regular basis and as their business as usual duties.

[6] Malcolm Davis-White QC attended the Part B focus group event on 3 September 2013.

[7] https://www.gov.uk/government/consultations/company-ownership-transparency-and-trust-discussion-paper

Costs to the private sector

24. Costs to businesses are considered to be familiarisation costs incurred by IPs[8] and lawyers to ensure they are up to date with the guidance.

25. Costs to IPs are estimated to be £760k. We would anticipate familiarisation taking up to 1 to 2 **hours** of an IP's time based on the assumption that this change is not complex to understand and would only need to be understood once. There are currently **1,352** IPs who take case appointments and we have assumed an average hourly rate for an IP of **£375** per hour. This is based on the average hourly charge out of an IP firm, at director/partner level.[9] Based on these figures, we would expect familiarisation costs to IPs to be **in a range of £507K to £1.014m, with a mid point of £760.5k.**

26. Familiarisation costs to lawyers are similarly expected to result from 1 to 2 hours spent in reading the new guidance. Whilst no hard data is available, officials from The Insolvency Service who deal with disqualification cases and lawyers instructed by directors estimate that a third of defendants to proceedings under section 6 CDDA and all defendants to proceedings under section 8 CDDA seek legal advice[10], with a range of between 1 lawyer per 1 to 2 disqualified directors. Including all lawyers instructed with respect to such proceedings by The Insolvency Service gives a range of 210 to 375 lawyers who might want to familiarise with the new guidance. Guidelines for the judiciary indicate that legal professionals can charge between £146 and 409 per hour[11] depending on their grade and location. The opportunity cost therefore ranges from (210 lawyers x £146 x 1hrs to 375 lawyers x £409 x 2hrs) **£30.7K to £306.8K with a mid point of £168.7K.**

27. In general costs to IPs and lawyers will fall within their Continuous Professional Development, as they will have to be aware of development in regulations as part of their job. However, these are still considered additional costs in this impact assessment as the time spent on understanding new guidance could otherwise be spent in other professional activities (including other types of continuous professional development).

28. **Overall one off costs from this option are therefore expected to be £538K to £1.32m with a mid point of £929K**

On going costs

29. It is not expected that the proposal will increase the number of cases that are in scope for an investigation from The Insolvency Service, as the same grounds of 'public interest' will still determine what constitutes misconduct and what doesn't. Therefore no ongoing costs are expected from this proposal either to the public or the private sector.

30. No other non-monetised costs are expected from this proposal.

Benefits

31. No transition benefits are expected from this proposal.

On-going Benefits

Wider benefits to the private sector

[8] Insolvency Practitioners are professionals (usually either accountants, lawyers or those who hold professional qualifications relating to the insolvency regime) who are licensed, principally by their own "recognised" professional bodies to act as liquidators, administrators receivers and managers etc. when a company enters into any form of insolvency proceedings

[9] See para 3.1 http://www.bis.gov.uk/insolvency/insolvency-profession/review-of-ip-fees

[10] The remainder choosing to undertake or to fight the proceedings without reference to legal advice

[11] https://www.judiciary.gov.uk/Resources/JCO/Documents/Guidance/guideline-hourly-rates-2010-v2.pdf

32. No hard data is available to quantify the benefits of this Option. The main benefits are however, described in a qualitative form below:

    a. A better understanding by lawyers and IPs of what constitutes misconduct and the grounds for which disqualifications are applied, can help them to provide clearer guidance to businesses and directors, improving in this way standards of company stewardship to the overall benefit of creditors;
    b. Clarity on what is considered misconduct could also potentially deter some directors who seek professional advice from engaging in misconduct, in particular, when a company is close to encountering financial difficulties; and
    c. A better understanding amongst those who operate within the insolvency regime, that is IPs, lawyers and judges can also help to improve the perception of the enforcing regime, increasing confidence in the overall system.

33. Given the above clarity and understanding, it is possible that some directors might give an undertaking earlier in the proceedings than they currently do. However, improved guidance will not change the perception that the matters of unfitness in Sch1 are too narrowly drawn. Whilst guidance might clarify the current law for its users, the law is still opaque and there is a limit to how much clarity guidance can provide as a result.

34. Given stakeholder feedback indicating that this option will not be as effective as Option 2, officials estimate its effect to be negligible and therefore the benefits have not been monetised.

Option 2: Replace Schedule 1 CDDA with a Broader Outline of Public Interest factors to be taken into consideration (Preferred Option)

35. The option of replacing Sch1 with a broader outline of public interest factors that must be taken into account is the preferred option as it will deliver greater certainty and transparency as to the conduct that may result in disqualification action by setting out comprehensively the matters that the court or the Secretary of State must (as opposed to may) take into account in determining unfitness. It will also increase the probability of disqualification cases being settled by way of undertaking, without recourse to, often costly, court action.

36. Although, generally, the current legislation is *broadly* fit for purpose, stakeholders would like to see more - and particularly more high profile - use of the disqualification powers and there has been some recognition that the schedule of the matters on which disqualification action can be taken is outdated and does not reflect the breadth of misconduct that could give rise to disqualification proceedings. *In extremis* this could result in matters not being considered by the court, when they should be. It also means there is a lack of transparency and a difference between what the law says and what the courts might consider in practice, which risks a perception that not all relevant public interest factors are taken into account when considering whether a director should be disqualified for misconduct. Whilst adding to Sch1 is not widely supported, a simpler recast of the matters determining unfitness currently set out in the CDDA to create a shorter, more generic list of factors would achieve such an update.

37. A greater level of certainty of what factors must be taken into account by the court or the Secretary of State would also assist a director who is facing disqualification proceedings to make the decision as to whether to resist such proceedings or to settle them by means of undertaking.

38. The aims of such a re-cast would be two fold: (i) to rework the matters determining unfitness to move away from a list of precise matters that the court shall have regard to, to a more generic set of factors that the court must take into account, and (ii) to mandate the civil court to consider the matters concerning unfitness in deciding whether and for how long to disqualify an individual, even when a determination of unfitness is not a requirement for a disqualification order.

39. Pursuant to this proposal the matters determining unfitness would be amended to move away from lists of legislation and towards consideration of the materiality of the conduct, culpability of the

individual and the impact of the individual's behaviour. The list of factors will become shorter and more generic and will take into account matters such as:

- Any misfeasance or breach of any fiduciary duty by the director (see paragraph 1 Schedule 1 CDDA).
- Material breaches of legislation by the individual as director (relevant to the role of director, for instance breach of the duties of directors under the Companies Act.
- The extent of the director's responsibility for:
    - any material breach of legislation or sector regulation by the company (whether while solvent or otherwise). This should be legislation relevant to the particular company, such as company, insolvency, employment, health and safety, and environmental law, and other legislation specific to the sector within which the company has operated; and
    - where applicable, the company becoming insolvent or trading past the point when it had become insolvent. This should capture conduct demonstrating reckless or irresponsible behaviour on the part of the director.
- Any previous positions as director of a company that has become insolvent and any relevant aspect of the director's track record in running these companies, including previous disqualifications. Having previously been a director of companies that have failed does not in itself make a director unfit, but it may indicate that the individual is honestly incompetent and therefore unfit to be involved in the management of a company. A director will, of course, be able to present any defence he might have, for instance if he were a business rescue professional.

Cost and Benefits of Option 2

Costs

Costs to public sector

40. As with Option 1 the costs of this option are limited to resource costs of The Insolvency Service in producing the guidance and familiarisation costs incurred by relevant judges.

41. As in Option 1 these costs are **negligible** as the activity will be part of business as usual for The Insolvency Service and judges.

Costs to private sector

42. As in Option 1 and 2 familiarisation costs are likely to be incurred by IPs and Lawyers. These are calculated as in Option 1 on the basis that the proposed change to Sch1 is not substantial and that Sch1 is quite short. It is a simple legal change and should not require any more familiarisation time that reading a leaflet clarifying Sch1 (option 1). **Overall one off costs from this option are therefore expected to be £538K to £1.32m with a mid point of £929K** (see paragraphs 25 to 28).

On going costs

43. It is not expected that the proposal will increase the number of cases that are in scope for an investigation from The Insolvency Service, as the same grounds of 'public interest' will still determine what constitute misconduct and what doesn't. Therefore no ongoing costs are expected from this proposal either to the public or the private sector.

44. No other non-monetised costs are expected from this proposal.

Benefits

45. No transitional benefits are expected from this proposal

On going Benefits – a greater proportion of pre-issue undertakings, resulting in a saving on legal expenditure

46. A greater clarity with respect to the matters the courts or the Secretary of State must take into account when determining unfitness may increase the percentage of directors who settle disqualification proceedings by way of undertaking, without recourse to, often costly, court proceedings.

47. Over recent years, data from The Insolvency Service shows that an average of 1,200 company directors are disqualified each year. Of these, 4% are disqualified following a criminal conviction under s2 CDDA. The remaining 96% of company directors could potentially undertake instead of going to court, but some choose to go to court and then give an undertaking, or await the court's determination of their unfitness.

48. Table 1 indicates how, following disqualification proceedings being taken, directors chose to settle proceedings, and the average legal costs incurred by The Insolvency Service in those cases (based on a sample of cases):

Table 1

	2012-13	**Average legal cost per case**
A) Pre-Issue Undertakings	60%	n/a
B) Post–Issue Undertakings	26%	£19,106
C) Court Orders	14%	£71,690

The average costs of a case were calculated from a sample of 10 cases where the disqualification order was made by the court - costs totalled £716,902 and ranged from £16,461 to £236,708, with a mean of £71,690 (median of £35,132). Analysis of the costs associated with a sample of 9 cases, settled by post issue undertaking, showed that costs totalled £171,957 and ranged from £3,808 to £37,352, with an average of £19,106 (median of £20,562).

49. Regardless of the proposed changes there will still be a proportion of company directors who choose not to undertake initially, or at all. This will include those who wish to defend the proceedings and want matters to progress to court, or directors who do not engage with the process and the disqualification is progressed to court as their views are unknown. With greater clarity brought to the law we would expect that a small number of directors who would otherwise go to court, to see more clearly that the matters they are being disqualified for, would be given weight by the court and may therefore choose to expedite matters by giving an undertaking.

50. Thus, although data is limited, officials estimate the proposed change to Sch1 would affect a fairly low number of directors. For the purposes of this impact assessment we are therefore using an estimated range of 0-15 more directors each year that might choose to undertake earlier than the stage at which they currently settle proceedings. Furthermore it is therefore likely that this increased number of directors who undertake would come from both populations (B and C in Table 1, above) ie (i) some directors who give an undertaking after court proceedings have been issued, may in future choose to settle earlier, before proceedings have been issued, and (ii) some directors who currently wait to go to court may instead choose to settle by undertaking,

51. Table 2 indicates how the company director behaviour may shift if 15 more directors gave an undertaking before proceedings were issued at court. The resulting reduction of directors in populations B and C have been reduced equally.

Table 2

	Current split	Number of disqualifications based on average 1200	Anticipated maximum change	New split from Sch1 proposals
A) Pre-Issue Undertakings	60%	720	+15	735
B) Post–Issue Undertakings	26%	312	-8	304
C) Court Orders	14%	168	-7	161

Cost savings to the taxpayer resulting from increased undertakings

52. An estimate of the legal costs saved in such cases may be calculated by reference to the average costs incurred in those cases (see paragraph 46). Table 3 shows that with a range of 0 to 15 directors choosing to undertake each year, before proceedings are issued at court, there are cost **savings ranging from £0 to £0.69m. At the mid point of numbers of undertakings the savings would be £0.37m**.

Table 3

	0 Directors		(mid point)		15 additional directors	
	Case nos.	**Cost**	**Case nos.**	**Cost**	**Case nos.**	**Cost**
Undertakings (legal costs £0)	720	£0	728	£0	735	£0
Post issue undertaking (£20,794)	312	£6.49m	308	£6.40m	304	£6.32m
Court order (£71,690)	168	£12.04m	164	£11.76m	161	£11.54m
Total	£18.53m		£18.16m		£17.86m	
SAVINGS			£0.37m		£0.69m	

Funding additional Disqualification Actions

53. Internal data from The Insolvency Service indicates that the average cost of an investigation is £35,295. Officials estimate that the conversion rate from investigations to a case that proceeds to a disqualification is approximately 50%. Therefore with a maximum benefit of 15 additional directors each year choosing to undertake before proceedings are issued at court and a consequent saving of £0.69m, this saving could potentially fund (£0.69m/£35K) an additional 20 investigation cases which might result in 10 additional disqualifications.

54. At the midpoint of a saving of £0.37m, this could fund an additional 10 cases (midpoint of the range 0-20 as above) which, on a 50% conversion, might result in an additional 5 disqualifications.

55. In 1999, the NAO undertook a study which quantified the benefits from disqualifying unfit directors[12]. The monetisation of benefits was based on the average debt left in failed companies where there was unfit conduct by directors and the percentage of directors of failed companies who were likely to be involved in a further company failure. The monetisation of impacts explained below is based on this methodology, although internal data from The Insolvency Service has usurped the NAO data in respect of average deficiency, which due to changing economic and credit conditions is estimated to be much greater than in the NAO study.

[12] http://www.official-documents.gov.uk/document/hc9899/hc04/0424/0424.pdf

56. According to this internal data from The Insolvency Service, in 2012-13, the average deficiency in failed companies where one or more directors have been disqualified was **£1.5m**[13] and the estimated probability of subsequent business failure[14] (during a period of disqualification of average length (5.5 years), if that director had not been disqualified) is **7%**.

57. Based on the increased number of disqualifications, the average debt left and the likelihood of further company failures, the overall monetised impact of the proposal is estimated from multiplying the following three factors:

Increased number of disqualifications (10, 5, or 0)	Number of further company failures prevented per disqualification (0.07)	Average deficiency (£1.5m)

58. Calculations have been undertaken on an annual basis for each of the scenarios (that is high -**9** directors per year, middle at **4** directors, low case – **0** directors):

    a. High case scenario - **£1.05m**
    b. Middle case scenario - **£0.52m**
    c. Low case scenario - **£0m**

Distinguishing between the impact and benefits of taking disqualification proceedings

59. Taking the above impacts one stage further, the methodology detailed in the annex indicates that for every disqualification, between 10-20% of its impact is a benefit to the economy. Conversely, 80-90% of its impact is an economic transfer.

60. Essentially a small proportion of disqualifications relate to actions with criminal intent. Where these can be prevented, there is an economic benefit in preventing money moving to the illegal economy.

61. For the remaining disqualification actions, the result is an impact rather than a benefit as the disqualification prevents an inappropriate transfer from creditors to a failed company. When a company fails, the debt left in the company is money that would otherwise be with the company's creditors. The money due to the creditors has been appropriated elsewhere, due to the misconduct of the director

	10% benefit		**15% benefit**		**20% benefit**	
	Benefit	**Transfer**	**Benefit**	**Transfer**	**Benefit**	**Transfer**
High case scenario £1.05m	£105K	£945K	£157.5K	£892.5K	**£210K**	£840K
Middle case scenario £0.52m	£52K	£468K	**£78K**	£442K	£104K	£416K
Low case scenario £0m	**£0**	£0	£0	£0	£0	£0

62. For example, the total impact in the middle case scenario of 5 additional disqualifications, breaks down into a benefit to the economy of £78K and a transfer of the remainder (£0.52m minus £78K) ie £442K.

63. The £78K benefit represents the value to the economy of future misconduct with criminal intent avoided by disqualifying that director, preventing them moving assets to the illegal economy. The best estimate of benefit of £78K is the mid point within a range of £0 to £210K.

Caveat to the analysis

[13] The original NAO calculation used a much lower figure but economic and credit conditions have changed – deficiencies are now greater

[14] Based on a calculation developed as part of the NAO methodology

For simplicity it has been assumed that each case in which disqualification action is taken, will only involve one company director. The Insolvency Service Data indicates that each case includes slightly more and therefore the benefits of this option are likely to be conservative estimates.

Additional non monetised benefits

64. It might also be that directors will now have a better understanding of what could constitute misconduct helping to improve standards of company stewardship to the overall benefit of creditors. However, this would only happen if it is clearly stated in Schedule 1 that the grounds for misconduct are not only restricted to the points above, otherwise the non-monetised costs mentioned above might outweigh any potential 'clarification benefits'.

65. Clarity on what is considered misconduct could also potentially deter some directors who seek professional advice from engaging in misconduct, in particular, when a company is close to encountering financial difficulties.

66. A general better understanding of the grounds for disqualification could help to improve the perception of the enforcement regime thereby increasing confidence in the overall system. This however would only happen if there is a genuine better understanding of what constitutes misconduct.

Rationale and evidence that justify the level of analysis used in the IA (proportionality approach);

67. This is considered to be a **low-risk, low- impact intervention** and therefore the analysis undertaken has mainly focused on identifying the groups affected, describing the impacts and where possible quantifying the effect rather than trying to monetise all costs and benefits. Monetisation of costs and benefits has only been done when data was readily available.

68. The main data constraint in this Impact Assessment, related to the quantification of the benefits of each option. Hard data has been limited on which of the three methods would be more effective in clarifying the legislation for its users. Therefore, benefits for each option have largely been described and the effectiveness of options compared against each other in a descriptive form.

Risks and assumptions;

69. It is considered that the risk that option 2, the preferred option, will not deliver the desired benefits will be negligible as the key to this option is the clarity it will deliver as to the broad nature of the factors the court or the Secretary of State must (as opposed to may) take into account when determining whether an individual is unfit to be concerned in the management of a company. The broad brush approach will serve to simplify any accompanying guidance and, thus, the risks that the costs incurred would be higher than expected would also be negligible.

Direct costs and benefits to business calculations (following OITO methodology);

70. The preferred option is not likely to impose any new direct costs and benefits on existing businesses. Any familiarisation costs to business are in-direct and therefore **out of scope** of OITO as stated in the Better Regulation Framework Manual[15].

Wider impacts

71. Specific Impact Tests:

[15] See page 40: www.gov.uk/government/uploads/system/uploads/attachment_data/file/211981/bis-13-1038-better-regulation-framework-manual-guidance-for-officials.pdf

d. Competition Assessment – the proposed policy will have no impact on competition as the legislative change represents a clarification, as opposed to a change to the substance of, current law.
e. Small Firms Impact Test –there will be familiarisation costs for legal and other professional advisors dealing, together with insolvency practitioners. Some of these will be represented by small firms. However, it is anticipated that any such familiarisation costs will be negligible.
f. Justice - The proposed policy will have no impact on Legal Aid, as it is not available to fund defended disqualification proceedings. As the legislative change represents a clarification, as opposed to a change to the substance of, current law any other effect will be marginal.
g. Sustainable Development - The proposed policy will have no direct impact on sustainable development.
h. Greenhouse Gas assessment - The proposed policy will have no direct impact on greenhouse gas assessments.
i. Other Environment - The proposed policy will have no direct impact on other environmental factors.
j. Health – The proposed policy will have no direct impact health.
k. Equality Impact Assessments - The proposed system will not have an adverse or disproportionate effect on any protected characteristics.
l. Human Rights – The proposed policy will have no impact on any human rights issues as the legislative change represents a clarification, as opposed to a change to the substance of, current law.
m. Rural Proofing - The proposed policy will have no direct impact on Rural Proofing.

Summary and preferred option with description of implementation plan

72. When determining whether a director is unfit, the court must take account of matters set out in Schedule 1 to the CDDA. The Secretary of State (or The Insolvency Service acting on his behalf) is required to have regard to the same matters when deciding whether to accept an offer of an undertaking from a person not to act in the management of any company. Although both legislation and case law have moved on since the enactment of the CDDA, there have been no substantive amendments to Schedule 1; giving rise to the question as to whether it is any longer fit for purpose and, in particular, is transparent about the breadth of misconduct that might lead to disqualification proceedings. Moreover, the list of matters to be taken into account in Schedule 1 is non-exhaustive and the court or the Secretary of State may treat any other conduct not explicitly set out in Schedule 1 as evidencing unfitness.

73. The preferred option, and the one that is in line with stakeholder feedback, is to amend the matters determining unfitness to move towards consideration of the materiality of the conduct, culpability of the individual and the impact of the individual's behaviour, by moving away from a list of precise matters that the court shall have regard to, to a more generic set of factors that the court must take into account.

74. It is therefore intended to legislate as soon as parliamentary time allows to amend the section 9 of and Schedule 1 to the CDDA to provide a broader, more comprehensive iteration of the factors that the Court or The Insolvency Service on behalf of the Secretary of State will have to take into account in determining whether an individual should be disqualified and, if so, for how long.

Annex A

MATTERS FOR DETERMINING UNFITNESS OF DIRECTORS

Part I

Matters Applicable in All Cases

1. Any misfeasance or breach of any fiduciary or other duty by the director in relation to the company.
2. Any misapplication or retention by the director of, or any conduct by the director giving rise to an obligation to account for, any money or other property of the company.
3. The extent of the director's responsibility for the company entering into any transaction liable to be set aside under Part XVI of the Insolvency Act (provisions against debt avoidance).
4. The extent of the director's responsibility for any failure by the company to comply with any of the following provisions of the Companies Act, namely—
    a. section 221 (companies to keep accounting records);
    b. section 222 (where and for how long records to be kept);
    c. section 288 (register of directors and secretaries);
    d. section 352 (obligation to keep and enter up register of members);
    e. section 353 (location of register of members);
    f. section 363 (duty of company to make annual returns);
    g. sections 398 and 703D (duty of company to deliver particulars of charges on its property).
5. The extent of the director's responsibility for any failure by the directors of the company to comply with—
    (a) section 226 or 227 of the Companies Act (duty to prepare annual accounts),
    or
    (b) section 233 of that Act (approval and signature of accounts).

5A. In the application of this Part of this Schedule in relation to any person who is a director of an open-ended investment company, any reference to a provision of the Companies Act is to be taken to be a reference to the corresponding provision of the Open-Ended Investment Companies Regulations 2001 or of any rules made under regulation 6 of those Regulations (Financial Services Authority rules).

Part II

Matters Applicable where Company has become Insolvent

6. The extent of the director's responsibility for the causes of the company becoming insolvent.
7. The extent of the director's responsibility for any failure by the company to supply any goods or services which have been paid for (in whole or in part).
8. The extent of the director's responsibility for the company entering into any transaction or giving any preference, being a transaction or preference—
    (a) liable to be set aside under section 127 or sections 238 to 240 of the Insolvency Act, or
    (b) challengeable under section 242 or 243 of that Act or under any rule of law in Scotland.

9. The extent of the director's responsibility for any failure by the directors of the company to comply with section 98 of the Insolvency Act (duty to call creditors' meeting in creditors' voluntary winding up).

10. Any failure by the director to comply with any obligation imposed on him by or under any of the following provisions of the Insolvency Act—

    (a) section 22 (company's statement of affairs in administration);

    (b) section 47 (statement of affairs to administrative receiver);

    (c) section 66 (statement of affairs in Scottish receivership);

    (d) section 99 (directors' duty to attend meeting; statement of affairs in creditors' voluntary winding up);

    (e) section 131 (statement of affairs in winding up by the court);

    (f) section 234 (duty of any one with company property to deliver it up);

    (g) section 235 (duty to co-operate with liquidator, etc.).

Annex B

The treatment of the impacts of the Insolvency Service disqualification regime

Purpose

- The purpose of the note is to set out a proposed approach to distinguishing misfeasance- from crime-related misconduct, and, therefore, to appropriately appraising the impacts of Insolvency Service director disqualification regime policy measures.

Aligning appraisal with the Home Office approach to estimating the economic impacts of crime

1. Director misconduct, when it results in insolvency of the company controlled by the director, necessitates investigation by The Insolvency Service and subsequent director disqualification.

2. A small proportion of director misconduct is driven by criminal intent; for example, fraudulent trading. Most director misconduct, however, involves civil misfeasance: the breaching of a duty of care, and the improper performance of a legal act.

3. Robust appraisal of the impacts of the disqualification regime should reflect the nature of the types of misconduct which lead to disqualification. Therefore, a nuanced approach to quantifying these impacts is required.

4. The transfer of resources, from one party to another, occurs in many contexts within the legal economy: for example, through social security payments, subsidies or gambling. Such transfers are not generally regarded as a cost to society (or a social benefit, if these transfers of resource are avoided). Crime also involves some similar transfers: for example, property crimes involve a transfer of property from the victim to the offender.

5. In the Home Office approach to appraising the economic impacts of crime and crime prevention, the fundamental distinction between a transfer and a cost to society (or a benefit, if the cost is avoided) is the distinction between a *wanted* and an *unwanted* transfer. A burglary, theft or robbery involves an illegal transfer of property that is *unwanted by one party*, the victim, and therefore the transfer of the property out of the legal economy. The Home Office treats transfers out of the legal economy and into the illegal economy as a cost of crime, and, therefore, the avoidance of such transfers as a benefit.

6. Appraisal of the impacts of The Insolvency Service disqualification regime should align with the approach taken by the Home Office.

7. Where there is criminal intent, the monies and assets (for instance, stocks of intermediate goods) lost to creditors as a result of director misconduct should be assumed to have transferred out of the legal economy and into the illegal economy. Therefore, where misconduct is driven by criminal intent, 'creditor damage' should be treated as a social cost, and the prevention of it - via increased numbers of, or accelerated, director disqualifications - treated as benefit.

8. Meanwhile, where director misconduct is a result of misfeasance, the monies and assets associated with 'creditor damage' should be assumed to have remained within the legal economy. Where misfeasance has occurred, therefore, the prevention of it, and the compensation of creditors for it, should be treated as a transfer.

Determining the extent of misconduct motivated by criminal intent

9. The Insolvency Service collects data on the nature of the director misconduct allegations. Allegations data for the period 2007/08 to 2011/12 (the last year for which a full dataset is readily available from Insolvency Service annual reporting) is presented below (note that each disqualification case may have more than one allegation against a director):

	Year				
Allegation types	**2007/08**	**2008/09**	**2009/10**	**2010/11**	**2011/12**
Crown debts	554	563	816	636	635
Accounting matters	250	381	448	342	200
Transaction to the detriment of creditors	161	246	391	392	161
Criminal matters	101	174	258	259	102
Misappropriation of assets	53	49	68	59	56
Technical matters – statutory obligations	37	46	33	70	52
Trading at a time when company knowingly or unknowingly insolvent	36	44	40	35	7
Phoenix companies or multiple failures	13	14	12	7	2
Other	n/a	n/a	98	n/a	n/a
Total allegations	1205	1517	2164	1800	1215
Total disqualifications	**1145**	**1281**	**1388**	**1437**	**1151**
Proportion of disqualifications resulting from criminal intent	**9%**	**14%**	**19%**	**18%**	**9%**

10. The table shows that, over the period, between 1145 and 1437 directors were disqualified per annum. The proportion of these disqualifications resulting from misconduct with criminal intent – and so, from criminal matters allegations – fluctuated between 9% and 19% in individual years. There were between 101 and 259 allegations of criminal matters per annum over the same period.

11. **Over the period 2007/08 to 2012/13**, when the 110 allegations of criminal matters and the 1031 disqualifications for 2012/13 are added to the data presented in the table above**, the per annum average percentage of disqualifications resulting from allegations of criminal matters** (whether alone or in conjunction with allegations of civil misfeasance) **was 14%**[16].

Implications for the appraisal of disqualification and compensation regime policy measures

12. The size of the loss incurred by creditors as a result of criminal intent is unlikely to be significantly different from that incurred as a result of the actions prompting the other types of misconduct allegations presented in the table above. Therefore, given the figures presented in the table above:

- Approximately 10% to 20% of all director disqualifications – and, therefore, the associated losses imposed on creditors - avoided by the implementation of policy measures are likely to be a result of misconduct driven by criminal intent.

13. Given that the appraisal of the impacts of The Insolvency Service disqualification regime policy measures should align with the Home Office approach to measuring the economic impacts of crime and crime prevention outlined above, this means that:

- Approximately 10% to 20% of the avoided creditor losses incurred as a result of misconduct should be treated as a benefit in the appraisal of disqualification policy measures.

[16] The allegations data presented in the table above are those allegations included in the disqualification reports prepared by the Insolvency Service. A given director may be disqualified as a result of more than one allegation (for instance, failure to pay tax (a Crown debt allegation) and transferring an asset (a misappropriation of assets allegation)). This means that in cases in which the Insolvency Service identifies as having criminal intent, there may also be a civil misfeasance allegation.

14. Conversely, given that they are likely to have stemmed from allegations of misfeasance, rather than criminal matters, 80% to 90% of the avoided creditor losses avoided should be treated as a transfer (from creditor businesses) avoided.

15. Given, as mentioned above, that allegations of misconduct often involve a blend of both criminal matters and misfeasance, the use of a 10% to 20% range in the classification of creditor losses avoided and compensation awards made as a benefit to creditors is likely to be an overestimate. Where this is the case, there is a challenge in uncoupling the effects of criminal matters and misfeasance. Further work should be undertaken to understand how the two combine to result in creditor losses.

Summary

- Any agreed approach to appraising the impacts of The Insolvency Service disqualification measures should be aligned with that of the Home Office in estimating the economic impacts of crime and crime prevention.

- The Home Office approach suggests that *unwanted* transfers between parties should be treated as a social cost, while those avoided should be treated as a benefit.

- The Insolvency Service data on misconduct allegations allows for estimates of the proportions of director misconduct, resulting in disqualification, which is driven by criminal intent (10% to 20%) and misfeasance (80% to 90%).

  Therefore, in appraisal:

- A range, of between 10% to 20%, of the losses associated with the disqualifications avoided under new policy measures should be treated as a benefit to creditor business, rather than a transfer from creditors to miscreant directors.

Title: Widening the scope of material that can be used in director disqualification proceedings **IA No:** BIS INSS008 **Lead department or agency:** The Insolvency Service **Other departments or agencies:** Department for Business, Innovation & Skills	Impact Assessment (IA) **Date: Published 24 April 2014** **Stage: Final** **Source of intervention: Domestic** **Type of measure: Primary legislation** **Contact for enquiries:** Sarah O'Sullivan 020 7291 6766

Summary: Intervention and Options

RPC Opinion: Not Applicable

Cost of Preferred (or more likely) Option

Total Net Present Value	**Business Net Present Value**	**Net cost to business per year** (EANCB on 2009 prices)	**In scope of One-In, Two-Out?**	**Measure qualifies as**
£1.46m	£0m	£0m	No	NA

What is the problem under consideration? Why is government intervention necessary?

Other than in certain narrow circumstances, only The Insolvency Service, acting on behalf of the Secretary of State, has the power to institute company director disqualification proceedings across the wider market. Other regulators will, often at the conclusion of their own enquiries, refer the matter to The Insolvency Service, which may take disqualification action on the basis of 'investigative material'. However, as currently drafted, the legal definition of 'investigative material' is so restrictive as to often require The Insolvency Service to undertake a separate investigation, duplicating enquiries already made, to be able to take disqualification action - incurring unnecessary additional cost.

What are the policy objectives and the intended effects?

To ensure that unacceptable conduct by company directors across the UK economy and particularly in key sectors is tackled expeditiously and using the best possible information.

Government intervention is required as the regulatory failure can only be resolved by an update to existing legislation

What policy options have been considered, including any alternatives to regulation? Please justify preferred option (further details in Evidence Base)

Option 1: Do Nothing
Option 2: (Preferred Option) Widen the legal definition of 'investigative material', within S8(1A) Company Directors Disqualification Act (CDDA) on which The Insolvency Service could rely to bring S8 CDDA disqualification proceedings, to include a more general reference to information gathered by a regulator in the course of bringing a sectoral sanction.

No other options were considered as the current problems arise from the wording of current law, which can only be amended via legislation.

Will the policy be reviewed? It **will not** be reviewed. **If applicable, set review date: Month/Year**

Does implementation go beyond minimum EU requirements?			N/A		
Are any of these organisations in scope? If Micros not exempted set out reason in Evidence Base.	**Micro** No	**< 20** No	**Small** No	**Medium** No	**Large** No
What is the CO_2 equivalent change in greenhouse gas emissions? (Million tonnes CO_2 equivalent)			**Traded: n/a**	**Non-traded: n/a**	

I have read the Impact Assessment and I am satisfied that (a) it represents a fair and reasonable view of the expected costs, benefits and impact of the policy, and (b) that the benefits justify the costs.

Signed by the responsible Minister: Jenny Willott Date: 5 March 2014

Summary: Analysis & Evidence Policy Option 3

Description: Widen the definition of investigative material, on which The Insolvency Service could rely to bring disqualification proceedings against an individual following referral from another regulator

FULL ECONOMIC ASSESSMENT

Price Base Year 2013	PV Base Year 2013	Time Period Years 10	Net Benefit (Present Value (PV)) (£m)		
			Low: 0	High: 4.49	Best Estimate: 1.46

COSTS (£m)	Total Transition (Constant Price)	Years	Average Annual (excl. Transition) (Constant Price)	Total Cost (Present Value)
Low	0		0	**0**
High	0		0	**0**
Best Estimate	£0		£0	**£0**

Description and scale of key monetised costs by 'main affected groups'

There are no additional or new costs to the public sector associated with this option – individual regulators and The Insolvency Service would continue to work together as necessary. This proposal would allow The Insolvency Service to treat a wider variety of information as 'investigative material' and more effectively use material provided by other regulators, to take disqualification action.

Other key non-monetised costs by 'main affected groups'

No other costs have been identified.

BENEFITS (£m)	Total Transition (Constant Price)	Years	Average Annual (excl. Transition) (Constant Price)	Total Benefit (Present Value)
Low	0		£0	**£0**
High	0	N/A	£0.5m	**£4.5m**
Best Estimate	£0		£0.2m	**£1.5m**

Description and scale of key monetised benefits by 'main affected groups'

The widened definition of 'investigative material' is likely to increase the number of S8 disqualifications as it will be more straightforward, quicker and cost effective to bring these on the basis of regulator information. This will free up resource which can be put towards additional investigations. Of those investigations that result in additional disqualifications, there is some benefit in preventing future damage that would otherwise have been caused by the director (see paragraph 44).

Other key non-monetised benefits by 'main affected groups'

Each additional disqualification can protect future creditors from an inappropriate transfer from them to a company that the director might control. There will also be benefits to the wider economy, a deterrent effect on other directors who might otherwise have been tempted to engage in unfit conduct; preventing disqualified directors from initiating misconduct in other sectors and triggering other company failures and helping to improve standards of company stewardship.

Key assumptions/sensitivities/risks **Discount rate (%)** 3.5

1) Regulators will refer all possible cases to The Insolvency Service; 2) The Insolvency Service finds grounds to investigate all cases referred by regulators. 3) Each case only affects one single director and one single company; 4) 80% of cases investigated end up in disqualification; 4) the reduction in costs allows The Insolvency Service to investigate S8 cases with no known effect on other types of investigations.

BUSINESS ASSESSMENT (Option 3)

Direct impact on business (Equivalent Annual) £m:			In scope of OITO?	Measure qualifies as
Costs: £0	Benefits: £0	Net: £0	No	NA

Evidence Base (for summary sheets)

Introduction

The CDDA and Disqualification of Company Directors

The Company Directors Disqualification Act 1986 (CDDA) aims to maintain the integrity of the business environment. Those who become directors of limited companies should:

- Carry out their duties with responsibility; and
- Exercise adequate skill and care with proper regard to the interests of the company's creditors and employees.

The majority of directors do this effectively, but the CDDA is a powerful tool against those who abuse the privilege of limited liability. The CDDA applies not just to persons who are formally appointed as directors but to those who carry out the functions of directors.

The Insolvency Service, on behalf of the Secretary of State has to decide whether it is in the public interest to seek a disqualification order against a director. It receives reports from insolvency practitioners dealing with insolvent companies. It also receives referrals from other regulators in respect of trading companies. Under the Companies Act 1985, The Insolvency Service has the power to investigate trading companies where information it receives suggests corporate abuse; this may include serious misconduct, fraud, scams or sharp practice in the way the company operates. The Insolvency Service is able to ask the court to wind up those companies if the public would be better protected. Under the CDDA (either section 8 if the company is trading, or section 6 if it has become insolvent), The Insolvency Service can then focus on the actions of the directors and bring disqualification proceedings against them if necessary.

Disqualification proceedings are brought by The Insolvency Service on behalf of the Secretary of State for Business, Innovation & Skills. The matter is heard, and decided by the court, unless the Secretary of State accepts a disqualification undertaking from a director. An undertaking has the same legal effect as a court order, but negates the need to go to court.

Under S6, the minimum period of disqualification is 2 years and the maximum 15 years. Under S8 the maximum period of disqualification is 15 years and there is no minimum.

If a company director is disqualified (by court order or by giving an undertaking), unless they have court permission, that person is disqualified for the period stated in the order or undertaking from:

- being a director of a company;
- acting as receiver of a company's property;
- directly or indirectly being concerned or taking part in the promotion, formation or management of a company; or
- being a member of or being concerned or taking part in the promotion, formation or management of a limited liability partnership.
- acting as an insolvency practitioner (IP).

Problem under consideration

1. Whilst The Insolvency Service has broad powers to disqualify company directors, where a company is still trading and information is received from a regulator, unless that information meets the narrow legal definition of 'investigative material,' The Insolvency Service cannot use it as the basis of a disqualification but instead has to re-investigate the matter. This can be a duplication of the regulator's efforts and will lead to delays before action can be taken against a company director.

2. Though confidence in The Insolvency Service's investigation and enforcement regime remains stable, there has been a perception that sometimes directors apparently responsible for major corporate failings have not faced consequences. Individual accountability, particularly at senior levels, is an important part of corporate governance, and has been a central focus of the Parliamentary Commission on Banking Standards (PCBS).

3. Tackling unacceptable conduct by company directors across the UK economy and, particularly, in key sectors depends on enforcement action being taken expeditiously, by those bodies who are best placed to do so (in most cases this will be The Insolvency Service), and using the best possible information. However, a significant barrier to The Insolvency Service taking disqualification action is the limitation imposed by the current legislation upon what material may be used as the basis for the institution of disqualification proceedings.

Detail

4. Due to their specialist expertise, other government bodies that can impose sanctions, and regulators within specific sectors are often best placed to sanction sectoral misconduct and tend to be charged with doing so as part of their remit. Individual regulators have a range of sanctions at their disposal when dealing with individuals and companies operating in their field and these may include the ability to ban individuals from working in their sector for lengthy periods – life in the most egregious cases. However, these regulators have no right to sanction or disqualify a director from the wider market, even where serious misconduct, including breaches of company law, may come to their attention in the course of their enquiries.

5. It might also be the case that a sanction, such as a fine, has been imposed upon a company itself, and a director of that company takes steps or causes the company to take steps to avoid complying with the sanction; thus frustrating the purpose of the regulator's actions. An example of this might be where a director of a company that has been found guilty of employing illegal workers and fined, then liquidates or abandons the company to avoid paying the fine and simply starts up again using a new company vehicle.

6. Under the current system, where a sectoral regulator uncovers breaches beyond their remit, or, having investigated and imposed their own sectoral sanction, considers that the conduct of an individual may justify a wider disqualification, they may refer the matter to The Insolvency Service for consideration of action under S8 CDDA. S8, as currently drafted, enables the Secretary of State (or The Insolvency Service acting on his behalf) to take disqualification action, against a company director, based upon 'investigative material'.

7. However, in practice, this will often mean that, before such action can be taken, The Insolvency Service will need to undertake a further investigation, normally using Companies Act investigation powers, because:

   - The sectoral regulator may not have provided the material necessary to take disqualification action because their enquiries did not concentrate on directorial culpability; and/or
   - The material that has been provided does not fall within the definition of 'investigative material' as provided by S8 CDDA.

8. In undertaking such a further investigation The Insolvency Service might even have to resort to taking the costly route of outsourcing the investigation to a specialist in the particular sector from which the matter was referred in the first place, if the expertise does not exist in-house.

9. Notwithstanding the obvious time lag that can exist between regulatory sanction and action taken by The Insolvency Service, this can lead to a situation whereby, unless the regulator has collected its material under specific provisions, it cannot be used by The Insolvency Service as the basis of an independent S8 CDDA application to disqualify that individual.

10. Practically speaking, this can mean that a director who is barred from working in a specific sector could continue to operate as a director in other sectors, despite the fact that, by breaching sectoral regulations, they may also have breached their duties as a director sufficiently to warrant disqualification.

Rationale for intervention

11. The overarching rationale for intervention is to remove the barriers to timely disqualification action against those directors whose misconduct within a regulated sector has been sufficiently heinous as to be deserving of a market wide ban.

12. In particular the proposal presented in this impact assessment is aimed at making it quicker and more straightforward, in certain specific instances, to disqualify a director once that individual has been shown to have committed a serious breach of sectoral regulations.

A) Addressing a market failure

13. Information asymmetries mean that directors have more information than creditors about their likely future behaviour. And high transaction costs (for example from trying to write the 'perfect contract') can prevent creditors from protecting themselves, inhibiting, in some instances investment from happening.

14. Government action is therefore needed to minimise the unintended consequences of limited liability by achieving a better alignment of incentives and so discouraging directors from misconduct, hence enabling optimal levels of risk-taking and investment in the market.

B) Enhancing the enforcement regime

15. Laws to address general director misconduct, primarily the CDDA, are currently in place. But it is the fair and consistent application and enforcement of these laws that determines the effectiveness in aligning director's incentives.

16. The current enforcement of disqualification law is not without its flaws and omissions. These proposals are aimed at addressing a regulatory failure in the public provision of law enforcement goods and services and therefore increase economic efficiency.

Policy objectives

17. The change proposed to the CDDA is aimed at ensuring that, where directors commit serious breaches of sectoral-specific rules and regulations, which are considered sufficient to warrant a directorial disqualification, they can where appropriate be removed and held to account for their actions within the wider market in the quickest, most cost-effective and efficient way possible.

Description of options considered

Option1: Do Nothing

18. S8(1) CDDA allows for disqualification after investigation of a live (trading) company and states "If it appears to the Secretary of State from investigative material that it is expedient in the public interest that a disqualification order should be made against a person who is, or has been, a director or shadow director of a company, he may apply to the court for such an order."

19. S8(1)(A) then goes on to list a number of statutory provisions under which documents or information need be obtained in order to qualify as investigative material under S8(1). The full list is presented in Annex A.

20. This effectively means that, when dealing with information obtained from other regulators, the SoS may rely only upon information gathered under one of the specified statutory pathways. In practice, other regulators do not always use the powers specified in S8(1)(A) to gather their information and the information provided by others is simply not captured at all – this can mean, in effect, that The Insolvency Service is unable to use the provided information and must re-investigate (using Companies Act powers) before it can take further action – a time-consuming and costly process, even with the material provided by the regulator to assist.

21. At present, individual sectoral regulators have their own specific powers to take enforcement action for breaches of rules of regulations within their sector. The Financial Conduct Authority (FCA), for example, has an extensive enforcement regime, encompassing the following sanctions:

    - Financial Penalty/Public Censure;
    - Suspension/Limitation;
    - Withdrawal of approved status in a particular field from an individual or firm;
    - Prohibition orders (from regulated activities);
    - Injunctions (including asset-freezing);
    - Criminal Prosecutions for market abuse;

22. Of the above, the closest penalty to disqualification available to the FCA would probably be the issuance of a prohibition order – this prohibits the person from performing regulated activities within that specific sector of the market. The scope of the order will depend upon the range of functions the individual concerned performs, the reasons they are not fit and proper and the severity of risk they pose to consumers or the market generally.

23. Where the FCA considers that a disqualification under the CDDA may also be appropriate for an individual, over and above their own sanctions, they may choose to refer the matter to The Insolvency Service for consideration under S8 of the CDDA.

24. In 2012/13 the IS received 39 complaints for consideration under S8 of the CDDA which were registered in its internal database as coming from UK Regulatory Bodies. This is 1.2% of all S8 complaints received in that year. The Insolvency Service then decided on the merits of each case whether to investigate it or not.

25. In the following year (2013-14) The Insolvency Service began to receive notifications of companies which had been sanctioned by the UK Border Agency (UKBA) and it started to track these against subsequent conduct reports from Insolvency Practitioners, where there had been a subsequent insolvency. As a result of this, one S6 disqualification was achieved on a principal allegation relating to the UKBA action and it is anticipated that there will be more in the future. Currently if UKBA made a referral in a live trading company, a Companies Act investigation would commence but would have to duplicate much of the work already carried out, given the restrictive definition of 'investigative materials' Therefore the likely increase in referrals from UKBA will potentially have a significant negative impact on resource.

26. Internal costs data from The Insolvency Service suggests that the average cost per case of an investigation undertaken under the Companies Act (i.e. a confidential 'live' company investigation) is £47,309, almost double the average cost of a 'disqualification only' investigation together with ensuing enforcement action which is £24,591 per case (based on analysis of the cost of an in-house investigation and taking enforcement action under S6 CDDA). Having to re-investigate matters that are referred is therefore not the most efficient use of resource.

Option 2: Amend S8 of the Company Director Disqualification Act

27. This option would amend S8 of the CDDA to widen the definition of 'investigative material', on which The Insolvency Service could rely to bring disqualification proceedings against an individual, following referral from another regulator. Under this option The Insolvency Service would continue to be responsible for bringing disqualification proceedings. However, in order to maximise the ability to achieve more expeditious disqualifications, there would also need to be greater collaboration and joined-up working between The Insolvency Service and sectoral regulators, which The Insolvency Service is actively progressing.

28. The scope of S8(1)(A) could be broadened considerably, either by widening the definition of investigative material or simply eliminating the strict definition of 'investigatory material' with the effect that The Secretary of State (or The Insolvency Service on behalf of the Secretary of State) could make the decision to institute disqualification proceedings based on any information that has been lawfully obtained.

29. There is an inherent risk in such a wide definition that The Insolvency Service would, as is sometimes the case at present, receive from other regulators material that fails to reach clear conclusions as to whether the behaviour highlighted was a material or serious breach of industry regulation. There is a risk that The Insolvency Service could simply be passed incomplete or otherwise unclear material and would be faced with conducting its own investigation if considered appropriate to do so, with the attendant resourcing and other implications, such as lack of specialist knowledge necessitating contracting-in specialist staff, staleness where time has passed since the original regulatory enquiry and simple insufficiency of detail to reach the threshold required in disqualification action.

30. Such a danger can be mitigated by a closer, more joined up approach between The Insolvency Service and sectoral regulators and it is intended that as part of a process to improve collaboration and the more effective use of information within the overall system, The Insolvency Service will explore the use of joint investigations in appropriate cases. This will involve early engagement with other sectoral regulators, through intelligence systems to ensure there is joint planning and participation between regulatory functions from the outset. In complex cases The Insolvency Service will also consider whether staff secondments might be used to ensure the body leading on the investigation has access to whatever skills are needed to take the most effective enforcement action.

31. Option 2 would allow The Insolvency Service to utilise a far broader range of material provided by regulators, to bring potential disqualification actions and could eliminate the need to conduct a separate and potentially duplicate Companies Act enquiry. Similarly it could eliminate the need to wait for a report from an Insolvency Practitioner before taking action under S6 CDDA in such cases, as at present. Where the individual regulator has already found there to be a serious breach of sectoral regulation, The Insolvency Service can use that finding to form the basis of any disqualification action.

Costs of Option 2

Cost to the public sector

32. No significant additional costs to the public sector are expected as both The Insolvency Service and the sectoral regulators would continue with business as usual.

Costs to businesses

33. Companies employing directors who are found to have engaged in misconduct, will generally have removed and replaced them (if necessary) once the sectoral regulator has taken action. Therefore there will not be any additional costs associated with replacing a director following market wide disqualification action taken by The Insolvency Service.

Monetised Impact and Benefits of Option 2

Benefits to creditors - preventing further economic damage caused by company directors

34. The main impact of taking disqualification action against company directors is the protection of future creditors from that director engaging in misconduct again. The calculations below show the impact upon creditors that will be prevented if additional directors are disqualified under this proposal. Note that most of the monetised impact is a transfer. When a company fails, the debt left in the company is money that would otherwise be with the company's creditors. The money due to the creditors has been appropriated elsewhere, due to the misconduct of the director. Additional disqualifications will prevent future damage to those creditors, in that the disqualified director will not be able to act in a way to cause that transfer of money from creditors. Some of the impact is a benefit as some of the transfer from directors might be to the illegal economy and preventing that transfer by disqualification, is a benefit to the economy.

35. Cost data from The Insolvency Service, covering 2011/12 to 2012/13 indicates that the average cost of a Companies Act investigation into a trading company is £47,309. The average cost of an investigation into an insolvent company (following receipt of a statutory conduct return from the insolvency practitioner dealing with the case) is £24,591. Therefore a S6 insolvent investigation costs £22,718 less than a Companies Act investigation.

36. If S8 CDDA was widened so that information referred from regulators could be used as the basis for taking disqualification against company directors, rather than having to reinvestigate, we can assume that the average cost of investigation would drop considerably. We estimate that for each referral from another regulator, the new cost of investigation would be more comparable to a S6 investigation i.e. for each referral, following S8 CDDA being changed, we would save £22,718 per investigation compared to current costs.

37. In 2012/13 there were 309 Companies Act investigations of which 39 were started following a referral from the Financial Conduct Authority. The Insolvency Service is actively working to improve its relationships with regulators in terms of sharing information. This coupled with this proposed change to better use the information that regulators provide, is likely to lead to an increase in referrals from other regulators. It is difficult to say exactly how many and therefore we will use an estimated range of 0 to 39 additional referrals per year, with a mid point of 20 referrals per year, (on top of the ones currently received).

38. With reduced investigation costs, depending on the number of referrals received, The Insolvency Service would be able to free up resources which it could divert to other disqualification investigations (number of referrals multiplied by the reduced cost of £22,718).

Table 1: Freed up resource from lower cost investigations

Low impact:	0 referrals,	£0 freed up resource
Medium impact:	20 referrals,	£454,360 freed up per year
High impact:	39 referrals,	£886,002 freed up per year

39. Data on investigations, including in-house and those that might be passed out to solicitors to progress, shows the average cost to be £35,295. With the freed up resource calculated above, there would be additional investigations that could be taken forward and eventually additional company directors that would be disqualified. If £454K were freed up, this could potentially fund 13 additional investigations (£454K/£35K). If £886K was freed up, this could potentially fund 25 additional investigations.

40. Data is limited on conversion rates from referrals, but they seem to have quite a high conversion rate from initial investigation to disqualification action, estimated by officials to be approximately 80%. If a regulator has found misconduct in a company it is much more likely to warrant sector wide disqualification, compared to complaints received from other sources which may not meet the criteria and public interest tests for disqualification action. Assuming a 100% investigation rate of those referrals, we have estimated a conversion range of 70% to 90% disqualification orders resulting from those investigations.

Table 2: Additional Disqualifications that might be obtained

	Low Impact (0 investigations)	Medium Impact (13 investigations)	High Impact (25 investigations)
High Conversion (90%)	0	12	**23**
Medium Conversion (80%)	0	**10**	20
Low conversion (70%)	**0**	9	18

Prevention of Further Economic Damage

41. In 1999, the NAO undertook a study which quantified the benefits from disqualifying unfit directors . The monetisation of benefits was based on the average debt left in failed companies where there was unfit conduct by directors and the percentage of directors of failed companies who were likely to be involved in a further company failure. The monetisation of the benefits explained below is based on this methodology, although it should be noted that the average debt left in failed companies has substantially increased, and the NAO figures have been usurped by data from The Insolvency Service.

42. According to The Insolvency Service's internal data, in 2012-13, the average deficiency in failed companies where one or more directors have been disqualified was £1.5m and the estimated percentage of subsequent failures is 0.07 .

43. Based on the increased number of disqualifications, the average debt left and the likelihood of further company failures, the overall monetised impact of the proposal is calculated by multiplying the additional number of disqualifications (23,10 or 0):by the number of further copany failures prevented (0.07) by the average deficiency (£1.5m)

    Calculations have been undertaken on an annual basis for each of the scenarios (that is high case – 23 cases per year, middle case – 10 cases, low case – 0 cases). :

    High case scenario £2.41m

    Middle case scenario - £1.05m

    Low case scenario - £0m

Distinguishing between the impact and benefits of taking disqualification proceedings

44. Taking the above impacts one stage further, the methodology detailed in Annex B indicates that for every disqualification, between 10-20% of its impact is a benefit to the economy. Conversely, 80-90% of its impact is an economic transfer. Essentially a small proportion of disqualifications relate to actions with criminal intent. Where these can be prevented, there is an economic benefit in preventing money moving to the illegal economy. For the remaining disqualification actions, the result is an impact rather than a benefit as the disqualification prevents an inappropriate transfer from creditors to a failed company.

	10% benefit		**15% benefit**		**20% benefit**	
	Benefit	**Transfer**	**Benefit**	**Transfer**	**Benefit**	**Transfer**
High case scenario £2.41m	£241K	£2.17m	£361.5K	£2.05m	£**482K**	£1.93m
Middle case scenario £1.05m	£105K	£0.945m	£**157.5K**	£0.89m	£210K	£0.84m
Low case scenario £0m	**£0**	£0	£0	£0	£0	£0

45. For example, the total impact in the middle case scenario of 10 additional disqualifications, breaks down into a benefit to the economy of £157.5K and a transfer of the remainder (£1.05m minus £157.5K) i.e. £0.89m.

46. The £157.5K benefit represents the value to the economy of future misconduct with criminal intent avoided by disqualifying that director, preventing them moving assets to the illegal economy. The best estimate of benefit is £157.5K, which is the mid point within a range of £0 to £482K.

Caveats to the analysis

47. In order for these figures to stand, the following assumption has been used:

    For simplicity, it has been assumed that each case referred by a regulator will only involve one director, but as The Insolvency Service data indicates that each case in which a disqualification is obtained includes more than one director, the benefits of this option are likely to be conservative estimates.

Non – monetised Benefits of Option 2

48. The primary rationale for the policy proposal is to address the perception that sometimes directors apparently responsible for major corporate failings have not faced consequences; with the concomitant effect upon confidence in the corporate regime, any action that will serve to address that perception should serve to increase trust in the regime. The quantum of additional cases would not be the primary issue in this respect but rather the proper and well publicised enforcement of significant cases of which the general public have become aware.

49. There will also be non-monetised benefits to the wider economy arising from additional disqualifications of directors; publicising disqualifications can contribute to a deterrent effect on other directors who might otherwise have been tempted to engage in unfit conduct; by disqualifying an additional number of directors, we also prevent them from initiating misconduct in other sectors and triggering other company failures – whereby the debts left in a failed company have a knock on effect on the viability of its creditors.

Risks and assumptions;

50. The key risks to option 2 (the preferred option) delivering the desired benefits will be around the level of co-operation between sectoral regulators and The Insolvency Service and the willingness of the courts to make disqualification orders based on the information provided by the sectoral regulator alone (albeit marshalled into a disqualification application by The Insolvency Service). The latter risk will be greatly mitigated by another proposed change to Schedule 1 of the CDDA (matters determining unfitness) under which the court will have to take into account sectoral breaches and breaches of domestic and overseas legislation in determining unfitness.

51. The preferred option above is unlikely to generate a significant impact on the overall number of disqualifications. The Insolvency Service disqualifies on average 1,200 directors each year and any increase in this number will be achieved by driving down the cost of disqualifications obtained under S8 CDDA, thus freeing finite resources for further disqualification action

Direct costs and benefits to business calculations (following OITO methodology);

52. The preferred option is not likely to impose any new direct costs and benefits on existing businesses. Any familiarisation costs to business are in-direct and therefore out of scope of OITO as stated in the Better Regulation Framework Manual.

Wider impacts

Specific Impact Tests:

Competition Assessment – the proposed policy will have no impact on competition as the legislative change enhances rather than changes the substance of current law.

Small Firms Impact Test –there may be familiarisation costs for legal and other professional advisors instructed by defendants to proceedings. Some of these will be represented by small firms. However, it is anticipated that any such familiarisation costs will be negligible.

Justice - The proposed policy will have no impact on Legal Aid, as it is not available to fund defended disqualification proceedings. As the legislative change represents a clarification, as opposed to a change to the substance of, current law any other effect will be marginal.

Sustainable Development - The proposed policy will have no direct impact on sustainable development.

Greenhouse Gas assessment - The proposed policy will have no direct impact on greenhouse gas assessments.

Other Environment - The proposed policy will have no direct impact on other environmental factors.

Health – The proposed policy will have no direct impact health.

Equality Impact Assessments - The proposed system will not have an adverse or disproportionate effect on any person as a consequence of race, ethnic origin, religion, gender or sexual orientation.

Human Rights – The proposed have no impact on any human rights issues as the legislative change represents a clarification, as opposed to a change to the substance of, current law.

Rural Proofing - The proposed policy will have no direct impact on Rural Proofing.

Summary and preferred option with description of implementation plan

53. Tackling unacceptable conduct by company directors across the UK economy and particularly in key sectors depends on enforcement action being taken expeditiously, by those bodies who are best placed to do so, and using the best possible information. This can best be achieved by removing discontinuities in the current system.
54. It is intended to legislate as soon as parliamentary time allows to amend the relevant sections of the Company Directors Disqualification Act and Companies Acts to allow investigators acting on behalf of the Secretary of State to make greater use of information provided by other regulators.

ANNEX A

CDDA S8 Investigative material provisions:

(1A)"Investigative material" means—

(a)a report made by inspectors under—

(i)section 437 of the Companies Act 1985;
(ii)section 167, 168, 169 or 284 of the Financial Services and Markets Act 2000; or
(iii)where the company is an open-ended investment company (within the meaning of that Act) regulations made as a result of section 262(2)(k) of that Act; and

(b)information or documents obtained under—

(i)section 447 or 448 of the Companies Act 1985;
(ii)section 2 of the Criminal Justice Act 1987;
(iii)section 28 of the Criminal Law (Consolidation)(Scotland) Act 1995;
(iv)section 83 of the Companies Act 1989; or
(v)section 165, 171, 172, 173 or 175 of the Financial Services and Markets Act 2000.

Annex B

The treatment of the impacts of the Insolvency Service disqualification regime

Purpose

- The purpose of the note is to set out a proposed approach to distinguishing misfeasance- from crime-related misconduct, and, therefore, to appraising appropriately the impacts of The Insolvency Service director disqualification regime policy measures.

Aligning appraisal with the Home Office approach to estimating the economic impacts of crime

1. Director misconduct, when it results in insolvency of the company controlled by the director, necessitates investigation by The Insolvency Service and subsequent director disqualification.

2. A small proportion of director misconduct is driven by criminal intent; for example, fraudulent trading. Most director misconduct, however, involves civil misfeasance: the breaching of a duty of care, and the improper performance of a legal act.

3. Robust appraisal of the impacts of the disqualification regime should reflect the nature of the types of misconduct which lead to disqualification. Therefore, a nuanced approach to quantifying these impacts is required.

4. The transfer of resources, from one party to another, occurs in many contexts within the legal economy: for example, through social security payments, subsidies or gambling. Such transfers are not generally regarded as a cost to society (or a social benefit, if these transfers of resource are avoided). Crime also involves some similar transfers: for example, property crimes involve a transfer of property from the victim to the offender.

5. In the Home Office approach to appraising the economic impacts of crime and crime prevention, the fundamental distinction between a transfer and a cost to society (or a benefit, if the cost is avoided) is the distinction between a *wanted* and an *unwanted* transfer. A burglary, theft or robbery involves an illegal transfer of property that is *unwanted by one party*, the victim, and therefore the transfer of the property out of the legal economy. The Home Office treats transfers out of the legal economy and into the illegal economy as a cost of crime, and, therefore, the avoidance of such transfers as a benefit.

6. Appraisal of the impacts of The Insolvency Service disqualification regime should align with the approach taken by the Home Office.

7. Where there is criminal intent, the monies and assets (for instance, stocks of intermediate goods) lost to creditors as a result of director misconduct should be assumed to have transferred out of the legal economy and into the illegal economy. Therefore, where misconduct is driven by criminal intent, 'creditor damage' should be treated as a social cost, and the prevention of it - via increased numbers of, or accelerated, director disqualifications - treated as benefit.

8. Meanwhile, where director misconduct is a result of misfeasance, the monies and assets associated with 'creditor damage' should be assumed to have remained within the legal economy. Where misfeasance has occurred, therefore, the prevention of it, and the compensation of creditors for it, should be treated as a transfer.

Determining the extent of misconduct motivated by criminal intent

9. The Insolvency Service collects data on the nature of the director misconduct allegations. Allegations data for the period 2007/08 to 2011/12 (the last year for which a full dataset is readily available from Insolvency Service annual reporting) is presented below (note that each disqualification case may have more than one allegation against a director):

	Year				
Allegation types	**2007/08**	**2008/09**	**2009/10**	**2010/11**	**2011/12**
Crown debts	554	563	816	636	635
Accounting matters	250	381	448	342	200
Transaction to the detriment of creditors	161	246	391	392	161
Criminal matters	101	174	258	259	102
Misappropriation of assets	53	49	68	59	56
Technical matters – statutory obligations	37	46	33	70	52
Trading at a time when company knowingly or unknowingly insolvent	36	44	40	35	7
Phoenix companies or multiple failures	13	14	12	7	2
Other	n/a	n/a	98	n/a	n/a
Total allegations	**1205**	**1517**	**2164**	**1800**	**1215**
Total disqualifications	**1145**	**1281**	**1388**	**1437**	**1151**
Proportion of disqualifications resulting from criminal intent	**9%**	**14%**	**19%**	**18%**	**9%**

10. The table shows that, over the period, between 1145 and 1437 directors were disqualified per annum. The proportion of these disqualifications resulting from misconduct with criminal intent – and so, from criminal matters allegations – fluctuated between 9% and 19% in individual years. There were between 101 and 259 allegations of criminal matters per annum over the same period.

11. **Over the period 2007/08 to 2012/13**, when the 110 allegations of criminal matters and the 1031 disqualifications for 2012/13 are added to the data presented in the table above**, the per annum average percentage of disqualifications resulting from allegations of criminal matters** (whether alone or in conjunction with allegations of civil misfeasance) **was 14%**[17].

Implications for the appraisal of disqualification and compensation regime policy measures

12. The size of the loss incurred by creditors as a result of criminal intent is unlikely to be significantly different from that incurred as a result of the actions prompting the other types of misconduct allegations presented in the table above. Therefore, given the figures presented in the table above:

- Approximately 10% to 20% of all director disqualifications – and, therefore, the associated losses imposed on creditors - avoided by the implementation of policy measures are likely to be a result of misconduct driven by criminal intent.

13. Given that the appraisal of the impacts of The Insolvency Service disqualification regime policy measures should align with the Home Office approach to measuring the economic impacts of crime and crime prevention outlined above, this means that:

[17] The allegations data presented in the table above are those allegations included in the disqualification reports prepared by the Insolvency Service. A given director may be disqualified as a result of more than one allegation (for instance, failure to pay tax (a Crown debt allegation) and transferring an asset (a misappropriation of assets allegation)). This means that in cases in which the Insolvency Service identifies as having criminal intent, there may also be a civil misfeasance allegation.

- Approximately 10% to 20% of the avoided creditor losses incurred as a result of misconduct should be treated as a benefit in the appraisal of disqualification policy measures.

14. Conversely, given that they are likely to have stemmed from allegations of misfeasance, rather than criminal matters, 80% to 90% of the avoided creditor losses avoided should be treated as a transfer (from creditor businesses) avoided.

15. Given, as mentioned above, that allegations of misconduct often involve a blend of both criminal matters and misfeasance, the use of a 10% to 20% range in the classification of creditor losses avoided and compensation awards made as a benefit to creditors is likely to be an overestimate. Where this is the case, there is a challenge in uncoupling the effects of criminal matters and misfeasance. Further work should be undertaken to understand how the two combine to result in creditor losses.

Summary

- Any agreed approach to appraising the impacts of The Insolvency Service disqualification measures should be aligned with that of the Home Office in estimating the economic impacts of crime and crime prevention.

- The Home Office approach suggests that *unwanted* transfers between parties should be treated as a social cost, while those avoided should be treated as a benefit.

- The Insolvency Service data on misconduct allegations allows for estimates of the proportions of director misconduct, resulting in disqualification, which is driven by criminal intent (10% to 20%) and misfeasance (80% to 90%).

  Therefore, in appraisal:

- A range, of between 10% to 20%, of the losses associated with the disqualifications avoided under new policy measures should be treated as a benefit to creditor business, rather than a transfer from creditors to miscreant directors.

Title: Extending the time limit for director disqualification proceedings under the CDDA **IA No:** BIS INSS006 **Lead department or agency:** The Insolvency Service **Other departments or agencies:** Department for Business, Innovation & Skills	Impact Assessment (IA) **Date: Published 24 April 2014** **Stage: Final** **Source of intervention: Domestic** **Type of measure: Primary legislation** **Contact for enquiries:** Sarah O'Sullivan 020 7291 6766

Summary: Intervention and Options

RPC Opinion: Not Applicable

Cost of Preferred (or more likely) Option

Total Net Present Value	Business Net Present Value	Net cost to business per year (EANCB on 2009 prices)	In scope of One-In, Two-Out?	Measure qualifies as
£1.36m	N/A	N/A	No	NA

What is the problem under consideration? Why is government intervention necessary?

Current law requires The Insolvency Service to commence (issue) company director disqualification proceedings within two years of the date of the insolvency. In most cases the current time limit is sufficient. However more time may be required in a complex case, or one where evidence is discovered late. The Court can grant leave to issue proceedings out of time, to give additional investigation time, but will only do so in exceptional circumstances. Further, if investigations have concluded and pre-issue negotiations with a defendant are protracted, proceedings must be issued 'protectively' in order not to breach the statutory time limit - thereby incurring otherwise unnecessary legal costs.

What are the policy objectives and the intended effects?

The overarching policy objective is to ensure that The Insolvency Service on behalf of the Secretary of State has sufficient opportunity to bring disqualification proceedings in circumstances where it is in the public interest to do so. The intention is to allow additional time for investigation in large or complex cases, to allow greater scope to consider 'late' evidence and to reduce the need for The Insolvency Service to issue proceedings protectively, which imposes some costs.

What policy options have been considered, including any alternatives to regulation? Please justify preferred option (further details in Evidence Base)

Three policy options were considered:

1. Amending the S7(2) CDDA discretionary power of the Court to grant 'out of time' applications
2. Removing time limits entirely from the section;
3. Expanding the current time limit from two, to three, years. (Preferred option)

The preferred option has been chosen as representing the best balance between The Insolvency Service's requirements, the costs to the parties involved and the prevailing views of stakeholders in the consultation. Extending the existing limit by one year will provide benefits ameliorating the issues identified above. It is not considered that option 1 would provide sufficient benefit and option 2 is too far out of step with stakeholder views, as it could be oppressive to company directors to have potential disqualification proceedings hanging over them for an unlimited time period.

Will the policy be reviewed? It **will** be reviewed. **If applicable, set review date: 04/2020**

Does implementation go beyond minimum EU requirements?			N/A		
Are any of these organisations in scope? If Micros not exempted set out reason in Evidence Base.	**Micro** No	**< 20** No	**Small** No	**Medium** No	**Large** No
What is the CO_2 equivalent change in greenhouse gas emissions? (Million tonnes CO_2 equivalent)			**Traded: n/a**	**Non-traded: n/a**	

I have read the Impact Assessment and I am satisfied that (a) it represents a fair and reasonable view of the expected costs, benefits and impact of the policy, and (b) that the benefits justify the costs.

Signed by the responsible Minister: Jenny Willott Date: 5 March 2014

Summary: Analysis & Evidence Policy Option 4

Description: To replace the existing S7(2) CDDA with an expanded discretionary power allowing the Court to decide on whether to allow proceedings to be issued out of time

FULL ECONOMIC ASSESSMENT

Price Base Year 2013	PV Base Year 2013	Time Period Years 10	Net Benefit (Present Value (PV)) (£m)		
			Low: -2.24	High: 7.04	Best Estimate: -0.68

COSTS (£m)	Total Transition (Constant Price)	Years	Average Annual (excl. Transition) (Constant Price)	Total Cost (Present Value)
Low	unknown	N/A	0	**0**
High	unknown		£0.24m	**£2.2m**
Best Estimate	£0		£0.12m	**£1.1m**

Description and scale of key monetised costs by 'main affected groups'

Legal costs incurred by The Insolvency Service to deal with out of time applications, per case, estimated at 40K, with a range of zero to six potential cases i.e. £0K to £240K with a mid point of £120K.

Other key non-monetised costs by 'main affected groups'

Initial familiarisation costs to judges. These are expected to be negligible as judges are already familiar with the legislation.
Increased ongoing costs to The Insolvency Service to investigate those cases where an extension is needed.

BENEFITS (£m)	Total Transition (Constant Price)	Years	Average Annual (excl. Transition) (Constant Price)	Total Benefit (Present Value)
Low	0	n/a	0	**0**
High	0		£0.8m	**£7.0m**
Best Estimate	£0		£0.1m	**£0.4m**

Description and scale of key monetised benefits by 'main affected groups'

There will be additional disqualifications from a range of zero to six cases. A best estimate is that (in two cases) three directors will be disqualified. For each disqualification there is an estimated benefit of preventing future transfers of assets to the illegal market (see Annex), from £0 to £756K with a best estimate of £47K

Other key non-monetised benefits by 'main affected groups'

There might be wider benefits from increased confidence in the system stemming from The Insolvency Service having greater flexibility to investigate larger, more complex cases.
There will be additional disqualifications from a range of zero to six cases. A best estimate is that (in two cases) three directors will be prevented from causing future unfair transfers from creditors.

Key assumptions/sensitivities/risks **Discount rate (%)** 3.5

As this option still allows for judicial discretion, it is a risk that despite a greater number of applications for leave to issue out of time, they may not all be granted by the court, hence a best estimate of two cases rather than a mid range of three, lower than the other options presented.
It is assumed that all additional cases in which leave is granted will result in disqualification

BUSINESS ASSESSMENT (Option 4)

Direct impact on business (Equivalent Annual) £m:			In scope of OITO?	Measure qualifies as
Costs: 0.1	**Benefits: 0**	**Net: -0.1**	No	NA

Summary: Analysis & Evidence Policy Option 5

Description: To eliminate the time limit entirely from bringing disqualification proceedings against a company director

FULL ECONOMIC ASSESSMENT

Price Base Year 2013	PV Base Year 2013	Time Period Years 10	Net Benefit (Present Value (PV)) (£m)		
			Low: 0.33	High: 8.12	Best Estimate: 1.36

COSTS (£m)	Total Transition (Constant Price)	Years	Average Annual (excl. Transition) (Constant Price)	Total Cost (Present Value)
Low	0	N/A	N/A	**N/A**
High	0		N/A	**N/A**
Best Estimate	£0		£0	**£0**

Description and scale of key monetised costs by 'main affected groups'

No costs have been monetised. No transition costs are expected from this proposal.

Other key non-monetised costs by 'main affected groups'

There might be increased costs to The Insolvency Service from longer investigations. These are likely to be small as the pool of cases where longer investigations are required is small. There might be costs to directors from having proceedings hanging over their heads for an undefined period of time. This would potentially represent a breach of human rights, which might increase the number of litigations by directors subject to investigations

BENEFITS (£m)	Total Transition (Constant Price)	Years	Average Annual (excl. Transition) (Constant Price)	Total Benefit (Present Value)
Low	0	N/A	£0.04m	**£0.3m**
High	0		£1.0m	**£8.1m**
Best Estimate	£0		£0.2m	**£1.4m**

Description and scale of key monetised benefits by 'main affected groups'

(1)Cost savings to The Insolvency Service from not having to issue 'protective' proceedings - £35,340 a year (2) and from not having to apply for leave to issue out of time (currently 0-2 cases per year at £40K each i.e. a range of £0 to £80K per year with a mid point of £40K) and (3) For each disqualification there is an estimated benefit of preventing future transfers of assets to the illegal market (see Annex), from £0 to £756K with a best estimate of £71K.

Other key non-monetised benefits by 'main affected groups'

There will be a range of zero to nine additional directors disqualified, preventing future unfair transfers from creditors to the company they would otherwise have controlled.

There might be wider benefits from the public having increased confidence in the enforcement system stemming from The Insolvency Service having greater flexibility to investigate larger, more complex cases.

Key assumptions/sensitivities/risks **Discount rate (%)** 3.5

The key risk with this option is that directors might litigate against The Insolvency Service for breaches of human rights, in particular in the case of very long investigations. Furthermore, having proceedings ongoing indefinitely risks reducing the economic output from those directors under investigation.

It is assumed that all additional cases will result in disqualification.

BUSINESS ASSESSMENT (Option 5)

Direct impact on business (Equivalent Annual) £m:			In scope of OIOO?	Measure qualifies as
Costs: 0	**Benefits: 0**	**Net: 0**	No	NA

Summary: Analysis & Evidence Policy Option 6

Description: An expanded three year period in which to bring disqualification proceedings – Preferred Option

FULL ECONOMIC ASSESSMENT

Price Base Year 2013	PV Base Year 2013	Time Period Years 10	Net Benefit (Present Value (PV)) (£m)		
			Low: 0.33	High: 8.12	Best Estimate: 1.36

COSTS (£m)	Total Transition (Constant Price)	Years	Average Annual (excl. Transition) (Constant Price)	Total Cost (Present Value)
Low	N/A	N/A	N/A	**N/A**
High	N/A		N/A	**N/A**
Best Estimate	Unknown		Unknown	**Unknown**

Description and scale of key monetised costs by 'main affected groups'

No costs have been monetised – please see evidence base.

Other key non-monetised costs by 'main affected groups'

No transition costs are expected to The Insolvency Service. There might be some familiarisation costs to Courts, but these are expected to be negligible given that the proposed change in legislation is very limited and straightforward. These have not been monetised. Those investigations that take longer will have a higher than average cost. However, the overall number of investigations lasting more than 2 years is likely to be very small.

BENEFITS (£m)	Total Transition (Constant Price)	Years	Average Annual (excl. Transition) (Constant Price)	Total Benefit (Present Value)
Low	0	N/A	£0.04m	**£0.3m**
High	0		£1.0m	**£8.1m**
Best Estimate	£0		£0.2m	**£1.4m**

Description and scale of key monetised benefits by 'main affected groups'

(1)Cost savings to The Insolvency Service from not having to issue 'protective' proceedings - £35,340 a year (2) and from not having to apply for leave to issue out of time (currently 0-2 cases per year at £40K each i.e. a range of £0 to £80K per year with a mid point of £40K) and (3) For each disqualification there is an estimated benefit of preventing future transfers of assets to the illegal market (see Annex) from £0 to £756K with a best estimate of £71K.

Other key non-monetised benefits by 'main affected groups'

There might be wider benefits from increased confidence in the system stemming from The Insolvency Service having greater flexibility to investigate larger, more complex, cases.

There will be a range of zero to nine additional directors disqualified, preventing a future unfair transfers from creditors to the company they would otherwise have controlled.

Key assumptions/sensitivities/risks **Discount rate (%)** 3.5

It has been assumed that 20 cases is representative of the cases that need issuing protectively each year. It is assumed that all additional cases will result in disqualification. A risk with this option is that the 3 year limitation period solves the issue for some of cases but not all of them. It is not anticipated, but it is possible that In some occasions a longer period is still potentially needed. For these cases, The Insolvency Service will still be able to apply to the court for leave to issue 'out of time' beyond three years.

BUSINESS ASSESSMENT (Option 6)

Direct impact on business (Equivalent Annual) £m:			In scope of OIOO?	Measure qualifies as
Costs: 0	**Benefits: 0**	**Net: 0**	No	NA

Evidence Base (for summary sheets)

Introduction

The CDDA and Disqualification of Company Directors

The Company Directors Disqualification Act 1986 (CDDA) aims to maintain the integrity of the business environment. Those who become directors of limited companies should:

- carry out their duties with responsibility; and
- exercise adequate skill and care with proper regard to the interests of the company's creditors and employees.

The majority of directors do this effectively, but the CDDA is a powerful tool against those who abuse the privilege of limited liability. The CDDA applies not just to persons who are formally appointed as directors but to those who carry out the functions of directors.

If there is any unfit conduct in an insolvent company, then the liquidator, administrative receiver, administrator or official receiver has a duty to send the Secretary of State for Business, Innovation & Skills a report on the conduct of all directors who were in office in the last 3 years of the company's trading.

The Insolvency Service, on behalf of the Secretary of State, has to decide whether it is in the public interest to seek a disqualification order against a director.

The proceedings are brought by the Secretary of State or, usually in compulsory winding-up cases, by the official receiver at the direction of the Secretary of State. The matter is heard, and decided by the court, unless the Secretary of State accepts a disqualification undertaking from a director. An undertaking has the same legal effect as a court order, but negates the need to go to court.

The minimum period of disqualification is 2 years and the maximum 15 years.

If a company director is disqualified (by court order or by giving an undertaking), unless they have court permission, that person is disqualified for the period stated in the order or undertaking from:

- being a director of a company;
- acting as receiver of a company's property;
- directly or indirectly being concerned or taking part in the promotion, formation or management of a company; or
- being a member of or being concerned or taking part in the promotion, formation or management of a limited liability partnership.
- acting as an insolvency practitioner (IP).

Investigation of Directors of failed companies

The Insolvency Service's access to information about company directors will depend on the type of insolvency:

- Compulsory liquidation – where a Court order has placed the company into liquidation, an Official Receiver is appointed as office holder. If the company has assets, an insolvency practitioner (IP) might subsequently be appointed as office holder, but from the first day of liquidation the official receiver has access to information about the conduct of the directors
- Non Compulsory insolvency (i.e. voluntary liquidation, administration, administrative receivership). In these cases an IP is the office holder dealing with the insolvency. The Insolvency Service remains responsible for dealing with the conduct of the director, but is largely reliant upon information received from the IP, which in practice will be received months after the insolvency.

Problem under consideration;

1. The CDDA s7(2) specifies that “except with the leave of the court, an application for the making under that section of a disqualification order against any person shall not be made after the end of the period of 2 years beginning with the day on which the company of which that person is or has been a director became insolvent.”
2. s7(2) applies specifically to applications under S6 of the CDDA, where the Secretary of State is applying to the Court in respect of a director of an insolvent company. There is no equivalent time limit for the institution of proceedings under other sections of the CDDA, s8 for example, where the Secretary of State is applying to Court for the disqualification of a director of non-insolvent company, has no time-limits.
3. In practical terms, the effect of s7(2) is that The Insolvency Service, when bringing proceedings under S6 against directors of insolvent companies, must have issued proceedings in Court (that is; completing a claim form, paying the court fee, having the court affix its seal to the form, issue a hearing number/date and involve solicitors in the process), within 2 years of the date of the relevant insolvency event. Whilst it is possible to apply to the Court for leave to issue outside of this period (‘out of time’ applications), if an investigation is still ongoing, in practice the Court generally takes the view that leave to do so is granted only in exceptional circumstances and where the Court is satisfied it can be justified.
4. For insolvency cases that are not compulsory liquidations, The Insolvency Service generally will not commence investigation into individual directors until receipt of an unfitted (or D1) return from the IP dealing with the insolvency. Such returns are received around six months after the date of insolvency – reducing, at a start, the time available to The Insolvency Service for investigation down to 18 months.
5. In practice, cases in which D1 returns are received must be vetted prior to investigation, and any case considered suitable for disqualification proceedings once investigated must be subject to independent scrutiny before Secretary of State authorisation to commence proceedings is granted. These processes, along with allowing a suitable period for pre-issue discussion with defendants, can consume up to a further 6 months of the limitation window.
6. Collectively, the above means that the window for actual investigation of cases for possible disqualification action in non compulsory liquidations is around one year. For the vast majority of cases targeted and concluded by The Insolvency Service, that time is sufficient. However, in a minority of cases – those perhaps where the insolvency has been particularly large or complex, those in which the IP has discovered evidence late in the day or those where the defendant is uncooperative, to name but three, this time can be insufficient.
7. In compulsory liquidation cases, although the Official Receiver has a longer window in which to investigate, it may still be the case that the insolvency is particularly complex or that evidence is discovered late in the day. The two year limitation might still cause difficulties although it is likely to be in fewer cases than in non compulsory liquidation cases.
8. Finally, s6 is also inconsistent, not only with the rest of the CDDA (s8 (live company investigations) and s2(disqualification following criminal conviction) impose no time limit), but also with wider legislation – the general rule on civil rights of action is six years for example. Whilst recognising that the limitation is intended to protect individuals from uncertainty and possible pernicious pursuit by the state – it is hard to justify such a short timescale given this inconsistency.

Detail of the practical difficulties of the time limit

9. Applying for leave to issue out of time, for ongoing investigations: The two year period causes practical difficulties in particular when attempting to investigate **larger failures** – a company operating across the UK, for example, would have a vast quantity of accounting and other records to be examined. In practical terms this not only slows investigations but, in non compulsory liquidations, it can slow the IP in finding misconduct to report to The Insolvency Service in the first place. Anecdotally, The Insolvency Service has received good evidence in some cases that has arrived at far too late a stage to begin investigating a case. Whilst The Insolvency Service can apply to Court in such cases for leave to issue out of time, it is not generally possible as the delay is not the fault of the defendant and the court will interpret s7(2) in his or her interest. This issue, has in some instances created the perception by IPs that **late discovered evidence** is not worth reporting

as The Insolvency Service will not be able to act upon it. If this means that even a small minority of cases that are deserving of disqualification action slip through the s6 "net" then for this reason alone, this is clearly unsatisfactory.

10. **Issuing proceedings protectively, for concluded investigations**: The strict two year limitation can cause The Insolvency Service to issue proceedings in more cases than may strictly be necessary for any other reason than the effect of the time limit alone. In most cases, The Insolvency Service looks to negotiate the offer of undertakings by directors as an alternative to Court action – this reduces costs to the public purse (and to the director, should the case eventually come before the Court). However, **negotiating an undertaking** can take some time and this is not always available. Where the investigation has concluded but negotiations are ongoing with the director, The Insolvency Service will have to issue proceedings 'protectively' to ensure compliance with the two-year window, incurring Court costs, despite the fact that negotiations are actively continuing and, with respect to the vast majority, are expected to meet with success, concluding with an undertaking. Issuing protectively allows the Court to hear the matter, should negotiations fail.

Economic rationale for intervention

11. The general economic rationale for dealing with misconduct is to address the moral hazard[1] problem generated by perverse incentives created by limited liability[2]. That is, directors are more likely to engage in misconduct and or take more risks if they are not personally responsible for the consequences of their actions[3]. Information asymmetries mean that directors have more information than creditors about their likely future behaviour. And high transaction costs (for example from trying to write the 'perfect contract') can prevent creditors from protecting themselves, inhibiting, in some instances, investment. Government action is therefore needed to minimise the unintended consequences of limited liability by achieving a better alignment of incentives and so discouraging directors from misconduct, hence enabling optimal levels of risk-taking and investment in the market.

12. Laws to address general director misconduct, primarily the CDDA, are currently in place. But it is the fair and consistent application and enforcement of these laws that determines the effectiveness in aligning director's incentives.

13. Government intervention is necessary to help to address any regulatory failures associated with disqualification activities delivered by The Insolvency Service. In particular the proposals in this impact assessment are aimed at removing regulatory barriers to the time spent investigating directors to ensure that rogue directors do not inadvertently escape sanction due to an arbitrary time limit, as may currently be the case in a very small minority of cases.

Policy Objective

14. Ensure that all directors who commit serious breaches in insolvent companies, and therefore become subject to the disqualification regime can, where appropriate, be targeted for disqualification and held to account for their actions. Disqualification prevents a director being a director of another limited company for a period of time and in that way stops them causing further damage to the economy.

15. Ensure that, whilst the majority of cases will continue to be brought within two years, The Insolvency Service may readily bring proceedings to disqualify individual directors outside of the current limitation period where such an action is justified.

16. Reduce the need to issue 'protectively' in cases where the time limit is approaching – a cost saving, and also reduces pressure on directors who seek to undertake as they will no longer have the added pressure of impending court proceedings.

[1] In economic theory, a moral hazard is a situation where a party will have a tendency to take risks because the costs that could incur will not be felt by the party taking the risk.
[2] Halpern et al. (1980) Limited Liability in corporate law
[3] One of the consultation responses argued, that, although there is firm grounding in the literature that limited liability generates a moral hazard problem, there is little empirical evidence of the e*xtend* of this problem. The extent of the problem would determine the degree of regulatory action, rather than the need for regulatory action, which is the subject of discussion in this section.

Description of options considered (including do nothing)

17. This impact assessment considers the impacts of three options in addition to doing nothing;

    - Option 1 – Amend and clarify the law relating to the Court's discretionary power to grant leave to The Insolvency Service to issue director disqualification proceedings outside the current two year time limit;
    - Option 2 – Entirely Remove the two year limit in which proceedings can be brought without court permission, or;
    - Option 3 – Extend the limit to three years.

Do Nothing (Least Favoured Option)

18. At present, The Insolvency Service is restricted, by law, to bringing proceedings against directors of insolvent companies, under s6 CDDA within the two-year limitation period. In most cases, this period is sufficient and, generally speaking, The Insolvency Service does not find itself in a period of abandoning cases solely due to age. In a small number of cases within each year, The Insolvency Service may also seek leave from the court (pursuant to s7(2) CDDA) to bring proceedings outside of the limitation period.
19. An example of such an application was in a recently reported case, Lapland New Forest Limited (2013). The Insolvency Service was pursuing s6 disqualification proceedings within the limitation period against an individual. These proceedings were subsequently dropped when the individual was convicted in a criminal court, which imposed a s2 disqualification order upon him. Later, the criminal conviction was overturned, which also removed the s2 disqualification. The Insolvency Service sought, and was granted, leave to reinstate the original proceedings outside of the limitation period, in the public interest, and the individual in question was later disqualified. Such cases are rare.
20. Whilst the above shows that the current system does function, the Court's discretion to allow such proceedings out of time is, in practice, limited by precedent – this fact was acknowledged by members of the judiciary at stakeholder events.

General Impact of Options 1- 3 – preventing further Economic Damage by Directors

21. The main benefit of taking disqualification action against company directors is the protection of future creditors from that director engaging in misconduct again. The calculations below show the impact upon creditors that will be prevented if additional directors are disqualified. Note that the **some of the monetised impact is a transfer and a small proportion is a benefit.** When a company fails, the debt left in the company is money that would otherwise be with the company's creditors i.e. an inappropriate transfer has taken place. The money due to the creditors has been appropriated elsewhere, due to the misconduct of the director. Where a director has carried out actions with criminal intent and the transfer has been to the illegal economy, it is a benefit to the economy to prevent those transfers. Additional disqualifications will prevent future damage to those creditors, in that the disqualified director will not be able to act in a way to cause those inappropriate transfers. This is fully explained in the Annex.
22. All of the following options allow The Insolvency Service to take disqualification action against more directors than it does currently, where evidence is received late, or a case is particularly large or complex. Data is not available but anecdotally, officials at The Insolvency Service say that a handful of cases might be affected, that it would be a very small number. An estimated range is assumed to be zero to six additional cases being investigated and with them a range of zero to nine company directors being disqualified (based on data from The Insolvency Service that indicates an average of 1.5 directors per company investigation that results in disqualification action).
23. This gives a likely estimate for Options 2 and 3, at the mid range of three cases, of between four and five directors being disqualified. As Option 1 still involves judicial discretion, it may result in fewer cases being successful than are initially identified by The Insolvency Service. The same calculations

as below are used in option 1, but on a range of zero to six cases in which leave is sought, but with a best estimate of two cases being granted leave, rather than midpoint of three.

24. The main benefit of a disqualification is the protection of future creditors from a director engaging in misconduct again. In 1999, the NAO undertook a study which quantified the benefits from disqualifying unfit directors[4]. The monetisation of benefits was based on the average debt left in failed companies where there was unfit conduct by directors and the percentage of directors of failed companies who were likely to be involved in a further company failure. The monetisation of impacts explained below is based on this methodology, although internal data from The Insolvency Service has usurped the NAO data in respect of average deficiency, which due to changing economic and credit conditions is much greater than in the NAO study.

25. According to The Insolvency Service's internal data, in 2012-13, the average deficiency in failed companies where one or more directors have been disqualified was **£1.5m**[5] and the estimated percentage of subsequent failures[6] (that might occur during a period of disqualification if that director had not been disqualified) is **0.07**.

26. Based on the increased number of disqualifications, the average debt left and the likelihood of further company failures, the overall monetised impact of the proposal is estimated from multiplying the following three factors:

Increased number of disqualifications (9, 4.5,3 or 0)	Number of further company failures prevented (0.07)	Average deficiency (£1.5m)

27. Calculations have been undertaken on an annual basis for each of the scenarios (that is high– six cases ie **9** directors per year, middle at three cases for options 2 and 3, or two cases for option 1 - ie **4.5** or **3** directors, low case – **0** directors):

    d. High case scenario - **£0.945m**
    e. Middle case scenario for Options 2&3 - **£0.472m**
    f. Middle case scenario for Option 1 - **£0.315m**
    g. Low case scenario - **£0m**

Distinguishing between the impact and benefits of taking disqualification proceedings

28. Taking the above impacts one stage further, the methodology detailed in the annex indicates that for every disqualification, between 10-20% of its impact is a benefit to the economy. Conversely, 80-90% of its impact is an economic transfer. Essentially a small proportion of disqualifications relate to actions with criminal intent. Where these can be prevented, there is an economic benefit in preventing money moving to the illegal economy. For the remaining disqualification actions, the result is an impact rather than a benefit as the disqualification prevents an inappropriate transfer from creditors to a failed company.

	10% benefit		15% benefit		20% benefit	
	Benefit	Transfer	Benefit	Transfer	Benefit	Transfer
High case scenario £0.945m	£94.5K	£850.5K	£141.75K	£803.25K	£189K	**£756K**
Middle case scenario, options 2,3 £0.472m	£47.2K	£424.8K	**£70.8K**	£401.2K	£94.4K	£377.6K
Middle case scenario, option 1 £0.315m	£31.5K	£283.5K	**£47.25K**	£267.75K	£63K	£252K
Low case scenario £0m	**£0**	£0	£0	£0	£0	£0

[4] http://www.official-documents.gov.uk/document/hc9899/hc04/0424/0424.pdf

[5] The original NAO calculation used a much lower figure but economic and credit conditions have changed – deficiencies are now greater

[6] Based on a calculation developed as part of the NAO methodology

29. As shown, the benefits for Option 1 range from £0 to £756K with a best estimate of £47K. The benefits for Options 2 and 3 range from £0 to £756K with a best estimate of £70.8K

General Benefits for Options 2&3 – issuing protectively, applying for leave to issue out of time

Reducing the need to issue proceedings protectively

30. As shown in Table 1, in 2012/13 The Insolvency Service issued proceedings in 40% of cases (385 out of 969 disqualifications obtained, being those that resulted from a court order or post-issue undertaking). 26% of disqualifications (254) were settled post-issue[7] by undertaking. It is unknown exactly what proportion of these represent cases that were issued 'protectively' as there are a variety reasons why a defendant might choose to undertake after proceedings have been issued. For example:

    - The defendant may intend initially to fight the case in Court but runs out of money to pay for their defence, at which point he decides to undertake.
    - The defendant may simply change their mind about defending for some reason.
    - The defendant ignores the process, The Insolvency Service issues proceedings and then the defendant's solicitor advises them to undertake.
    - The matter goes to Court and the initial stages of the hearing go badly for the defendant, as a result of which they decide to undertake.

Table 1. Point at which Cases were Settled (the Company Director was Disqualified)

	2012-13
Pre-Issue Undertakings	584
Post–Issue Undertakings	254
Court Orders	131
Total Disqualifications under s6 CDDA	**969**

31. However, it is possible find a proxy for 'protective' cases by looking at the cases where The Insolvency Service settled proceedings by post issue undertaking within 28 days of issuing proceedings at Court. These cases are likely to be 'protective' because of the short period between issuing and the final undertaking i.e. as an undertaking was given so soon after proceedings were issued, it is likely that undertakings were being negotiated before proceedings were issued at court. In 2012/13 there were **20** of these cases. Data is not available on trends but the number of disqualifications is broadly stable so it can be assumed that 20 cases issued protectively is a fair representation of an average.

32. In 2012/13, the average solicitors' costs to issue proceedings in each case were **£1,767.** The costs savings to The Insolvency Service from not having to issue proceedings 'protectively' are therefore estimated to be **£35,340 per year**

Reducing the Need to Apply to Court for Leave to Issue out of Time

33. The average costs per case to The Insolvency Service of requesting leave to issue out of time is unknown. There are very few occasions where request for leave is made and this is not registered in The Insolvency Service's internal systems. As an illustrative example we have taken a case where an application for leave under s7(2) was made in 2011 - Instant Access Properties Ltd. The total solicitor's costs in this case were £93,100.

34. We have assumed that approximately £90K is representative of the solicitor's costs in a case where leave to issue out of time is applied for. Data from The Insolvency Service for a sample of 19 cases that were concluded by post issue undertaking or by order, give an average (mean) legal cost per case of just under £48K. So for each case where The Insolvency Service does apply for with leave to issue out of time, there is a saving £40K per case. As The Insolvency Service currently estimates

[7] i.e. after court proceedings have been commenced

that it applies for leave to issue out of time in between zero and two cases per year, this is a range of **£0 to £80K per year, with a mid point of £40K**.

35. Costs in cases that resulted in a pre-issue undertaking have been ignored for this calculation. If a case warrants applying for leave to issue out of time, it is likely that evidence has been received late, or the case is particularly complex. The Insolvency Service would not therefore be in a position to conclude an investigation and negotiate undertakings early. It is more comparable to consider the costs where the cases were concluded later i.e. by order or by post issue undertaking.

36. General note about cost savings: The above savings in total range from £35K to £115K with a midpoint of £75K per year. These savings could be applied to other investigation cases which may in turn result in additional disqualification orders. Data from The Insolvency Service indicates that the average cost of a company investigation is £35K. So at the mid point and best estimate of a £75K saving, there may be resources to carry out two additional investigations. That said, these options also acknowledge that they allow for existing investigations to be carried out for a longer period of time, and that comes at additional cost. We therefore **assume that the savings** from not having to issue proceedings protectively, or apply to court for leave to issue proceedings out of time, **will first be applied to funding existing investigations** that will, under these proposals last a little longer and therefore cost more.

Option 1: Expanding the Discretionary Powers of the Court

37. This option would replace the existing s7(2) CDDA with an expanded discretionary power allowing the Court to decide on whether to allow proceedings to be issued out of time. Such an option might, for example, contain a short but non-exhaustive list of reasons in which there would be a presumption of additional time – the provision of late evidence by a third party not otherwise available to The Insolvency Service for example.

38. This option would seek to build upon and enhance existing precedent by inserting a presumption that an extension to the time limit would be justified in specified circumstances. It would remain the domain of the court to assess the circumstances of the request and satisfy itself of the legitimacy of the request, which would serve to lessen any perceived imbalance between the Secretary of State and the defendant in such cases.

39. Several respondents to the recent Transparency and Trust discussion paper[8] referred to the importance of the court's role in disqualification proceedings; both respondents who were in favour of increasing the time limit (options 2 and 3) and those respondents who disagreed with an extension of time. Comments included that proceedings should not hang over directors and that the court should more readily grant leave to issue out of time.

40. There is a risk that this option may not fully achieve the policy objectives (see paragraph 51) as this option allows for Court discretion in each case in deciding whether it is justified to bring proceedings late. The Secretary of State might not therefore be able to bring disqualification proceedings in all cases identified as meriting them.

Cost and Benefits of Option 1

Costs

41. There will be initial transition costs for the judiciary to familiarise itself with the proposals. These costs are non monetised but are expected to be negligible as judges are already familiar with 'out of time' requests.

42. There might be increased costs to The Insolvency Service from seeking leave under the new powers, and also from a small number of longer investigations if the 'out of time' application is granted.

43. These costs will only apply to the minority of cases where currently the two year limit imposes a practical difficulty in completing an investigation. The Insolvency Service does not keep data on out

[8] https://www.gov.uk/government/consultations/company-ownership-transparency-and-trust-discussion-paper

of time applications, but officials estimate that under option 1 we would expect to apply for leave in more cases and be granted it in more cases. We have estimated a range of **zero to six additional cases** per year.

44. Using the illustrative example in paragraph 33, we estimate the legal costs incurred by The Insolvency Service in a case where leave to issue out of time is applied for, that are in addition to any other case incurring legal costs, is £40K per case i.e. a **range of £0 to £240K per year.**

Benefits

45. The main benefit would be that The Insolvency Service should be granted leave to issue out of time in more cases than it currently is. This will be as a result of The Insolvency Service making more applications and also of the court granting leave more readily. This may allow The Insolvency Service to disqualify a few more directors than it does currently therefore preventing those directors from causing further economic damage.

46. As option 1 still allows the court some discretion to allow cases to proceed, it is possible that not all cases in which The Insolvency Service applies for leave to issue out of time will have that leave granted by the court. Option 1 estimates that The Insolvency Service would take forward between zero and six cases, to apply to court for leave to act out of time. But the court may not grant leave in all cases, and the best estimate is therefore based on two cases rather than a mid point of three cases ie a range of impacts from £0m to £0.945m, with a likely impact of £0.315m, being a transfer from the creditors to the company that is prevented by disqualifying directors. Within that range or transfers, there is a benefit from preventing future criminal transfers, ranging **from £0 to £756K with a likely estimated benefit of £47.25K** (see paragraph 28 and the annex). It has been assumed that all cases in which the court grants leave to issue out of time will result in a disqualification[9].

47. It should be noted that whilst The Insolvency Service's budget for investigation work is capped, the cases in which it applies for leave to issue proceedings out of time will have a high degree of public interest and if money is not available to fund the investigation from The Insolvency Service budget, it would have the option of bidding for additional resource in those exceptional cases. Taking forward a handful of cases in these circumstances would not reduce the number of disqualification cases progressed elsewhere.

48. Taking forward additional cases might in turn increase the confidence in the enforcement regime as The Insolvency Service will have fewer obstacles to investigating more complex, perhaps high impact cases.

49. With greater confidence that leave to issue out of time would be granted, it is more likely that The Insolvency Service would apply for leave in all available cases, and the range of costs reflects a range of potential cases that would require leave to issue out of time.

Risks

50. It should be noted that the Court considers that its existing powers in this area are wide and unfettered[10], except to the extent to which they must follow precedent. Recent judgments have made clear that there is no threshold test exercised by the Court over which the Secretary of State must rise – the matter is purely one of judicial discretion.

51. Whilst, under this option, The Insolvency Service is likely to apply for leave in more cases than it does currently, if the law is redrafted in such a way to give more confidence that leave would be granted, under this option the level of flexibility achieved will still rely on the judges' discretion, similar to the current system. The risk is therefore that the policy objective of holding to account all directors where appropriate may not be fully achieved as this option will still depend on judicial discretion. This is reflected in the lower estimated economic benefit of this option compared with options 2 and 3.

Option 2: No Time Limits to Bringing Director Disqualification Proceedings

[9] Data from The Insolvency Service indicates that less than 5% directors whose conduct is subject to disqualification proceedings will have those proceedings discontinued.

[10] Specifically stated in Instant Access Properties Ltd – Secretary of State for Business, Innovation and Skills v Gifford [2012] 1 BCLC 710

52. This option would remove the time limit entirely – the vast majority of cases would continue to be brought within two years, but cases with special circumstances might otherwise be taken forward at any time. Whilst it is recognised that such a policy might be considered oppressive, the ultimate arbiter of whether a case may be considered would remain the Court, which would act as a brake in cases where it considered the matters to be stale or unduly late.

53. The no time limits option would ensure that all cases might be pursued, even those where the evidence is provided very late or the financial affairs of the failed company are so complex that the investigation itself takes several years. It might also remove the barrier to an IP notifying late recovered information to The Insolvency Service as there is currently a perception that it is too late to report new evidence at a late stage.

54. Removing the limitation period would be of particular use for those investigations where information is provided to The Insolvency Service at a late stage. In insolvency cases involving regulated firms, for example, misconduct may also have been investigated after the insolvency by the relevant regulator. However, by the time the regulator concludes its enquiries, it can be too late for The Insolvency Service to incorporate these findings into disqualification proceedings, as insufficient time remains. By removing the limitation, this difficulty would be eliminated. Readers should note the link to another current proposal that might also assist in eliminating this issue – there are parallel proposals to improve information sharing gateways so The Insolvency Service might receive information more quickly from other regulators.

55. Respondents to the Transparency and Trust discussion paper have broadly indicated that they would not be in favour of an unlimited timescale, believing it incompatible with limitation periods in other areas, such as that for fraud actions (actions can be taken up to six years from the discovery of the fraud). Whilst some respondents were in favour of an extension to the time limit, the majority were still in favour of there being a time limit albeit longer than the current two year limit.

Costs

56. No transition costs to The Insolvency Service or Courts are expected from this proposal.

57. As with Option 1, there may be costs to The Insolvency Service from progressing a handful of longer investigations. Those investigations that take longer will have a higher than average costs. However, the overall number of investigations lasting more than 2 years is likely to be very small as mentioned earlier. These costs could be partly offset by the savings in not having to issue proceedings protectively or apply to court for leave (see paragraph 36). Furthermore as The Insolvency Service would be able to seek additional funding if needed, these additional costs are not expected to impact other investigation cases being taken forward (see paragraph 47) and as they would be small, they have not been monetised.

58. Unlike Option 1, there will be no costs from requesting leave to act out of time more often.

59. There might be costs to directors from having proceedings hanging over their heads for an undefined period of time. A few respondents to the Transparency and Trust discussion paper were concerned that unlimited timescales could have a negative impact on directors, their personal lives and their economic productivity. Also mentioned were the risks introducing inefficiencies into the investigative process, without a time limit.

Benefits

60. As with all options the main benefit is enabling The Insolvency Service to disqualify a few more directors than it does currently therefore preventing those directors from causing further unfair impact on creditors by a company they may otherwise have controlled. Paragraphs 21 to 27 estimate the impact to range from £0m to £0.945m. Most of this impact has not been included as a benefit on the front of this impact assessment, as it is a transfer. However within that range there is a benefit to the economy of preventing future transfers to the illegal market. See paragraph 28 and the annex. Within the range of £0 to £0.945m the **benefits to the economy are estimated to range from £0 to £756K with a likely estimated benefit of £70.8K**.

61. There will be costs savings to The Insolvency Service from not having to issue proceedings ‘protectively’ in cases where the investigation has concluded and undertaking negotiations are ongoing. These have been estimated to be **£35,340** per year. This is based on the proxy used for the number of ‘protective’ cases in 2012/13 (as per paragraph 31). That is 20 cases and the average solicitors’ costs for each case (£1,767 as set out in paragraph 32).

62. There will be further cost savings from not having to apply for leave to issue out of time proceedings in cases where additional time is needed to investigate because of the complexity of the investigation or because evidence has been received late. This is a saving of £40K per case and a range of zero to two cases per year i.e. **£0 to £80K** saving per year, with a mid point of £40K.

63. Finally as in option 1 benefits are also expected to stem from increased flexibility to The Insolvency Service to be able to deal with more complex, longer cases i.e. this in turn might increase confidence from the general public in the regime as there will be no external time limit barrier to investigative work. These benefits have not been monetised.

64. There may be time savings to courts from not dealing with requests for leave to issue out of time. These have not been monetised as they are minimal. The Insolvency Service pays fees to issue proceedings in court and therefore monetary savings benefit The Insolvency Service rather than the court and have been included above.

65. This option offers full flexibility compared to the other options, however it also involves a certain level of litigation risk by directors, which might undermine its overall impact.

Risks

66. There is clearly an inherent risk with this option that, leaving the possibility of proceedings hanging over the heads of individual directors would be oppressive and, potentially, a breach of their human rights. This brings with it the risk of human rights litigations being brought against The Insolvency Service.

67. As mentioned above, it is recognised that such an approach might produce 'cases without end,' introducing inefficiencies into the process. Furthermore there is the damage that an unlimited timescale might have on the economic productivity of those directors awaiting the conclusion of an investigation.

Option 3: An expanded Time Limit within which to bring Disqualification Proceedings against Directors (Preferred Option)

68. This option expands the current two-year limit to three years. The benefits to The Insolvency Service of this approach are similar to those listed above for no time limits as, in practise, it is unlikely that a case would be investigated for longer than three years before issue. In the vast majority of cases the current two year time limit is sufficient to investigate a case and to bring disqualification proceedings where it is in the public interest to do so. In a minority of cases evidence is received late in the day or the case is so complex that additional time is needed to carry out the investigation. Officials consider that even complex or late cases could be investigated with a relatively short amount of additional time.

69. It is not anticipated that a period of longer than three years would be needed to complete an investigation but if there was an exceptional case, the option to apply to court for leave to act out of time would still be available and the Court would still have the ability to decide if the extension was reasonable.

70. An expanded time limit would provide an additional window in the most serious, complex cases to gather evidence and build a case against the directors. Again, it is considered unlikely that all but a handful of cases would be issued outside of the existing two-year window, so the use of the expanded period would be rare.

71. The limitations of this option are similar to those in Option 2 (no time limits), although the possibility of abuse is lessened as a definite time limit for action remains. Directors will have a finite time within which action might be taken.

72. In 2012/13 the average length of time from insolvency date to post-issue undertaking was just over two and a half years. This means that with additional year in which to bring proceedings, most directors who want to give an undertaking rather than going to court would be able to do so. There may still be some cases issued and brought to court where negotiations take longer than three years (e.g. a case is defended and representations from both sides extend the time needed). This is the same process as exists at the moment and would be under the jurisdiction of the court to ensure proceedings were not unfairly delayed and that the director under investigation is not left in an uncertain situation for an unreasonable amount of time.

Costs

73. No transition costs are expected for The Insolvency Service. There might be some familiarisation costs to Courts, but these are expected to be negligible given that the change in legislation is very simple and that the Court's role in disqualification proceedings is not being altered. These have not been monetised.

74. Those investigations that take longer will have a higher than average costs. However, the overall number of investigations lasting more than 2 years is likely to be very small as mentioned earlier. These costs could be partly offset by the savings in not having to issue proceedings protectively or apply to court for leave (see paragraph 36). Furthermore as The Insolvency Service would be able to seek additional funding it needed, these additional costs are not expected to impact other investigation cases being taken forward (see paragraph 47) and as they would be small, they have not been monetised.

75. Unlike Option 1, there will be no additional costs for requests for leave to issue out of time.

Benefits

76. As with all options the main benefit is enabling The Insolvency Service to disqualify a few more directors than it does currently therefore preventing those directors from causing further unfair impact on creditors by a company they may otherwise have controlled. Paragraphs 21 to 27 estimate the impact to range from £0m to £0.945m. Most of this impact has not been included as a benefit on the front of this impact assessment, as it is a transfer. However within that range there is a benefit to the economy of preventing future transfers to the illegal market. See paragraph 28 and the annex. Within the range of £0 to £0.945m the **benefits to the economy are estimated to range from £0 to £756K with a likely estimated benefit of £70.8K**.

77. As with option 2, there will be costs savings to The Insolvency Service from not having to issue proceedings 'protectively' in cases where the investigation has concluded and undertaking negotiations are ongoing. These have been estimated to be **£35,340** per year. This is based on the proxy used for the number of 'protective' cases in 2012/13 (as per paragraph 31). That is 20 cases and the average solicitors' costs for each case (£1,767 as set out in paragraph 32).

78. As with option 2, there will be further cost savings from not having to apply for leave to issue out of time proceedings in cases where additional time is needed to investigate because of the complexity of the investigation or because evidence has been received late. This is a saving of £40K per case and a range of zero to two cases per year ie **£0 to £80K** saving per year and a midpoint of £40K.

79. As in option 2, there may be time savings to courts from not dealing with as many requests for leave to act out of time. These have not been monetised as they are minimal. The Insolvency Service pays fees to issue proceedings in court and therefore monetary savings benefit The Insolvency Service rather than the court and have been included above.

80. Wider benefits from this proposal stem from increased flexibility to The Insolvency Service to be able to deal with more complex, larger cases, which in turn might increase confidence from the general public in the enforcement regime.

81. This option, offers a middle ground between full flexibility (Option 2) and current limitations (2 years). It is expected that this middle ground would 1) accommodate the small number of cases that need longer investigation, and 2) reduce the risk of litigation by the director that a longer limitation period might bring.

Summary and preferred option with description of implementation plan

82. In summary, the idea behind this policy is to ensure that the Secretary of State has sufficient opportunity to bring disqualification proceedings in circumstances where it is in the public interest to do so.

83. Whilst all of the considered options are likely to bring some benefit, Option 1 relies on judicial discretion and may not fully realise the benefits. Options 2 and 3 both bring benefits in terms of cost savings to the Exchequer and in preventing, in additional cases, the economic damage caused by directors. Option 2 however has greater risks associated with it, for example the risk of litigations under Human Rights Act. It is therefore considered that **Option 3 will achieve the policy objective and has the least risk of the options put forward**.

84. To summarise the current difficulties; where the Official Receiver is the office holder in a compulsory liquidation, investigations can be started early. For non compulsory liquidations, the Secretary of State generally cannot commence investigation into the conduct of individual directors until the receipt of a report from the IP dealing with the insolvency. On average, these reports are not received until around six months after the date of the insolvency, thereby immediately reducing the time available for investigation by The Insolvency Service on behalf of the Secretary of State to 18 months.

85. Furthermore, the protocol under s16 of the CDDA, requires 10 days' notice to be given to a director before proceedings can be issued. Although the investigation can run right up to that last couple of weeks before the two year limitation, as matter of operational practice The Insolvency Service try and leave a period of up to 3 months to allow a reasonable period of time for the prospective defendant to make representations and for undertaking negotiations to occur.

86. In addition, in some cases the investigation cannot begin until a year or more has elapsed. For example, where:

- the insolvency is particularly large or complex, it takes longer for the IP to report;
- the IP discovers evidence a long time after the insolvency has commenced (for example, if the director has been uncooperative or unforthcoming in providing information and documentation);
- an earlier insolvency event has triggered the two-year time limit. When two insolvency events occur in succession (e.g. administration followed immediately by liquidation) the two-year application period begins when the company enters administration and does not re-set upon the onset of liquidation[11]. As such, much of the two-year period would have elapsed before the second IP, who may have access to more information, is able to report to the Secretary of State.

87. The consequence of these procedures often results in The Insolvency Service having far less time to investigate, scrutinise information and decide whether to make an application for a disqualification order than the two-year period would initially suggest and in certain cases the court will have to be approached to extend the time available to investigate, but the circumstances in which the court will grant this leave are quite restricted.

88. Furthermore, the current two-year time limit often results in unnecessary additional costs. The Secretary of State may accept a disqualification undertaking rather than seeking a disqualification order from the court. Often this process involves a certain amount of negotiation between The Insolvency Service and the director in question, which may be protracted and, where it appears that negotiation may extend beyond the two-year time limit for making an application for a disqualification order, The Insolvency Service often needs to issue proceedings protectively, in order to retain the option of eventually seeking a disqualification order at court, should negotiations prove fruitless. The need to issue protectively involves instructing solicitors, thereby incurring costs which could otherwise be avoided.

89. The preferred option is to amend s7(2) CDDA to replace the current two year limit within which to bring proceedings, with three years, at the earliest opportunity. The new time limit would apply, going forward, only to insolvencies occurring on or after the implementation date.

Rationale and evidence that justify the level of analysis used in the IA (proportionality approach)

90. This is considered to be a low-risk, low-impact intervention and therefore the analysis undertaken have mainly focused on identifying the groups affected, describing the impacts and where possible quantifying the effect rather than trying to monetise the overall costs and benefits. This has only been done when data was readily available.

91. Available data is limited, on cases that might require longer than two years to conclude. However, it has been reinforced by several internal sources that the number of cases requiring longer investigatory periods is small, which gives reassurance that the monetisable impacts of the policy are likely to be small.

[11] Where there is a state of solvency between two insolvency events, then the two-year period starts again on the onset of the second event.

Direct costs and benefits to business calculations (following OITO methodology)

92. The preferred option is not likely to impose any new direct costs and benefits on existing businesses. Any familiarisation costs to business are in-direct and therefore **out of scope** of OITO as stated in the Better Regulation Framework Manual[12].

Wider Impacts:

Statutory Equalities Duties - The proposal has no impact on protected groups

Competition -The proposal has no impact

Small Firms -The proposal has no impact. (The proposal is not regulatory and a Small and Micro Business Assessment has not therefore been completed).

Wider Environmental Issues - The proposal has no impact

Health and Well-being / Human Rights

We are conscious that the proposal will extend the time, in a small number of cases, before an individual is brought before proceedings in a civil court. This is minimised by retaining a deadline of three years and is also offset by the reduced need to issue proceedings protectively i.e. for some individuals they will have additional time to negotiate and consider a defence before proceedings are brought before the court, which may reduce the pressure and stress that the current time limit imposes in a small number of cases.

Justice System

We expect the proposal to involve negligible familiarisation costs for the judiciary as it is proposed to amend the timescale within which to bring proceedings. The nature of the process is not changing. Given the additional time within which to investigate, it is likely there will be a reduction of 'out of time' applications brought before the court.

Rural Proofing - The proposal has no impact.

Sustainable Development - The proposal has no impact.

[12] See page 40: www.gov.uk/government/uploads/system/uploads/attachment_data/file/211981/bis-13-1038-better-regulation-framework-manual-guidance-for-officials.pdf

ANNEX A

The treatment of the impacts of The Insolvency Service disqualification regime

Purpose

- The purpose of the note is to set out a proposed approach to distinguishing misfeasance- from crime-related misconduct, and, therefore, to appropriately appraising the impacts of The Insolvency Service director disqualification regime policy measures.

Aligning appraisal with the Home Office approach to estimating the economic impacts of crime

1. Director misconduct, when it results in insolvency of the company controlled by the director, necessitates investigation by The Insolvency Service and subsequent director disqualification.

2. A small proportion of director misconduct is driven by criminal intent; for example, fraudulent trading. Most director misconduct, however, involves civil misfeasance: the breaching of a duty of care, and the improper performance of a legal act.

3. Robust appraisal of the impacts of the disqualification regime should reflect the nature of the types of misconduct which lead to disqualification. Therefore, a nuanced approach to quantifying these impacts is required.

4. The transfer of resources, from one party to another, occurs in many contexts within the legal economy: for example, through social security payments, subsidies or gambling. Such transfers are not generally regarded as a cost to society (or a social benefit, if these transfers of resource are avoided). Crime also involves some similar transfers: for example, property crimes involve a transfer of property from the victim to the offender.

5. In the Home Office approach to appraising the economic impacts of crime and crime prevention, the fundamental distinction between a transfer and a cost to society (or a benefit, if the cost is avoided) is the distinction between a *wanted* and an *unwanted* transfer. A burglary, theft or robbery involves an illegal transfer of property that is *unwanted by one party*, the victim, and therefore the transfer of the property out of the legal economy. The Home Office treats transfers out of the legal economy and into the illegal economy as a cost of crime, and, therefore, the avoidance of such transfers as a benefit.

6. Appraisal of the impacts of The Insolvency Service disqualification regime should align with the approach taken by the Home Office.

7. Where there is criminal intent, the monies and assets (for instance, stocks of intermediate goods) lost to creditors as a result of director misconduct should be assumed to have transferred out of the legal economy and into the illegal economy. Therefore, where misconduct is driven by criminal intent, 'creditor damage' should be treated as a social cost, and the prevention of it - via increased numbers of, or accelerated, director disqualifications - treated as benefit.

8. Meanwhile, where director misconduct is a result of misfeasance, the monies and assets associated with 'creditor damage' should be assumed to have remained within the legal economy. Where misfeasance has occurred, therefore, the prevention of it, and the compensation of creditors for it, should be treated as a transfer.

Determining the extent of misconduct motivated by criminal intent

9. The Insolvency Service collects data on the nature of the director misconduct allegations. Allegations data for the period 2007/08 to 2011/12 (the last year for which a full dataset is readily available from Insolvency Service annual reporting) is presented below (note that each disqualification case may have more than one allegation against a director):

	Year				
Allegation types	**2007/08**	**2008/09**	**2009/10**	**2010/11**	**2011/12**
Crown debts	554	563	816	636	635
Accounting matters	250	381	448	342	200
Transaction to the detriment of creditors	161	246	391	392	161
Criminal matters	101	174	258	259	102
Misappropriation of assets	53	49	68	59	56
Technical matters – statutory obligations	37	46	33	70	52
Trading at a time when company knowingly or unknowingly insolvent	36	44	40	35	7
Phoenix companies or multiple failures	13	14	12	7	2
Other	n/a	n/a	98	n/a	n/a
Total allegations	**1205**	**1517**	**2164**	**1800**	**1215**
Total disqualifications	**1145**	**1281**	**1388**	**1437**	**1151**
Proportion of disqualifications resulting from criminal intent	**9%**	**14%**	**19%**	**18%**	**9%**

10. The table shows that, over the period, between 1145 and 1437 directors were disqualified per annum. The proportion of these disqualifications resulting from misconduct with criminal intent – and so, from criminal matters allegations – fluctuated between 9% and 19% in individual years. There were between 101 and 259 allegations of criminal matters per annum over the same period.

11. **Over the period 2007/08 to 2012/13**, when the 110 allegations of criminal matters and the 1031 disqualifications for 2012/13 are added to the data presented in the table above**, the per annum average percentage of disqualifications resulting from allegations of criminal matters** (whether alone or in conjunction with allegations of civil misfeasance) **was 14%**[13].

Implications for the appraisal of disqualification and compensation regime policy measures

12. The size of the loss incurred by creditors as a result of criminal intent is unlikely to be significantly different from that incurred as a result of the actions prompting the other types of misconduct allegations presented in the table above. Therefore, given the figures presented in the table above:

- Approximately 10% to 20% of all director disqualifications – and, therefore, the associated losses imposed on creditors - avoided by the implementation of policy measures are likely to be a result of misconduct driven by criminal intent.

13. Given that the appraisal of the impacts of The Insolvency Service disqualification regime policy measures should align with the Home Office approach to measuring the economic impacts of crime and crime prevention outlined above, this means that:

- Approximately 10% to 20% of the avoided creditor losses incurred as a result of misconduct should be treated as a benefit in the appraisal of disqualification policy measures.

[13] The allegations data presented in the table above are those allegations included in the disqualification reports prepared by the Insolvency Service. A given director may be disqualified as a result of more than one allegation (for instance, failure to pay tax (a Crown debt allegation) and transferring an asset (a misappropriation of assets allegation)). This means that in cases in which the Insolvency Service identifies as having criminal intent, there may also be a civil misfeasance allegation.

14. Conversely, given that they are likely to have stemmed from allegations of misfeasance, rather than criminal matters, 80% to 90% of the avoided creditor losses avoided should be treated as a transfer (from creditor businesses) avoided.

15. Given, as mentioned above, that allegations of misconduct often involve a blend of both criminal matters and misfeasance, the use of a 10% to 20% range in the classification of creditor losses avoided and compensation awards made as a benefit to creditors is likely to be an overestimate. Where this is the case, there is a challenge in uncoupling the effects of criminal matters and misfeasance. Further work should be undertaken to understand how the two combine to result in creditor losses.

Summary

- Any agreed approach to appraising the impacts of The Insolvency Service disqualification measures should be aligned with that of the Home Office in estimating the economic impacts of crime and crime prevention.

- The Home Office approach suggests that *unwanted* transfers between parties should be treated as a social cost, while those avoided should be treated as a benefit.

- The Insolvency Service data on misconduct allegations allows for estimates of the proportions of director misconduct, resulting in disqualification, which is driven by criminal intent (10% to 20%) and misfeasance (80% to 90%).

Therefore, in appraisal:

- A range, of between 10% to 20%, of the losses associated with the disqualifications avoided under new policy measures should be treated as a benefit to creditor business, rather than a transfer from creditors to miscreant directors.

Title: Enabling Liquidators and Administrators to assign to third parties certain rights of action that only they can bring under the Insolvency Act 1986 and to extend the right to bring fraudulent and wrongful trading actions to an administrator **IA No:** BIS INSS007 **Lead department or agency:** The Insolvency Service **Other departments or agencies:** Department for Business Innovation and Skills	Impact Assessment (IA) **Date: Published 25 June 2014** **Stage:** Final **Source of intervention:** Domestic **Type of measure:** Primary legislation **Contact for enquiries:** Muhunthan Vaithianathar 020 7637 6515

Summary: Intervention and Options

RPC Opinion: Green

Cost of Preferred (or more likely) Option

Total Net Present Value	Business Net Present Value	Net cost to business per year (EANCB on 2009 prices)	In scope of One-In, Two-Out?	Measure qualifies as
-0.90	-0.90	0.09	Yes	**Zero net cost**

What is the problem under consideration? Why is government intervention necessary?

Currently, a liquidator may bring a civil claim for fraudulent or wrongful trading[14] against the directors of an insolvent company. An administrator or liquidator might do the same to recover property where there has been a preference given, a transaction at an undervalue, or an extortionate credit transaction.[15] These actions can only be brought by the liquidator in respect of fraudulent trading and wrongful trading and by the administrator or the liquidator ("the officeholder") in respect of the other causes of action. They are not capable of assignment to a third party.

However, not many of these actions have been taken forward in the past. Government intervention is required to ensure that all opportunities are given to officeholders, to recover monies from those individuals who cause loss to creditors (particularly the unsecured creditors) by taking advantage of the privilege of limited liability, where there has been misconduct.

What are the policy objectives and the intended effects?

We wish to give the officeholder the maximum opportunity and flexibility to take forward any potential claims and to get the best value for creditors. The intended effect of the policy is to increase confidence in the insolvency and enforcement regime by using the current laws to increase the likelihood of miscreant directors being held accountable for their actions and being required to compensate creditors in cases where they have acted inappropriately.

[14] Fraudulent Trading – Cause of action arises if, in the course of winding-up a company, it appears that any business of the company has been carried on with intent to defraud creditors of the company or creditors of any other person or has been carried on for any fraudulent purpose
Wrongful Trading – Cause of action arises if in the course of winding-up a company where the company has gone into insolvent liquidation and at some time before the commencement of the winding up, that director knew or ought to have known that there was no reasonable prospect that the company would avoid going into insolvent liquidation

[15] Preference – Cause of action arises where the company enters administration or goes into liquidation and the company has at a relevant time given a preference to any person where that person is a creditor of the company or a surety or guarantor for the company's debts and the company does anything which has the effect of putting that person in a position which, if the company becomes insolvent will be better than the position he would have been in if that thing had not been done.
Transactions at an undervalue – Cause of action arises where the company enters administration or goes into liquidation and the company has at a relevant time entered into a transaction at an undervalue. Transaction at an undervalue includes the giving of a gift or receiving consideration at significantly less than the value of the asset. However, the court must not make an order where the company entered into the transaction in good faith for the purpose of carrying on the business and at the time it did so, there were reasonable grounds for believing that the transaction would benefit the company.
Extortionate credit transactions – Cause of action arises where the company enters administration or goes into liquidation and the company is, or has been, a party to a transaction for, or involving, the provision of credit to the company within a three year period ending on the day on which the company entered administration or went into liquidation.

What policy options have been considered, including any alternatives to regulation? Please justify preferred option (further details in Evidence Base)

Two policy options were considered:

- Do nothing;
- Enable liquidators and administrators to assign to third parties certain rights of action that only they can bring under the Insolvency Act 1986 and to extend the right to bring fraudulent and wrongful trading actions to an administrator. The option would also include strengthening the information gateways between liquidators and official receivers and the Insolvency Service to better target cases where financial redress is available. Better communication between liquidators and the Insolvency Service may enable liquidators to decide if it is possible and worthwhile to bring actions to get financial redress for creditors. (Preferred option);

The preferred option has been chosen as this will enable unsecured creditors to benefit from the proceeds of the sale and allow for more officeholder claims to be pursued. We anticipate that the incipient market that stakeholders have told us is taking hold in these actions would develop further, and increase the prospect of actions being taken against miscreant directors. This information has been evidenced from a key consultee response.

Will the policy be reviewed? It will be reviewed. **If applicable, set review date:** April 2020

Does implementation go beyond minimum EU requirements?			**N/A**		
Are any of these organisations in scope? If Micros not exempted set out reason in Evidence Base.	Micro No	< 20 **No**	Small No	Medium No	Large No
What is the CO_2 equivalent change in greenhouse gas emissions? (Million tonnes CO_2 equivalent)			**Traded:** N/A	**Non-traded:** N/A	

I have read the Impact Assessment and I am satisfied that (a) it represents a fair and reasonable view of the expected costs, benefits and impact of the policy, and (b) that the benefits justify the costs.

Signed by the responsible Minister: Jenny Willott **Date:** 14 June 2014

Summary: Analysis & Evidence Policy Option 1

Description: Enabling liquidators and administrators to assign to third parties certain rights of action that only they can bring under the Insolvency Act 1986 and to extend the right to bring fraudulent and wrongful trading actions to an administrator (recommended option)

FULL ECONOMIC ASSESSMENT

Price Base Year 2013	PV Base Year 2013	Time Period Years 10	Net Benefit (Present Value (PV)) (£m)		
			Low: -1.30	High: -0.50	Best Estimate: -0.90

COSTS (£m)	Total Transition (Constant Price)	Years	Average Annual (excl. Transition) (Constant Price)	Total Cost (Present Value)
Low	0.5	1	0	0
High	1.3		0	0
Best Estimate	0.9		0	0

Description and scale of key monetised costs by 'main affected groups'

There is a one off familiarisation cost to insolvency practitioners (IPs) and lawyers in becoming familiar with the legislation estimated to be £0.93m.

Depending on how the market develops and the number of assigned cases, based on our indicative figures there could also be a transfer from miscreant directors to creditors (insolvent estates) and civil litigation firms. This is estimated to be £77,000 a case. The split between creditors and litigation firms is expected to be 50:50 at the beginning, but as more competition comes into the market, this may change with a higher proportion going to creditors. There could also be wider legal fees of £17,260 a case which would be paid by the miscreant director.

Other key non-monetised costs by 'main affected groups'

No other costs have been identified.

BENEFITS (£m)	Total Transition (Constant Price)	Years	Average Annual (excl. Transition) (Constant Price)	Total Benefit (Present Value)
Low	0	N/A	0	0
High	0		0	0
Best Estimate	0		0	0

Description and scale of key monetised benefits by 'main affected groups'

The main beneficiaries of this policy are creditors and insolvency litigation firms who will benefit from a transfer from miscreant directors. The benefit would be the average £77,000 a case based on our illustrative example. This would initially be split evenly between creditors and civil litigation firms but could change if there is more competition in the market.

Legal firms/parties could also benefit from any actions that are taken forward. Again this would be a transfer from the miscreant directors to the legal firm.

Other key non-monetised benefits by 'main affected groups'

There may be some wider non-monetised benefits relating to increased confidence in the enforcement and civil recovery regime by allowing more claims to be pursued and won. There could also be a deterrent effect by allowing the possibility for more claims to be pursued, miscreant directors who otherwise might have engaged in wrongful or fraudulent behaviour may be deterred from doing so.

Key assumptions/sensitivities/risks **Discount rate (%)** 3.5

As mentioned above, there is uncertainty as to how this market will develop and these figures are indicative, based on data and information provided by a consultee response in this field. However consultees have told us there is an insipient market developing for insolvency civil litigation action and we expect this proposal will result in further development of this market. We were unable to obtain data from many other sources and as a lot of claims are settled informally out of court, there are restrictions on what information is publicly available. However we have tried to sense check the information used by talking to other parties in the civil litigation and insolvency field. The assumptions are explained in further detail below.

BUSINESS ASSESSMENT (Option 1)

Direct impact on business (Equivalent Annual) £m:			In scope of OITO	Measure qualifies as
Costs: 0.1	Benefits: 0	Net: -0.1	Yes	Zero net cost

Evidence Base (for summary sheets)

- Problem under consideration:

Rationale for intervention and intended effects

1. Currently, a liquidator may bring a civil claim for fraudulent or wrongful trading[1] against the directors of an insolvent company. An administrator or liquidator might do the same to recover property where there has been a preference given, a transaction at an undervalue, or an extortionate credit transaction.[2] These actions can only be brought by the liquidator in respect of fraudulent trading and wrongful trading and by the administrator or the liquidator ("the officeholder") in respect of the other causes of action. They are not capable of assignment to a third party. In addition it should be noted that these are civil recoveries, not a result of criminal action. Any recoveries would be pursued and realised by the administrator or liquidator.

2. However, not many of these actions have been taken forward in the past. Responses to the Transparency and Trust discussion paper[3] suggested that there have only been 29 reported cases under s214 of the Insolvency Act 1986 (IA86), (wrongful trading claims) between 1986 and 2013 with liability being imposed in only 11 of those cases. There have been 80 cases under s238 IA86 (transactions at an undervalue) and over 50 under s239 IA86 (wrongful preference) over the same period. This equates to on average about 6 cases a year. These would have been brought in the officeholder's name by an insolvency practitioner (IP).

3. This might be for example due to insufficient assets in the insolvency estate[4] with which to fund an action by the officeholder and creditors being reluctant to fund them where that is the case, coupled with a high evidential bar and a lack of director's assets, against which to enforce a successful claim. Officeholders are under a duty to realise assets and distribute the proceeds to creditors. It may be the case that there is a potential right of action, but it requires additional funds to proceed with the action. There may not be enough monies from asset realisations to fund an action and creditors may be unwilling to fund the action as they have already lost monies due to the insolvency of the company. Since money is limited, officeholders are only likely to proceed with an action where they believe the case has a very good chance of success and they are funded to bring it.

4. We know from case law that the evidential bar for fraudulent trading is fairly high and more difficult to bring than wrongful trading. Therefore we do not expect a large number of fraudulent trading actions in particular to be assigned.

5. These were all reasons suggested in consultation responses by representative legal bodies, R3 (the trade body for insolvency practitioners), insolvency practitioners, Institute of Credit Management and Jordans (company formation agent and corporate services provider). Whilst all the reasons above were mentioned, greater weight was given to the high evidential bar and lack of director assets with which to pay an award as the main reasons why claims are not currently taken forward. Government intervention is required to ensure that all opportunities are given to officeholders, to recover monies from those individuals who cause loss to creditors (particularly the unsecured creditors) by taking advantage of the privilege of limited liability, where there has been misconduct.

[1] Fraudulent Trading – Cause of action arises if, in the course of winding-up a company, it appears that any business of the company has been carried on with intent to defraud creditors of the company or creditors of any other person or has been carried on for any fraudulent purpose
Wrongful Trading – Cause of action arises if in the course of winding-up a company where the company has gone into insolvent liquidation and at some time before the commencement of the winding up, that director knew or ought to have known that there was no reasonable prospect that the company would avoid going into insolvent liquidation

[2] Preference – Cause of action arises where the company enters administration or goes into liquidation and the company has at a relevant time given a preference to any person where that person is a creditor of the company or a surety or guarantor for the company's debts and the company does anything which has the effect of putting that person in a position which, if the company becomes insolvent will be better than the position he would have been in if that thing had not been done.
Transactions at an undervalue – Cause of action arises where the company enters administration or goes into liquidation and the company has at a relevant time entered into a transaction at an undervalue. Transaction at an undervalue includes the giving of a gift or receiving consideration at significantly less than the value of the asset. However, the court must not make an order where the company entered into the transaction in good faith for the purpose of carrying on the business and at the time it did so, there were reasonable grounds for believing that the transaction would benefit the company.
Extortionate credit transactions – Cause of action arises where the company enters administration or goes into liquidation and the company is, or has been, a party to a transaction for, or involving, the provision of credit to the company within a three year period ending on the day on which the company entered administration or went into liquidation.

[3] https://www.gov.uk/government/consultations/company-ownership-transparency-and-trust-discussion-paper.

[4] Insolvency estate – assets or property which the officeholder can deal with to pay the creditors. Officeholders are under a duty to realise assets and then distribute the proceeds to creditors after deducting their costs and fees.

6. In addition, as a claim for fraudulent and wrongful trading is not currently available to be taken forward by administrators (without first putting the company into liquidation), we wish to allow administrators the same right as liquidators to bring wrongful and fraudulent trading actions themselves, thus allowing more actions to be taken where justified and saving the unnecessary cost of having to first put the company into liquidation.

7. We wish to give the officeholder the maximum opportunity and flexibility to take forward any potential claims and to get the best value for creditors. The intended effect of the policy is to increase confidence in the insolvency and enforcement regime by using the current laws to increase the likelihood of miscreant directors being held more accountable for their actions and being required to compensate creditors in cases where they have acted inappropriately.

8. The proposed legislation will be GB wide and apply to England and Wales and Scotland. The total number of liquidations and administrations in Great Britain for the calendar year 2013 were 15,714 liquidations and 2,365 administrations.

9. Presently, when considering whether to bring an insolvency action, the officeholder (IP), has a number of options:

(i) They can bring the claim themselves. They will do this if they are funded to do so (or there are assets in the estate that will provide the monies for this) and they believe that the case has a very good prospect of success, including recovery of any monies awarded.

(ii) They may work with a solicitor or a firm on a CFA[5] (conditional fee agreement). This could occur when they do not have the funds to pursue the case in its entirety but believe there is still a good chance of a successful outcome. The claim in these agreements will generally still be in the officeholder's or company name. Currently the vast majority of insolvency litigation actions are taken forward on this basis.

(iii) If they do not have the funds to bring a case themselves, they can currently assign or sell some actions such as recovering monies from directors loans accounts, director misfeasance claims, breach of contract claims, to a civil recovery litigation firm. They may use this option if they prefer monies up front, don't have funds to bring an action themselves, or don't have the risk appetite to bring a case due to the possibility of adverse costs being awarded against them, or may prefer to use the expertise of the civil litigation firm. It may also be the case that they don't want to invest funds and resource carrying out investigation work for a potentially uncertain outcome if, for example, the director's circumstances change and they can't enforce an award or there is difficulty in evidencing a claim. This would then be a sunk cost which is difficult to recover.

10. The current most popular method for civil recovery is the use of conditional fee agreements (CFA). This option may be less viable in insolvency cases after April 2015 when reforms to this type of funding arrangement are due to be implemented, leaving claimants unable to recover 'success fees' from defendants when claimants succeed in litigation. As an insolvency practitioner may be personally liable for costs incurred as a consequence of litigation, they protect themselves by the use of After the Event insurance (ATE). As the system currently exists, CFA success fees and ATE insurance premiums are recoverable from the defendant if a judge, on the merits of the case, considers them to be liable. These are usually accounted for by charging an uplift on normal fees that are charged during litigation. These arrangements account for the majority of actions taken against directors, either on a formal or informal basis.

11. Due to a lack of information on these cases, it is difficult to estimate the proportion of the market that operates on this basis. However we have been told by a number of stakeholders (insolvency practitioners and solicitors/litigation firms) that the majority of the

[5] A CFA is an agreement between a client and the firm/person representing them under which the client agrees to pay fees at less than standard rates if the case is not successful, and at standard rates plus a "success fee" (expressed as a percentage of the difference between the discounted rates and the standard rates) if the claim is successful.

civil litigation market operates in this way, perhaps upwards of 90%. We would continue to expect those firms/companies that operate on this basis to continue to do so, but they may change their basis of charging. This is based on information received from a legal firm that has operated in this market for a number of years and their view of how the market will adapt. In addition other firms who operate in this field have informally also told us that they too would also continue to operate on the same basis. Consultation responses were generally unhelpful on the cost and benefits and therefore this has necessitated reliance on the evidence of one key consultee and informal discussions with a couple of other stakeholders.

12. We have assumed that the CFA market will be relatively unaffected by the proposals as they tend to be appointed by IPs and we expect in the short term at least for this to continue. This is due to the fact that the proposal is for assigning actions that the current officeholder does not wish to take forward themselves for whatever reason, be it lack of funds or risk appetite, etc. If an IP wished to use a CFA agreement, the proposals allowing the assignment of officeholder actions should not make a difference to this decision, as they can already use a CFA agreement if they so wish.

13. However there is a growing market in the assignment of civil recovery actions for insolvency and we believe this market will take advantage of the proposals allowing an officeholder to sell/assign an action. This is the feedback we have received from one particular respondent to the consultation and informal views from others in this field of litigation.

Viable policy options (including alternatives to regulation)

14. Do Nothing: Currently available civil remedies are used infrequently. This is partly because of the evidential bar needed to bring a successful action and the lack of assets that a director may have. However we are told by insolvency practitioners and their main representative body (R3, Association of Business Recovery Professionals) that it is largely because of the constraints on an insolvency practitioner bringing actions and the need to find funds to bring such court actions. It is difficult to quantify the amount of funding required to bring an action but practitioners are only likely to bring an action where there are monies or assets in the insolvency estate to do so or they believe a claim can be successfully pursued on a CFA basis.

15. Option 1: **(Preferred Option)** To introduce a right for administrators to be able to bring claims for fraudulent and wrongful trading and to permit liquidators and administrators the statutory right to sell or assign officeholder claims to any third party. Unsecured creditors would benefit from the proceeds of the sale and officeholder claims would be more likely to be pursued. We anticipate that a market in these actions would develop, and increase the prospect of actions being taken against directors. This would occur if IPs prefer the certainty of having up front funds or do not want to take the risk of pursuing funds or fighting a case that might involve litigation and uncertain costs that could be difficult to recover in full.

Initial assessment of business impact

Option 0: Do Nothing (Least Favoured Option)

16. There will still be the possibility that officeholders will use the currently available recovery actions (fraudulent trading, wrongful trading, wrongful preferences, transactions at an undervalue and extortionate credit transactions) to obtain some financial redress for creditors where there has been misconduct but concerns will remain over the restrictions on bringing such actions, how many such actions will be taken and how much creditors will benefit and thus the perception of the recovery regime in the eyes of stakeholders and their confidence in it.

17. Currently available civil remedies are used infrequently. This is partly because of the evidential bar needed to bring a successful action and the lack of assets that a director may have. However some respondents to the consultation also mentioned that it is largely because of the constraints on an insolvency practitioner bringing actions and the need to find funds to bring such court actions.

18. Some practitioners may continue to use CFA agreements to fund actions, but their use may become more limited after April 2015 when a reform to this type of litigation funding is

introduced. Some practitioners may therefore decide to assign actions instead but from informal discussions with firms that use this method of funding, we expect this to be a relatively low number. However any changes to the CFA market that result due to this reform will be due to this particular change rather than any impact of the assignments option that is being proposed.

19. In addition, if administrators wish to bring actions for fraudulent and wrongful trading actions themselves, they will have to continue to convert the administration to liquidation, which is an unnecessary cost.

20. This is our least favoured option as it does nothing to address concerns over the lack of financial redress for creditors.

Option 1: Enabling Liquidators and Administrators to assign to third parties certain rights of action that only they can bring under the Insolvency Act 1986 and to extend the right to bring fraudulent and wrongful trading actions to an administrator (recommended option)

21. Although insolvency law contains civil remedies that insolvency practitioners (e.g. liquidators and administrators) may use to seek financial redress against directors, we understand that these powers are used infrequently, largely because funds are not available to the insolvency practitioner to bring court actions. Insolvency practitioners have informed us that the threat of litigation results in some settlement of claims from directors but as these are not publically disclosed, it is difficult to estimate how often this occurs in practice. However we have been told by respondents to the consultation and others who litigate insolvency claims that the vast majority of cases are settled before any court action occurs.

22. This civil claim is not a sanction available to administrators. An administrator wishing to pursue this type of claim would first have to put the company into voluntary liquidation. That is an unnecessary cost and we therefore propose to allow administrators the same right as liquidators to bring wrongful and fraudulent trading actions themselves. This part of the proposal has not been quantified.

23. In addition there are also other causes of action that can only be brought by an administrator or liquidator (officeholder claims), such as where there has been a preference given, a transaction at an undervalue, or an extortionate credit transaction, within a defined time period before the company entered into administration or became insolvent.

24. We propose to grant liquidators and administrators the statutory right to sell or assign any officeholder claims, i.e. those claims which only a liquidator or administrator can bring in their own right, not on behalf of the company. This would enable an officeholder to sell the claim on to an individual creditor, group of creditors, a former director or any third party. Subject to the terms of the assignment, the purchaser could take all the risk and bear all the cost of pursuing the prospective claim, but would stand to gain fully from potential benefits arising from the action.

25. The number of additional claims this proposal will allow to take forward is **unknown** as it will depend on how the market develops. Neither we nor stakeholders can robustly forecast how this new market will develop, but we have tried to show the potential impacts based on information received from a consultation response (in confidence), who specialises in insolvency litigation (through purchasing claims outright and also supporting officeholder claims). We have been told by the consultee that a specialised market is developing in civil litigation for insolvency actions, even though a lot of insolvency officeholders are currently more averse to taking forward actions themselves due to not having sufficient monies to bring an action and the time and resource required for a successful claim. However, it is expected that the number of additional cases will be relatively low for the following reasons:

    i. Even if there is increased flexibility for officeholders to take forward claims, the evidential bar to prove the claim will remain high.

    ii. In addition, there is still the risk that directors will not be able to pay the claim.

26. An incipient market is developing for insolvency civil litigation action. One popular model is to pay the insolvent company a nominal fee plus a percentage of net proceeds to purchase a case (percentage varies but typically it is around 50%). There is generally a fixed cost contract with lawyers which is capped at a fairly low level to cover work up to the issue of proceedings. However the vast majority of the work is carried out by staff of the civil litigation firm itself with access to key information provided by the insolvency practitioner. This approach keeps costs to

a minimum and is a relatively quick process and has proved to be successful in returning monies to creditors. This type of model may become more prevalent once the new provisions are in place and officeholder actions are assignable and further compete with the CFA model. This model has proved highly successful for a firm in the field of civil litigation of insolvency claims and we have used data from this firm to estimate the potential costs and benefits of additional cases that maybe assigned.

27. It should be remembered though that the majority of the market for civil recovery actions is carried out on a CFA basis and we expect this to continue to a large extent.

28. We expect insolvency professionals to have regard to existing professional and ethical standards in judging when to assign causes of action. The Insolvency Act 1986 already contains provisions which allow the actions of a liquidator or administrator to be challenged (see s168(5) and paragraph 74(1) of Schedule B1 to the IA86 respectively).

29. The proceeds from any assignment or sale of the action would become assets for distribution in the insolvency so unsecured creditors should thereby benefit. We anticipate that a market in these actions would develop, and increase the prospects of actions being taken against directors more frequently where there has been misconduct. Once directors realise that the threat of action is more likely, long-term changes to behaviour (i.e. less detrimental conduct) could potentially result.

30. There may be practical barriers which affect a purchaser's ability to pursue a claim. For example, the purchaser would not have the same access to information (such as the company's records) or the statutory right to make enquiries that a liquidator, for example has. This would limit to some extent the likelihood of claims being pursued, but we will continue to explore ways in which these issues could be overcome.

31. To strengthen the regulation, this option also proposes that the SoS and officeholder strengthen their information gateways to better enable successful recovery actions to be taken forward by the officeholder. Information sharing between the SoS and officeholders already takes place through a formal information disclosure process (D return) and through general 'intelligence requests'. Further mechanisms could be introduced to strengthen and streamline the information sharing process and ensure information is shared as early as possible. Indeed there are further measures proposed to ensure this.[6] This would enable better financial redress for creditors.

32. Recovery actions require a detailed investigation of the books and records and other evidence that is available. The SoS or official receiver may have already carried out a comprehensive investigation of the case and this evidence could be made more readily available to the officeholder. This would make it easier for them to then instigate a recovery action against the directors which would potentially result in financial redress for the creditors.

33. Where the officeholder is a liquidator, the same situation would apply for taking forward wrongful and fraudulent trading cases. These types of cases can be difficult to evidence and take forward so any investigative material that is held by the SoS or official receiver would be of benefit to the officeholder if he/she is considering taking forward such a case. This will help in obtaining some form of financial redress for creditors.

Other options considered

34. Information sharing between the SoS and officeholders is already possible and does take place to some extent. However, this can be made more formal through updating internal guidance used by Insolvency Service staff. This is the reason why it was not considered as an alternative option as it is difficult to know how many more recovery actions would take place if this was further promulgated.

35. It was suggested that the evidence bar could be changed but this policy is not about creating new causes of action or increasing the potential liability of directors. It would bring officeholder claims into line with other claims of the insolvent company for losses caused which can be subject to civil

[6] The process to streamline the reporting process i.e. the D return being sent to SoS earlier and submission of the D-return electronically. http://www.bis.gov.uk/insolvency/Consultations/RedTapeChallenge?cat=open

A regulatory measure which will enable the SoS to go directly to any 3rd party where they believe that 3rd party has information relevant to the investigation of the case.
http://services.parliament.uk/bills/2013-14/deregulation/documents.html

recovery action and which can already be assigned.

36. The policy is about making sure current provisions/protections for creditors are used where possible and if not, allowing for a greater opportunity for these current provisions to be used. We therefore did not consider or consult on reducing the evidence bar.

Costs and benefits of Option 1 (illustrative)

37. **As it is very difficult to estimate the exact number of cases which will be assigned, an illustrative example of the number of cases has been estimated. Thereafter, a break-even analysis has been used to calculate the number of cases that need to be assigned over the 10 year appraisal period to cover the one-off familiarisation costs.**

Costs

Costs to the private sector – court and wider legal costs

38. No *transition costs* are expected to the public sector from implementing this proposal.

39. There might be *on going costs* to the justice system from an increase in the number of claims against a director taken to court. We have attempted to estimate legal costs but as explained below we do not believe that there will be a significant number of new cases.

40. The number of additional cases going to court, on a per annum basis, has been calculated using the following assumptions:

41. All assignments purchased in the market result in a successful pursuit of miscreant directors (as evidenced by information provided by a consultee). Officeholders and litigation firms normally only take a case forward where they are very confident of a success. The evidence from the consultee shows a 100% success rate and informal views from other litigation firms also shows a very high success rate. Therefore, all additional court and legal fees are met by the director.

42. All proceedings under Option 1 are additional, and would not be brought to court or proceeded with under the Do Nothing option. As evidenced earlier the number of reported court cases in the 27 years since the recovery provisions were enacted average out at about six a year and these have been taken into account in our analysis below.

43. The potential market for the number of actions is capped at 1200. This is based on the average number of disqualifications that are brought by the Insolvency Service (acting on behalf of the Secretary of State) each year. A disqualification would need to prove unfit conduct, indicating a potential cause of action. Although a cause of action can be brought without a disqualification occurring, we have been told by consultees that a high evidential threshold is required to bring a successful action and to take a case forward, they have to be fairly confident of a successful outcome before proceeding further. Therefore we have used the number of disqualifications as a guide for the potential size of the market.

44. There are already certain recovery actions that can be assigned under current legislation (such as recovering directors' loan accounts, breach of contracts, general misfeasance/director negligence, etc.). These claims can already be assigned under current legislation as they do not arise immediately upon the insolvency. Our proposal is to allow officeholder claims that arise upon the insolvency to also be capable of assignment.

45. We have assumed that the types of action that can already be assigned are out of scope of the potential market for Option 1 as the proposal has no impact on this. Currently about a half of the consultees assignments/actions they take relate to claims that are currently assignable (the remainder being where they act for the officeholder). Therefore the market has reduced by another 50%. The pool of potential cases is based on actions that cannot currently be assigned and which we believe litigation firms would be interested in buying and taking forward if they were permitted to do so.

46. The market is further restricted by the number of directors who cannot pay an award. This was stated by consultee respondents as another reason why cases aren't currently taken forward. We have therefore assumed that the market is reduced by a further 10-20% to take into account the fact that some directors are not able to meet a potential claim against them. This figure is based on conversations with a couple of firms that take these cases forward on a CFA basis and also on internal Insolvency Service data on the proportion of cases where costs are sought in disqualification cases and are not recoverable due to the inability of the director to pay. If they cannot meet the costs of a case, they would not be able to meet any litigation award.

47. The facilitation of assignments under Option 1 has limited impact on the market for CFAs as it has been assumed that these cases would already be taken forward by IPs on a CFA basis where they thought it worthwhile. It is only where they do not have the funds or do not think they can bring a claim for whatever reason (do not think the evidence is there, not willing to risk bringing the claim) that others may wish to purchase the claim due to their higher risk profile or greater expertise/economies of scale in bringing such actions. If an IP wishes to use a CFA agreement to take a claim forward, he already can and the ability to assign a claim should make no difference to this decision. If however, he does not wish to take a claim forward because he thinks it is too risky or does not think he has the precise evidence base to bring a claim, then he may wish to assign the claim if there is a willing party to purchase it, who might be less risk averse and/or have greater expertise in bringing such claims. An IP may be unwilling to bring such cases if he has to expend time and effort and is uncertain if he will recover monies to cover this time and cost. This would be a sunk cost to him.

48. As explained above, due to the absence of consultation responses addressing this particular issue and also the lack of data on current CFA arrangements, **an indicative range** has been constructed for the number of actions that may be assigned, on a per annum basis, under Option 1. This is based on the assignment market taking 10 to 30% of the number of potential litigation actions as follows:

    'Low growth' scenario – 40 to 50 cases per year

    'Medium growth' scenario – 90 to 100 cases per year

    'High growth' scenario - 140 to 160 cases per year

    These percentages are based on discussions with a key consultee and how he expects his firm to grow and also any impact this option has on the CFA market and the current available options open to IPs. The model used by the key consultee response may continue to grow and IPs may decide to assign a case rather than proceed on a CFA basis or not take forward a case at all.

49. These market share assumptions have been used to construct the growth scenario ranges introduced above. In the 'Low growth' scenario, 10% of claims are assigned. In the 'Medium growth' scenario, 20% of claims are assigned and in the high growth scenario, 30% of claims are assigned. These are claims that are not currently taken forward or if they are taken forward, do so on a CFA basis. These percentages are in line with the growth rate of the consultees business and are indicative of how the market may develop.

50. The low growth is based on a potential market of 600 claims (1200*50% of claims that are not currently assignable). 10% of the market gives 60 claims which are then subject to a further reduction due to 10-20% of directors not being able to meet an award. We have also taken away the 6 cases a year that currently goes to court (see para. 2 above). This gives a range of roughly 40 to 50 cases a year in the low growth scenario. This also takes into account the fact that most insolvency claims are currently able to be taken forward on a CFA basis and so these new assignments are likely to be cases that were not previously taken forward under the CFA model.

51. For the medium growth scenario, we have assumed that 20% of potential claims are assigned. 20% of the market gives 120 claims, which is then subject to the same situation as above, with a further 10-20% reduction due to 10-20% of directors not being able to pay. After taking away the 6 cases a year that currently go to court, this gives a range of roughly 90-100 cases a year.

52. For the high growth scenario, we have assumed that 30% of the potential claims are assigned. 30% of the market gives 180 claims, which are then subject to the same reductions as above. This gives a range of roughly 140 to 160 additional assignment cases a year.

53. Responses from the consultee and informal discussions with other stakeholders suggest that the majority of cases are settled out of court, in fact, upwards of 90%. Court costs are estimated to be £885 per day based on figures from HMCTS. We have estimated that a court case would last on average one day based on estimates provided by the

consultee.

54. In addition to court costs, the defendant director will be required to meet the wider legal costs which accrue to additional cases being pursued, whether they are settled or heard in court. Figures provided by the consultee suggest that the legal costs incurred by the civil litigation firm assigned a case will average £8,640 per case. These will be matched in size by the defendant director's own legal costs. Therefore, wider legal costs are assumed to average £17,280 per case. The assumption about the proportion of cases being settled in court (5% or 10%) is irrelevant, as the assumption of each side bearing £8640 of legal costs is based upon the consultees average cost per case, irrespective of whether it is settled in court or via an out of court agreement. This would be specific legal costs, rather than the general investigation costs which would be recovered from the proceeds of any successful action. Overall legal costs would be paid from the miscreant director to the legal firms/parties.

Costs to the private sector

One off cost to Insolvency Practitioners

55. *Transition costs* to IPs are estimated to be £760k. We would anticipate familiarisation taking up to one to two hours of an IP's time based on the assumption that this change is not complex to understand and would only need to be understood once. There are currently 1,352 IPs who take case appointments and we have assumed an average hourly rate for an IP of £375 per hour. This is based on the average hourly charge out of an IP firm, at director/partner level.[7] Based on these figures, **we would expect familiarisation costs to IPs to be in the region of £0.5m to £1.0m with a mid point of £0.8m.** These familiarisation costs are also in line with other impact assessments for proposals affecting IPs, for example the impact assessment on Insolvency Practitioners Fee regime.

56. Familiarisation **costs to lawyers** are similarly expected to result from one to two hours spent in reading the new guidance. Whilst no hard data is available, officials from the Insolvency Service who deal with disqualification cases, and lawyers instructed by directors, estimate that a third of defendants to proceedings under section 6 CDDA and all defendants to proceedings under section 8 CDDA seek legal advice, with a range of one lawyer per one to two disqualified directors. Including all lawyers instructed with respect to such proceedings by the Insolvency Service gives a range of 210 to 375 lawyers who might want to familiarise themselves with the new guidance. Guidelines for the judiciary indicate that legal professionals can charge between £146 and £409 per hour depending on their grade and location. The cost therefore ranges from (210 lawyers x £146 x 1hrs to 375 lawyers x £409 x 2hrs), £30.7k to £306.8k with a mid point of **£0.2m**.

57. In general costs to IPs and lawyers will fall within their continuous professional development as they will have to be aware of developments in regulations as part of their job. However, these are still considered additional costs in this impact assessment as the time spent on understanding the new guidance could otherwise be spent on other professional activities (including other types of continuous professional development).

58. Overall one off cost to the private sector from this option is therefore expected to be **£538k to £1.32m with a mid point of £929k**. Table showing familiarisation costs to lawyers and insolvency practitioners:

	Lower estimate (£m)	**Middle estimate (£m)**	**Upper estimate (£m)**
Costs to IPs (paragraph 57)	0.51	0.76	1.01

[7] See para 3.1 http://www.bis.gov.uk/insolvency/insolvency-profession/review-of-ip-fees

Costs to lawyers (paragraph 58)	0.03	0.17	0.31
Overall one-off cost to private sector	**0.54**	**0.93**	**1.32**

Recurring costs to Insolvency Practitioners

59. There will also be additional *on going* costs to IPs (acting as officeholder) from preparing the sale offer to prospective assignees, if the officeholder wishes to sell a claim (including an assessment of whether the prospective claim has a reasonable chance of success).

60. It has been estimated that three hours is required for a sale offer to be prepared. This is based on the fact that IPs can already assign other insolvency actions and so the process to do this should already be reasonably well known and so the process for preparing the assignment fairly routine. The required documentation would be prepared by a suitably-qualified solicitor or legal executive. HM Court Service guidelines suggest that the hourly fee for preparing this documentation is £177.00[8]. The overall costs of preparing the contracts for assigning actions are calculated by multiplying the assumed number of cases by £531 (three hours at £177). These costs would be accounted for in the sale offer and would be a net cost to the insolvency estate (and therefore not included separately in the costs/benefits), but would be recovered by the sale proceeds and any subsequent award from the assignment.

Directors

61. No additional costs to compliant directors are expected from this proposal. Wrongful and fraudulent trading claims, unfair preferences, transactions at an undervalue and extortionate credit transactions are already currently stipulated in the legislation. Compliant directors will therefore not be affected by the increased flexibility to pursue a claim where there has been misconduct.

62. However, miscreant directors – those who have engaged in wrongful and fraudulent trading claims, unfair preferences, transactions at an undervalue and extortionate credit transactions – may bear additional costs under Option 1, if there is sufficient evidence to suggest that a case against them can be made.

Benefits

63. It is important to note that, while these additional claims against miscreant directors are a cost to the directors, they are a benefit to insolvent estates and the civil litigation firms which have been assigned the cases. In effect, Option 1 allows for a benefit/transfer from miscreant directors to insolvent estates and civil litigation firm assignees.

64. The following assumptions have also been employed in estimating the size of this benefit/transfer:

    a. The average case value, according to the consultee's current book of business, is £77,000.

    b. The average case value size excludes court costs and wider legal fees.

    c. The award is split equally between the civil litigation firm assignee and the insolvent estate that had previously sold the action (and thus affects the distribution of the transfer).

65. The overall size of the benefit/transfer is calculated by multiplying the number of assigned cases

[8] The use of a £177.00 hourly rate assumes that solicitors and legal executives with over four years of post-qualification experience, including at least four years litigation experience, are used to prepare the documentation.

by £77k. The distribution of awards may change over time, as the market for assignments becomes more competitive. The equal share between insolvent estates and civil litigation firms reflects the current business model used by the consultee, in the insipient market for claims, which consultees suggest is currently a highly concentrated market. As more civil litigation firms enter the market, it is likely that the right to 50% share of awards, which is currently purchased by civil litigation firms, will be bid downwards. There is no evidence pointing to the speed at which this market maturation will occur, and so changes to the distribution of the awards between insolvent estates and civil litigation firms has been excluded from the analysis.

66. As mentioned above, it is very difficult, due to the lack of formal evidence, to estimate the number of cases that will be assigned, as this will be a new market. **However, for illustrative purposes, we have undertaken a 'break even' analysis to estimate the number of assignment cases which would need to be acquired in order to justify the one-off familiarisation costs to IPs and lawyers contained within this proposal.**

67. The main benefit of taking disqualification action is to prevent a director from being in a position to commit further unfit conduct. It therefore prevents a forced transfer of resources from creditors and others to the director, resulting from a breach of their obligations under the Companies Act. Because the benefit of this transfer to the director would occur as a result of a regulatory breach, we do not consider it in this analysis and the result of preventing the transfer is therefore a net benefit.

68. The benefits from assigning a case have been estimated to be £77,000 with associated legal costs of £17,280, resulting in a net benefit of about £60,000 per case.

69. **The one off costs identified (familiarisation costs to IPs and lawyers) are estimated to be between £538k and £1.32M, with a mid point of £929k. Therefore to cover these costs, using the mid point costs of £929k, over a 10 year appraisal period, the number of assignments required to neutralise the (net) familiarisation costs identified has been estimated to be two assignments a year.**

70. There may be some wider non-monetised benefits mainly related to:

    i. Increased confidence in the recovery regime by allowing more claims to be pursued and won.
    ii. Deterrent effect – the increased chance of pursuing a claim against directors might deter directors who otherwise might have been tempted to engage in misconduct.

71. However, these benefits will depend on the number of claims that are actually going to be pursued due to assigning or selling of rights of action. As mentioned earlier this number is expected to be low and therefore the benefits associated will also be proportional to this level.

<u>Distributional impacts of assigning officeholder claims</u>

72. Annex A of this Impact Assessment provides an explanation of how a market for claims would work. No net costs or benefits to the overall economy are expected from operating a new market for claims as the market will only clear up when it is mutually beneficial for the agents to engage in a transaction; that is when their benefits cover the costs. The market will however redistribute the payoffs differently.

Directors to creditors

73. It might be expected that directors will be more likely to pay higher 'prices' for settlements, and agree to settlements which previously may have been rejected. We do not know how many cases are settled currently, but whatever the pool of cases, the final payoff is likely to be higher due to the greater likelihood of claims of some value being successfully pursued.

Officeholders to creditors

74. As mentioned in some consultation responses, the fact that the officeholder will sell the claim at a discount on the expected recovery (to cover for risks of non-recovery) could in some instances be to the detriment of the general body of creditors who will only receive a proportion of the recovery the officeholder could have achieved by litigating directly. This is a judgment for the insolvency practitioner to make as they are bound by statute to realise assets for creditors. It will remain open to them to pursue the claim themselves if that is the better option.

75. In addition, there might be some redistribution between creditors if the claim is sold to one

creditor. Risk neutral creditors will be able to buy claims from risk adverse creditors, and pursue the claim with mutual benefit.

Rationale and evidence that justify the level of analysis used in the Impact Assessment (proportionality approach)

76. As previously stated there is uncertainty as to how the market for assigning officeholder actions will develop. We have therefore attempted to provide an indication of the potential costs and benefit using data provided by a consultee in confidence and presented this in a break-even analysis. We had no other formal responses or access to data other than that provided by this consultee but have spoken to other stakeholders in confidence to try and sense check some of the assumptions used.

77. The main data limitation has been to understand the extent to which the number of claims pursued in future will be by the CFA model or by the model as used by our consultee. As previously mentioned CFA funding will be reformed for insolvency cases after April 2015, but there is no certainty as to what model will replace it. We have assumed in our analysis of the costs and the benefits, that the model that will become more prevalent will be similar to that of the consultee, and any increase in assignments is based on data provided by them. Even though this piece of data is uncertain, it has been assumed that the increase will be low. This is based on the fact that the proposal, although it allows more flexibility, it does not address other problems related to the financial redress of creditors, such as the high evidential bar on certain claims and the fact that some directors are already bankrupt when personal liability is sought from them or they have insufficient assets to meet a claim for liability. Moreover where there is a strong case, claims may still be directly pursued by the insolvency practitioner.

Risks and assumptions

78. A risk with the recommended option is that there will be very few additional cases taken forward and not many actions sold or assigned so creditors do not receive any additional financial redress. However evidence from firms operating in this area suggests this is a growing market with claims increasing at a fast rate and this proposal opens up the market even more by allowing all officeholder claims to be assigned so that there is an increased chance of directors being held accountable for their actions.

79. There is also a risk of speculative or opportunistic claims being brought against directors who may be ill placed to defend themselves. However, this risk should be small as we expect insolvency professionals to have regard to existing professional and ethical standards in judging when to assign causes of action. An assignment of such a claim should also be capable of challenge in court by the person against whom such an action would be brought, i.e. the person aggrieved by such an assignment, e.g. a director.

80. A further risk is that insolvency practitioners will sell claims at too low a value, thus reducing benefits for creditors. This risk should be small as insolvency practitioners have a duty to maximise returns for creditors and do not need to sell the claim unless they think it is in the best interests of creditors.

Summary and preferred option with description of implementation plan

81. The preferred option is to allow officeholder claims to be sold or assigned and for administrators to be given the right to bring fraudulent and wrongful trading actions. This would create a greater market for such actions and increase the likelihood of miscreant directors being held to account and obtaining financial redress for creditors and to combine this with (the non-legislative option) fuller information being passed as appropriate to insolvency practitioners. If legislation is passed to this effect, this is planned to come into effect two months after Royal Assent and this will be communicated to stakeholders in journal articles and via both the BIS and Insolvency Service websites.

Direct costs and benefits to business calculations (following OITO methodology):

82. This proposal is in scope of OITO and constitutes a zero net cost to business as presented in the break-even analysis showing only two assignments a year are needed to cover the one-off familiarisation costs of £0.93m. It is a deregulatory measure as it provides more options to an officeholder (IP acting as an administrator or liquidator) to deal with a claim that belongs to them in their capacity as officeholder.

Annex A. A market for officeholder claims

83. The introduction of a power to sell or assign officeholder claims, as proposed under this option, is likely to lead to the development of a market for such actions. The expected mechanics of this market are explained below[9].

- *Supply side*

84. Liquidators and administrators own the claims/actions against a director and they can take it forward on behalf of creditors. Under this proposal, officeholders will be the only sellers of the claim.

- *Demand side*

85. On the demand side, purchasers will buy the claim from officeholders. Three types of potential purchasers have been identified:

86. Individual creditors willing to pursue the claim on their own.

87. Specialised litigation firms, perhaps backed by insurance, debt collecting or litigation funding companies.

88. Directors or lawyers or others on behalf of creditor(s)?

- *Market transaction*

89. From an economic perspective, the sale of an officeholder claim will be possible if there exists:

90. A difference in the risk factors (perceived and actual – e.g. due to greater experience in pursuing such claims, which might increase the probability of success) of the individuals involved and the resulting 'certainty equivalent'; that is the minimum amount of money a person would rather have for certain instead of taking some risk;

91. A difference in the costs curve of the various agents; that is how cheaply each of them can pursue the claim (it might be expected that specialized law/litigation firms will be able to carry out evidence gathering in a more efficient way than an IP perhaps); and

92. A difference in what each party expects the value of the claim will be post litigation.

- *Officeholders (Liquidators and Administrators)*

93. From an officeholders' perspective the decision will be between three options:

94. Officeholders can **pursue the claim** themselves if their expected recovery is higher than the costs and they have enough funds to cover up front costs. This is generally not the case as explained in 'rationale for intervention' above; either because litigation in these cases is expensive or because the evidential threshold makes the likelihood of success more difficult.

95. Officeholders will also be able to **sell the claim**. According to economic theory, this will only happen if the price equals the officeholders 'certainty equivalent' which in this case would be their expected recovery from the claim less a discount the officeholder is willing to assume for the forgone risk.

96. As mentioned in some consultation responses, the fact that the liquidator will sell the claim at a discount on the expected recovery (to cover for foregone risks) will be to the detriment of the general body of creditors who will only receive a proportion of the recovery the liquidator could have achieved by litigating him/herself. This could equally apply to any officeholder claim. If an officeholder decided to sell or assign a claim that he could have taken forward himself, it will invariably be for a sum less than what the assignee hopes to realise from the claim. Otherwise he would probably not agree to purchase it from the officeholder. He is relying on his greater risk appetite or expertise and economies of scale in carrying out the full investigation and bringing forward the claim to realise a profit for him. This could be regarded as monies that may have gone to the creditors if the officeholder had taken forward the claim himself.

97. The officeholder can also decide to **negotiate with the director** and attempt to obtain a settlement. In the current system, officeholders are not in a strong position when negotiating, as

[9] This analysis is mainly base don the literature on Markets for Tort claims, and in particular the paper 'Selling Your Torts: Creating a Market for Tort Claims and Liability', Isaac Marcushamer, 2005: http://law.bepress.com/cgi/viewcontent.cgi?article=2479&context=expresso&sei-redir=1&referer=http%3A%2F%2Fscholar.google.co.uk%2Fscholar%3Fhl%3Den%26q%3Dmarket%2Bfor%2Btort%2Bclaims%26as_sdt%3D1%252C5%26as_sdtp%3D#search=%22market%20tort%20claims%22

the only other option they have is the litigation route. The director is the only one with the market power to buy the claim via a negotiation. In economic theory it is said that the director enjoys a monopsonist position[10].

98. The proposed changes remove the director's monopsonist position by introducing competition on the purchasers' side. The officeholder will now have more options and this might increase the 'price' the director is willing to pay to purchase the claim if he/she indeed wants to avoid litigation. In addition, the fact under this option, all creditors would be better off by the simple option given to them without any further need for litigation.

- *Purchasers*

99. The decision on whether or not to buy the claim and what to do next is likely to depend on the type of purchaser.

- *Individual creditors*

100. Granting officeholders the right to sell or assign their actions allows creditors who are expected to be risk averse (thus preferring a lower but certain amount of money) to sell the claim to individual creditors who are risk neutral (thus are more willing to pursue the claim), with mutual benefit. Risk neutral creditors will have a higher certainty equivalent, meaning that they will require a higher amount of compensation to settle.

- *Specialised litigation firms*

101. It is expected that litigation firms specializing in pursuing such claims will be able to do so more cheaply than IP's, because of scale effects and accumulation of expertise. Thus they will be likely to buy claims from officeholders to realize profit, even if from the officeholder's point of view pursuance of such claims may not be profitable.

- *Directors*

102. Benefits to directors include an independent third party assessment of the strength of the claim. If a third party is willing to buy the claim, directors should have a cause to worry and believe that the claim has some chance of success.

103. This will also help them to determine the market price for a settlement. As mentioned above, this is likely to be higher than in the current system due to increased competition.

- Wider Impacts:

Statutory Equalities Duties - The proposal has no impact.

Competition -The proposal has no impact.

Small Firms – Some of the firms who will be purchasing and selling the claims could be small businesses. However the proposal will benefit both the purchaser and seller in that they will benefit from a claim that might not have been taken forward if nothing had changed. Also some of the creditors who could also benefit from this proposal could also be small businesses.

Wider Environmental Issues - The proposal has no impact.

Health and Well-being / Human Rights – The proposal has no impact. There will be no impact on compliant directors. Wrongful and fraudulent trading claims, unfair preferences, transactions at an undervalue and extortionate credit transactions are already currently stipulated in legislation. Therefore compliant directors will not therefore be affected by the increased flexibility to pursue a claim where there has been misconduct.

Justice System – Due to the likelihood of more cases being assigned, there is a chance that some extra cases could be heard in Court. However we expect this to be fairly negligible due to the vast majority of cases currently being taken forward being settled out of court (over 90%). We have attempted to calculate the cost to the courts above.

Rural Proofing - The proposal has no impact.

[10] Monopsony - A market situation in which the product or service of several sellers is sought by only one buyer

Sustainable Development - The proposal has no impact.

Title: Giving the court and Secretary of State (SoS) a power to make a compensatory award against a director **IA No:** BIS INSS003 **Lead department or agency:** The Insolvency Service **Other departments or agencies:** Department for Business Innovation and Skills	Impact Assessment (IA) **Date:** Published 25 June 2014 **Stage:** Final **Source of intervention:** Domestic **Type of measure:** Primary legislation **Contact for enquiries:** **Muhunthan Vaithianathar** **020 7637 6515**

Summary: Intervention and Options

RPC Opinion: Not Applicable

Cost of Preferred (or more likely) Option

Total Net Present Value	Business Net Present Value	Net cost to business per year (EANCB on 2009 prices)	In scope of One-In, Two-Out?	Measure qualifies as
-0.90	-0.90	0.09	No	n/a

What is the problem under consideration? Why is government intervention necessary?

The main purpose of the disqualification regime is to provide protection to the market and consumers from the acts of those directors whose conduct falls below expected standards. However, those who have suffered from that misconduct do not directly benefit from the disqualification action, and many remain sceptical about how effective disqualification is in tackling poor director behaviour. A complaint often raised in Ministerial correspondence from creditors is that although disqualification can prevent a director acting as such in future, it provides no compensation to those who have suffered from their misconduct and the disqualified directors don't appear to have suffered financially. Information asymmetries and transaction costs might prevent some creditors from protecting themselves against misconduct and therefore government intervention is needed to provide the right level of protection for creditors and discourage director's misconduct, increasing in turn confidence and trust in the overall disqualification regime.

What are the policy objectives and the intended effects?

The objective of the policy option is to improve stakeholder confidence in the enforcement regime and effect a change of behaviour in directors by increasing the likelihood of culpable directors being called to account for their actions, whilst providing better recourse to creditors who have suffered.

What policy options have been considered, including any alternatives to regulation? Please justify preferred option (further details in Evidence Base)

Do Nothing: This will likely result in the continuation of the current infrequent use of civil recovery mechanisms and no change to the likelihood of directors being financially accountable for their actions.

Option 1 (**preferred option**): Giving the court and Secretary of State (SoS) a power to make a compensatory award against a director. This option would give the courts the power to require an individual who has been disqualified to pay compensation to the creditors where the actions of that director have caused loss to the creditors (a "compensation order") on application by the SoS. We also propose to allow the SoS to request and accept compensation awards (compensation undertakings) from directors to avoid the need for court proceedings (same principle as a disqualification undertaking – see para. 20 below). This option would also include strengthening the information gateways between liquidators and official receivers and the Insolvency Service to better target cases where financial redress is available. Better communication between liquidators and the Insolvency Service may enable liquidators to decide if it is possible and worthwhile to bring actions to get financial redress for creditors.

No other options were considered as the only mechanism for increasing the likelihood of miscreant directors being held more financially accountable for their actions and to provide better redress for creditors who have suffered is to allow the making of a compensation award against a director. No other mechanism allows this. Existing civil recovery mechanisms are used infrequently and there is a perception that directors of failed companies get off lightly, even where disqualified, if they pay no financial penalty. Compensation awards will allow this.

Will the policy be reviewed? It will be reviewed. **If applicable, set review date:** April 2020

Does implementation go beyond minimum EU requirements?			N/A		
Are any of these organisations in scope? If Micros not exempted set out reason in Evidence Base.	**Micro** No	**< 20** No	**Small** No	**Medium** No	**Large** No

What is the CO_2 equivalent change in greenhouse gas emissions? (Million tonnes CO_2 equivalent)	**Traded:** N/A	**Non-traded:** N/A

I have read the Impact Assessment and I am satisfied that (a) it represents a fair and reasonable view of the expected costs, benefits and impact of the policy, and (b) that the benefits justify the costs.

Signed by the responsible Minister: Jeremy Hunt Date: 18 June 2014

Summary: Analysis & Evidence

Policy Option 7

Description: Giving the court and Secretary of State (SoS) a power to make a compensatory award against a director

FULL ECONOMIC ASSESSMENT

Price Base Year 2013	PV Base Year 2013	Time Period Years 10	Net Benefit (Present Value (PV)) (£m)		
			Low: -1.30	**High: -0.50**	**Best Estimate: -0.90**

COSTS (£m)	Total Transition (Constant Price)	Years	Average Annual (excl. Transition) (Constant Price)	Total Cost (Present Value)
Low	0.5	1	0	**0**
High	1.3		0	**0**
Best Estimate	0.9		0	**0**

Description and scale of key monetised costs by 'main affected groups'

There are one off familiarisation costs to insolvency practitioners (IPs) and lawyers in becoming familiar with the legislation estimated to be £0.93m.

Other key non-monetised costs by 'main affected groups'

Since we cannot be certain about the number of compensation cases that will be taken forward, an illustrative scenario has been constructed. The costs which are associated with this scenario have not been included in the NPV or EANCB calculations, as they are not sufficiently robust for this purpose.
Based on our illustrative figures, the increased investigation costs incurred by the Insolvency Service in pursuing a compensation award are in the range of £0m to £1.73m per annum. This is a cost to the Insolvency Service.
Based on our illustrative figures, there could be increased court fees/costs to be paid in the range of £0m to £0.07m per annum.
There could also be wider legal fees in the range of £0m to £1.96m per annum. This will cover both the directors own legal costs and that of the Insolvency Service in pursuing the compensation award. These costs will be paid/claimed from the miscreant director.

BENEFITS (£m)	Total Transition (Constant Price)	Years	Average Annual (excl. Transition) (Constant Price)	Total Benefit (Present Value)
Low	0	N/A	0	**0**
High	0		0	**0**
Best Estimate	0		0	**0**

Description and scale of key monetised benefits by 'main affected groups'

No monetised benefits have been identified (see below).

Other key non-monetised benefits by 'main affected groups'

Since we cannot be certain about the number of compensation cases that will be taken forward, an illustrative scenario has been constructed. Therefore those benefits which are associated with this scenario have not been included in the NPV or EABC calculations.
Based on our illustrative figures there would be a benefit occurring from miscreant directors to creditors (insolvent estates). This equates to a range of £0m to £11.6m per annum. This would be paid by miscreant directors.
There may also be some wider non-monetised benefits relating to increased confidence in the enforcement and civil recovery regime, if directors believe there is a greater chance of them being held financially accountable for their actions, this may deter them from committing misconduct in the first place, which may result in smaller losses to creditors and also fewer disqualifications resulting from any reduced misconduct.

Key assumptions/sensitivities/risks **Discount rate (%)** 3.5

It is difficult to predict either how many cases the SoS (Insolvency Service) will seek a compensation award in or the ability of the directors in these cases to meet such an award. Therefore the analysis undertaken has mainly focussed on identifying the groups affected, describing the impacts and where possible quantifying the effect rather than trying to monetise all the costs and benefits. Monetisation of impacts has only been done when data was readily available. Where none has been available, quantification has been presented as an indicative/illustrative breakdown. The assumptions are explained in further detail below.

BUSINESS ASSESSMENT (Option 7)

Direct impact on business (Equivalent Annual) £m:			In scope of OITO?	Measure qualifies as
Costs: 0.1	**Benefits:** 0.0	**Net:** -0.1	No	n/a

Evidence Base (for summary sheets)

Introduction

The CDDA and Disqualification of Company Directors

The Company Directors Disqualification Act 1986 (CDDA) aims to maintain the integrity of the business environment. Those who become directors of limited companies should:

- Carry out their duties with responsibility; and
- Exercise adequate skill and care with proper regard to the interests of the company's creditors and employees.

The majority of directors do this effectively, but the CDDA is a powerful tool against those who abuse the privilege of limited liability. The CDDA applies not just to persons who are formally appointed as directors but to those who carry out the functions of directors.

If there is any unfit conduct in an insolvent company, then the liquidator, administrative receiver, administrator or official receiver has a duty to send the Secretary of State for Business, Innovation & Skills a report on the conduct of all directors who were in office in the last three years of the company's trading.

The Insolvency Service, on behalf of the Secretary of State has to decide whether it is in the public interest to seek a disqualification order against a director.

The proceedings are brought by The Insolvency Service on behalf of the Secretary of State for Business, Innovation & Skills or, usually in compulsory winding-up cases, by the official receiver at the direction of the Secretary of State. The matter is heard, and decided by the court, unless the Secretary of State accepts a disqualification undertaking from a director. An undertaking has the same legal effect as a court order, but negates the need to go to court.

The minimum period of disqualification is two years and the maximum 15 years.

If a company director is disqualified (by court order or by giving an undertaking), unless they have court permission, that person is disqualified for the period stated in the order or undertaking from:

- Being a director of a company;
- Acting as receiver of a company's property;
- Directly or indirectly being concerned or taking part in the promotion, formation or management of a company; or
- Being a member of or being concerned or taking part in the promotion, formation or management of a limited liability partnership.
- Acting as an insolvency practitioner (IP).

Problem under consideration

1. The main purpose of the disqualification regime is to provide protection to the market and consumers from the acts of those directors whose conduct falls below expected standards. However, those who have suffered from that misconduct do not directly benefit from the disqualification action, and many remain sceptical about how effective disqualification is in tackling poor director behaviour.
2. A frequent complaint in Ministerial correspondence from creditors is that although disqualification can prevent a director acting as a director in future, it provides no compensation to those who have suffered from their misconduct. More importantly, for those creditors who have experienced financial loss, there is the perception that directors are able to walk away from the liabilities of the company, while remaining financially unscathed, and are able to start again, leaving creditors out of pocket and with little financial recourse.

3. Responses to the consultation paper also revealed there is a feeling that the threat of disqualification alone is not a sufficient deterrent to stop directors from misbehaving as the likelihood of them having to personally pay for their actions is not great enough.

4. Currently, there are a number of actions that can be taken against a director with the aim of getting financial redress for the company and creditors under the Insolvency Act 1986. These include actions for wrongful[1] and fraudulent trading[2], misfeasance or breach of directors' duties[3], wrongful preference[4] and transactions at an undervalue[5]. These are all civil actions although a criminal action for fraudulent trading under the Companies Act also exists. This proposal only concerns civil actions.

5. Responses to the Transparency and Trust discussion paper[6] suggested that there have only been 29 reported cases under s214 of the Insolvency Act 1986 (IA86), (wrongful trading claims) between 1986 and 2013 with liability being imposed in only 11 of those cases. There have been 80 cases under s238 IA86 (transactions at an undervalue), over 50 under s239 IA86 (wrongful preference) and over 60 claims were noted under s212 IA86 (misfeasance by directors) over the same period.

6. This might be for example due to insufficient assets in the insolvency estate[7] with which to fund an action by the officeholder and creditors being reluctant to fund the cases, coupled with a high evidential bar and a lack of director's assets, against which to enforce a successful claim. Officeholders are under a duty to realise assets and distribute the proceeds to creditors. It may be the case that there is a potential right of action, but it requires additional funds to proceed with the action. There may not be enough monies from asset realisations to fund an action and creditors may be unwilling to fund the action as they have already lost monies due to the insolvency of the company. Since money is limited, officeholders are only likely to proceed with an action where they believe the case has a very good chance of success and they are funded to bring it.

7. These were all reasons suggested in consultation responses by representative legal bodies, R3 (the trade body for insolvency practitioners), insolvency practitioners, Institute of Credit Management and Jordans (company formation agent and corporate services provider). However, the greatest weight was given to the high evidential bar and lack of director assets with which to pay an award as the main reasons why claims are not currently taken forward.

[1] Wrongful Trading – Cause of action arises if in the course of winding-up a company where the company has gone into insolvent liquidation and at some time before the commencement of the winding up, that director knew or ought to have known that there was no reasonable prospect that the company would avoid going into insolvent liquidation.

[2] Fraudulent Trading – Cause of action arises if, in the course of winding-up a company, it appears that any business of the company has been carried on with intent to defraud creditors of the company or creditors of any other person or has been carried on for any fraudulent purpose.

[3] Misfeasance – Cause of action arises if, in the course of winding-up a company, it appears that a person has misapplied or retained, or become accountable for, any money or other property of the company, or has been guilty of any wrongdoing or breached their duties of trust (for example, duty to hold something in trust) in relation to the company.

[4] Preference – Cause of action arises where the company enters administration or goes into liquidation and the company has at a relevant time given a preference to any person where that person is a creditor of the company or a surety or guarantor for the company's debts and the company does anything which has the effect of putting that person in a position which, if the company becomes insolvent will be better than the position he would have been in if that thing had not been done.

[5] Transactions at an undervalue – Cause of action arises where the company enters administration or goes into liquidation and the company has at a relevant time entered into a transaction at an undervalue. Transaction at an undervalue includes the giving of a gift or receiving consideration at significantly less than the value of the asset. However, the court must not make an order where the company entered into the transaction in good faith for the purpose of carrying on the business and at the time it did so, there were reasonable grounds for believing that the transaction would benefit the company.

[6] http://www.gov.uk/government/consultations/company-ownership-transparency-and-trust-discussion-paper

[7] Insolvency estate – assets or property which the officeholder can deal with to pay the creditors. Officeholders are under a duty to realise assets and then distribute the proceeds to creditors after deducting their costs and fees.

8. Although the main purpose of the disqualification regime is to provide protection to the market and consumers from the acts of those directors whose conduct falls below expected standards, greater stakeholder confidence can be achieved by increasing the likelihood of miscreant directors being required to compensate creditors in appropriate cases. This would result in greater personal liability as a result of directors' misconduct, and potentially mitigates the unintended consequences of limited liability protection of directors. The latest survey by the Insolvency Service suggested that around 65% of those questioned had confidence in the enforcement regime[8]. We believe this figure could be increased with the introduction of the proposals to improve financial redress for creditors.

9. The behaviours/misconduct that are often identified in disqualification reports are linked in many ways with the civil recovery actions that officeholders can currently bring under the Insolvency Act, such as those identified above, e.g. wrongful trading, transactions at an undervalue, unfair preferences, misfeasance by directors. Although not specifically mentioned in those same terms, the general behaviour/misconduct identified is similar. By being able to use a lot of this information in seeking a compensation award, the SoS should have less of the evidential issues officeholders may have in pursuing civil recovery actions.

10. The option of the SoS seeking a compensation order or agreeing a compensation undertaking from a miscreant director will enable greater financial redress for creditors, where the officeholder (IP) has not taken any of the available actions him/herself or it is considered that further action in addition to that taken by the IP is merited.

11. This could be due to the IP not having any funds to pursue a civil recovery action, or deciding that it would consume too much of their time to investigate and evidence a potential claim and not worth the risk, or feeling they don't have the specialist expertise to bring a claim. If this occurs, then the SoS (through the Insolvency Service) can consider bringing a compensation claim if they think it is in the public interest and the award can be recovered from the miscreant director. This could result in monies being paid to creditors in circumstances where previously they would have received nothing unless the officeholder (IP) brought a civil recovery action against the miscreant director.

Rationale for intervention

12. Laws to address general director misconduct, primarily the Company Directors Disqualification Act 1986 (CDDA), are currently in place. However, it is the strength of these laws and the level of punishment and compensation built into them that determine the effectiveness of aligning director and creditor incentives and ensuring the right level of protection for creditors.

13. The proposals presented in this impact assessment are aimed at addressing a **regulatory failure** in the public provision of law enforcement goods and services and therefore increase economic efficiency. In particular they are aimed at improving the efficiency of the law in protecting and preventing misconduct by explicitly allowing for a compensation award to be imposed against directors after misconduct has been established.

14. Director misconduct is a **moral hazard**[9] problem. This problem is caused by the perverse incentives, which, in turn, are created by limited liability[10]. Under moral hazard, directors are more likely to engage in misconduct or take more risks if they are not personally responsible for the consequences of their actions. [11]

15. Government action is therefore needed to minimise the unintended consequences of limited liability by achieving a better alignment of creditor and director incentives. This will be done

[8] 'Stakeholder Confidence Survey', Insolvency Service, 2012: http://www.bis.gsi.gov.uk/insolvency/About-us/our-performance-statistics/StakeholderConfidence

[9] In economic theory, a moral hazard is a situation where a party will have a greater risk appetite because the costs associated with risk taking will not be incurred by the risk-taking party.

[10] Halpern et al. (1980) Limited Liability in Corporate Law.

[11] One of the consultation responses argued, that, although there is firm grounding in the literature that limited liability generates a moral hazard problem, there is little empirical evidence of the e*xtent* of this problem. The extent of the problem would determine the degree of regulatory action, rather than the need for regulatory action, which is the subject of discussion in this section.

by discouraging directors from engaging in misconduct, by allowing for a greater possibility of miscreant directors being financially accountable for their actions, by allowing the SoS to seek or agree a compensation award from the miscreant director, an individual identified as worthy of being stopped from acting in the management or formation of a company.

Policy objective

16. The objective of the policy option is to improve stakeholder confidence in the enforcement regime and effect a change of behaviour in directors by increasing the likelihood of culpable directors being held financially accountable for their actions, and better compensating creditors who have suffered.

17. In turn, it is hoped that this will enable risk-taking and investment in the market which are nearer to the socially-optimal scale. Under the preferred option, there will now be scope for a compensation award to be paid from directors to creditors. Therefore, there is a greater chance that these monies can be used by the creditors of miscreant directors to grow or create a business. This measure should help support enterprise.

Description of options considered (including do nothing)

Do Nothing

18. There are a number of actions that can be taken against a director with the aim of getting financial redress for creditors under the Insolvency Act 1986. These include actions for wrongful and fraudulent trading, misfeasance or breach of directors' duties, wrongful preference and transactions at an undervalue. However existing civil recovery mechanisms are used infrequently and there is a perception that directors of failed companies get off lightly, even where they are disqualified, if they pay no financial penalty. Liquidators rarely bring actions against directors due to the cost and the complications (including a high evidential burden) involved. By doing nothing, this will remain the case.

Option 1 – Allowing Courts and the Secretary of State (SoS) to make compensation orders (recommended option)

19. This option is to give the courts and the SoS a power to make or agree, respectively, a compensatory award against a director at the time it makes a disqualification order or agrees a disqualification undertaking.[12] This measure is intended to improve stakeholder confidence in the enforcement regime by increasing the likelihood of miscreant directors being required to compensate creditors in appropriate cases.

20. In order to ensure that more directors make financial contributions to creditors of failed companies where they are responsible for that failure, we would like to give the courts the power to require an individual who has been disqualified to pay compensation to the creditors (a "compensation order") on application by the SoS. We also propose to allow the SoS to request and accept compensation awards from directors to avoid the need for court proceedings (a "compensation undertaking"), in the same way as the SoS can currently accept from an individual an undertaking not to act in the management of a company instead of applying to the court for a disqualification order. The size of these awards would be related to the misconduct found in the disqualification and the identifiable loss to creditors.

21. The criteria that must be fulfilled for either a compensation order to be made or a compensation undertaking to be accepted are:

    i. the individual must be disqualified under the CDDA;

[12] A disqualification order is made by the court under the Company Directors Disqualification Act 1986 (CDDA). Disqualification proceedings are taken under civil law, not criminal law. An order for disqualification can be made under a number of different sections of the CDDA. The order will specify the period of disqualification. A disqualification order usually carries with it an order to pay the costs and expenses of the SoS or the Official Receiver or both. Alternatively, directors may offer to give an undertaking. An undertaking is the administrative equivalent of a disqualification order and can be entered into, voluntarily, without the need for Court proceedings. Undertakings may be offered to the SoS, and once agreed, have the same effect as a Court order.

ii. the court (or SoS) must be satisfied that the conduct for which the individual was disqualified has caused loss to creditors of a company of which the individual was a director; and

iii. that company must be or have been insolvent.

22. The compensation may be awarded to a particular creditor or creditors, a class or classes of creditors, or may form a contribution by the director to the assets of the company. The court may order to whom the compensation is paid or the SoS may determine this in the case of a compensation undertaking, taking into account what is equitable in all the circumstances.

23. The amount of the compensation should be at the discretion of the court where a compensation order is made, or agreed between the director and the SoS if a compensation undertaking is given. It should never be greater than the loss caused. There are a number of factors that should be taken into account by the court or SoS in determining the amount of the compensation. These are:

i. The quantum of the loss suffered by the creditors;

ii. The severity of the director's misconduct;

iii. The degree to which the director's behaviour caused loss to the creditors;

iv. Whether the director has already made any financial contribution to the company or creditors in recompense for the conduct that lead to his disqualification (e.g. under a criminal compensation order or following a fraudulent or wrongful trading action);

v. Whether the misconduct was committed by more than one director or is attributable to one in particular.

24. To strengthen the regulation, this option also proposes that the SoS and officeholder strengthen their information gateways to better enable successful recovery actions to be taken forward by the officeholder. Information sharing between the SoS and officeholders already takes place through a formal information disclosure process (D return) and through general 'intelligence requests'. Further mechanisms could be introduced to strengthen and streamline the information sharing process and ensure information is shared as early as possible. Indeed there are further measures proposed to ensure this.[13] This would enable better financial redress for creditors.

25. Recovery actions require a detailed investigation of the books and records and other evidence that is available. The SoS or official receiver may have already carried out a comprehensive investigation of the case and this evidence could be made more readily available to the officeholder. This would make it easier for them to then instigate a recovery action against the directors which would potentially result in financial redress for the creditors.

26. Where the officeholder is a liquidator, the same situation would apply for taking forward wrongful and fraudulent trading cases. These types of cases can be difficult to evidence and take forward so any investigative material that is held by the SoS or official receiver would be of benefit to the officeholder if he/she is considering taking forward such a case. This will help in obtaining some form of financial redress for creditors.

Other options considered

27. Information sharing between the SoS and officeholders is already possible and does take place to some extent. However, this can be made more formal through updating internal guidance used by Insolvency Service staff. This is the reason why it was not considered as an alternative option as it is difficult to know how many more recovery actions would take place if this was further promulgated.

[13] The process to streamline the reporting process i.e. the D return being sent to SoS earlier and submission of the D-return electronically. http://www.bis.gov.uk/insolvency/Consultations/RedTapeChallenge?cat=open
A regulatory measure which will enable the SoS to go directly to any 3rd party where they believe that 3rd party has information relevant to the investigation of the case.
http://services.parliament.uk/bills/2013-14/deregulation/documents.html

28. The only option of increasing the likelihood of miscreant directors being held more financially accountable for their actions and to provide better redress for creditors who have suffered is to therefore allow for the making of a compensation award against a director. No other option allows this.

29. It was suggested that the evidence bar could be changed for existing civil recovery actions but this policy is not about changing existing causes of action or increasing the potential liability of directors in relation to existing actions. It is about using current misconduct by miscreant directors to obtain financial redress for creditors. We therefore did not consider or consult on reducing the evidence bar for civil recovery actions.

Costs of Option 1

30. Monetised costs

a) Transition costs

Costs to the public sector

It is expected that initial familiarisation will be incurred by the Insolvency Service and the Courts in order to understand and start applying the new legislation. These costs are estimated to be negligible as:

i. Costs to Courts:

One would expect some familiarisation costs to the courts and judges. These are unknown but they are expected to be negligible given the fact that judges are used to considering new legislation and published guidance on a regular basis and as part of their business as usual duties.

ii. Costs to the Insolvency Service:

Additional resource costs to the Insolvency Service to produce the guidance for staff and others on compensation awards are expected to be negligible as they will be incurred as part of the business as usual operation of the Insolvency Service. Information sharing systems between the SoS and the officeholder are already in place so the costs of learning how to share information in an effective way will be negligible.

The Insolvency Service's internal guidance material (the Enforcement Investigation Guide) will need to be updated. However, updating guidance is a continuous, business as usual process. The new guidance will be publicised using the Insolvency Service's existing channels, that is IP guidance material and changes to disqualification guidance on their website.

Costs to the private sector

31. Insolvency practitioners and lawyers will also need to familiarise themselves with the new legislation and the way it works.

32. **Costs to IPs** are estimated to be £760k. We would anticipate familiarisation taking up to one to two hours of an IP's time based on the assumption that this change is not complex to understand and would only need to be understood once. There are currently 1,352 IPs who take case appointments and we have assumed an average hourly rate for an IP of £375 per hour. This is based on the average hourly charge out of an IP firm, at director/partner level. Based on these figures, we would expect familiarisation costs to IPs to be in a range of £0.51m to £1.01m with a mid point of **£0.76m**.

33. Familiarisation **costs to lawyers** are similarly expected to result from one to two hours spent in reading the new guidance. Whilst no hard data is available, officials from the Insolvency Service who deal with disqualification cases, and lawyers instructed by directors, estimate that a third of defendants to proceedings under section 6 CDDA and all defendants to proceedings under section 8 CDDA seek legal advice, with a range of one lawyer per one to two disqualified directors. Including all lawyers instructed with respect to such proceedings by the Insolvency Service gives a range of 210 to 375 lawyers who might want to familiarise themselves with the new guidance. Guidelines for the judiciary indicate that legal

professionals can charge between £146 and £409 per hour depending on their grade and location. The cost therefore ranges from (210 lawyers x £146 x 1hrs to 375 lawyers x £409 x 2hrs), £30.7k to £306.8k with a mid point scenario of **£0.12m** (292.5 x £277.5 x 1.5hrs) (see table in para. 35 below).

34. In general costs to IPs and lawyers will fall within their continuous professional development, as they will have to be aware of developments in regulations as part of their job. However, these are still considered additional costs in this impact assessment as the time spent on understanding new guidance could otherwise be spent on other professional activities (including other types of continuous professional development). Any familiarisation costs to business are indirect and out of scope of OITO.

35. Overall one off cost to the private sector from this option is therefore expected to be **£538k to £1.32m with a mid point of £882k**. Table showing familiarisation costs to lawyers and insolvency practitioners:

	Lower estimate (£m)	**Middle estimate (£m)**	**Upper estimate (£m)**
Costs to IPs (paragraph 32)	0.51	0.76	1.01
Costs to lawyers (paragraph 33)	0.03	0.12	0.31
Overall one-off cost to private sector	0.54	0.88	1.32

*b) Ongoing costs (**based on an illustrative approach)***

Costs to the public sector

36. **It is very difficult to estimate the exact number of cases the SoS will decide to pursue compensation on, as the decision will be made on a case by case basis and will depend on the merits of the case and the extent to which it is in the public interest to seek compensation. Therefore an illustrative example of the number of cases has been estimated.**

37. As this will be a new process, it is difficult to estimate the costs and benefits precisely. There is no existing evidence to show the type of cases or what extra investigation activity and how much extra resource (i.e. grade of staff, number of letters/paperwork generated) there would need to be to take forward an investigation claim to pursue a compensation award. This impact assessment can only estimate what may occur and has come up with indicative costs and benefits. Taking an illustrative approach, there are two types of costs which could be incurred by the Insolvency Service from dealing with the compensation proceedings in addition to the existing disqualification process:

38. *Investigatory costs*: Insolvency Service officials will have to determine whether the claim is worth pursuing based on the merits of the case and the capacity of the director to pay the compensation. Data on investigations, including in-house and those passed out to solicitors to progress, shows the average cost to be £35,295 per case. This is the cost required to obtain a disqualification.

39. It is difficult to estimate how much extra investigation would be required to pursue a compensation award, but we envisage the majority of the evidence and work will have been completed in the disqualification investigation. We have therefore estimated that an additional 20-50% investigation cost may be required to pursue a compensation award. This would entail presenting the case for a compensation award in a suitable way to the court so it is clear to all parties the basis and evidence for the claim. This gives a range between £7,059 and £17,648 for the extra investigation costs required for a compensation case with a middle point of £12,353.

40. Internal Insolvency Service data on disqualifications shows that in 2012/13 there were **376** cases where the disqualification was six years or more (formally called middle and upper

bracket cases). These cases, in general, tend to involve the most serious misconduct and resulting in most harm to creditors and also most likely to be the cases where the SoS will seek a compensation award.

41. The allegations in the 376 cases were varied; crown debts[14] (41%), accounting records[15] (29%), criminal matters[16] (11%), transactions to the detriment[17] (10%), technical matters[18] (7%), and misapplication of assets (2%)[19].

42. Given that the main purpose of the compensation award is to provide financial redress for creditors, it is reasonable to believe that compensation could be sought from, **at least** those cases where there has been an identifiable loss to creditors, for example: misapplication of assets, transactions to the detriment, criminal matters and accounting records. On the other hand, it is also reasonable to assume that whatever the allegation, the SoS will also seek compensation for those cases where there are a lot of unsecured creditors or 'vulnerable' members of the public who have lost out. A quantification of these types of cases is not available from Insolvency Service internal data.

[14] Crown debts – Where debts are incurred to HMRC by a company and are knowingly treated differently to other debts, for example, slow or non payment or not filing returns, preventing HMRC establishing what they are owed. Crown Debt cases are basically Transactions to the Detriment of the Crown. Further examples of how we have described Crown Debt cases are:
Misconduct ranged from those who treated the Crown unfairly by paying other creditors ahead of the taxman, or who charged customers VAT and then failed to hand it over to HMRC, to those engaged in blatant tax fraud.
And
Directors who push the Crown to the back of the queue when conducting their business affairs are seeking an unfair advantage over their competitors by not paying their taxes and operating with lower overheads, thus undercutting those who play by the rules.

[15] Accounting records - When a company fails, its outstanding affairs need to be dealt with, and its trading history and the decisions of those controlling it come under scrutiny. Without records this process is hampered. This allegation considers the effects of not having records or where those records are not in a position to explain transactions which the company has or has not made.

[16] Criminal matters – For example where there has been intent to defraud creditors or carry on a business for a fraudulent purpose, i.e. knowingly carrying out criminal activity or where an individual has acted as a director of a company whilst bankrupt or in breach of a disqualification order or undertaking – the Insolvency Service may take disqualification action in such cases as well as referring the matter to a prosecuting authority.

[17] Transactions to the detriment - any transaction or series of transactions which adversely affects the interests of creditors. Detriment can be to creditors generally or just to a particular creditor or group of creditors. This allegation particularly considers the directors conduct and motivation in carrying out these transactions.

[18] Technical matters – There are various statutory obligations that a director is responsible for, such as filing accounts, annual returns, etc. Of itself, failing to undertake these duties may not be serious misconduct but persistent breaches of these duties may be considered as misconduct as they undermine the structures for viable and sustainable businesses.

[19] Misapplication of assets - A director has a duty to the liquidator or administrator to detail the assets that a company has. If he/she intentionally omits to detail these assets or provide details of their disposal/sale and they are considered to have a material value, then this can be considered as misconduct - creditors may lose out if assets cannot be traced.

43. Finally, all relevant factors will be taken on board before compensation awards are sought including investigative priorities, whether the pursuance of a case is in the public interest, the likelihood of the director being able to pay the compensation award. The assumption is that 2012/13 is a representative year and therefore these cases are extrapolated for a 10 year period.

44. Based on the assumptions above, the following scenarios have been built to assess the extent of the impact of the policy.

i. High case scenario: From the 376 middle and upper bracket cases, only **50%** of the 196 cases with allegations of misapplication of assets, transactions to the detriment, criminal matters and accounting records are considered for compensation awards. That is a total of **98 cases**.

ii. Middle case scenario: From the 376 middle and upper bracket cases, only **25%** of the 196 cases with allegations of misapplication of assets, transactions to the detriment, criminal matters and accounting records are considered for compensation awards. That is a total of **49 cases**.

iii. Low case scenario: None of the cases above have enough public interest to merit a compensation award to be sought.

45. **Based on these case scenarios, the per annum investigation costs to present a compensation award are estimated to be between £0 and £1,729k. Over a 10-year period, these costs are estimated to be between £0 and £17.29m.** These figures are undiscounted. The discounted NPV figures are shown in the summary table below in paragraph 60.

46. *Court costs*: It is expected that as a result of this proposal, a higher amount of disqualification cases might be taken to court instead of being settled as an undertaking. This could be due to directors having more incentive to litigate the cases in order to determine the 'right' level of compensation if the offer provided by the Insolvency Service is not perceived as fair; or if a director believes that he/she should not pay any compensation requested by the Insolvency Service, the director might decide to defend the case in court or he/she might not have any funds to settle, so might decide to have their day in court.

47. The cost to the Insolvency Service will be incurred in two ways; for cases already going to court for a disqualification, there will be extra court costs involved – these are estimated to be an extra court day and; for cases currently being settled as an undertaking where the director is incentivised to fight, there will be extra costs from taking both the disqualification and the compensation case to court. From looking at a sample of cases, the average length of a disqualification case is three days. Therefore for both a disqualification and compensation hearing together, this would take on average four days. The estimate of one day to hear the compensation award is based on evidence from stakeholders relating to the assignment of other civil recovery actions where a day is set-aside to hear any applications that result in a court hearing and not settled beforehand. Court costs are estimated to be £885 per day based on figures from HMCTS.

48. It is very difficult to estimate how many and which cases directors will decide to take to court and no approximation is available to the Insolvency Service. On average, 80% of disqualification cases are settled by undertaking while in the other 20%, proceedings are issued to go to court.

49. Based on these figures, the following scenario has been considered.

As per paragraph 44, it is assumed that, under Option 1, zero to 98 cases per annum are investigated in preparation for compensation litigation. It is assumed that 80% of these do not currently go to court (zero to 78), and are settled out of court via undertaking. This assumes that the current split for disqualifications (between court orders and undertakings) will equally apply to compensation awards.

Further, 10-20% of the cases currently settled out of court are assumed to be litigated for both disqualification and compensation (0 to 16) under Option 1. This takes into account stakeholder feedback in relation to assignment cases, where only about 10% of cases result in a court hearing. Since this will be a new process, we have used an indicative range of 10-20% based on the fact that compensation awards will be similar to other forms of financial redress, so we have assumed that a similar number of cases will be settled out of court as currently occurs in cases which IPs take forward.

Of the 20% of cases currently litigated (zero to 20 cases per annum), under Option 1, there will be the requirement of further litigation for the compensation award.

The Insolvency Service gathers data on the legal costs borne in cases brought. For 2012/13, the median average legal cost of a disqualification case settled by court order, from a sample of 10 cases, was £35,132. Since the average disqualification court case lasts three days, the average per day legal cost is estimated to be £11,711. Compensation proceedings are assumed to last a further day. So, under Option 1, a disqualification and compensation order hearing is expected to last an average of four days.

Based on these figures, the total legal costs from compensation awards to the Insolvency Service on a per annum basis are estimated to be as follows:

	Multiplied	Plus
Compensation hearing plus disqualification hearing (£35,132 + £11,711) Court costs: (£885/day*4)	By the number of cases that were previously undertakings that are now going to court Zero to 16 cases	Number of cases already currently going to court Zero to 20 cases

50. It has been assumed that the Insolvency Service (acting on behalf of the SoS) will only pursue a case where they are very confident of success (similar to the pursuit of assignment cases by civil litigation firms and IPs), and therefore all additional court and legal fees will be met by the miscreant director. We have also assumed that the legal costs incurred by the Insolvency Service will be matched in size by the defendant director's own legal costs.

51. **Therefore, based on these scenarios, the per annum legal costs will be between £0m and £2.00m. Over a 10-year period these costs are estimated to be between £0m and £20.00m. This covers both parties' costs, with the Insolvency Service legal costs being recovered from the miscreant director.** These figures are undiscounted. The discounted figures are shown in the summary table in paragraph 60 below. Table showing per annum legal and court costs to the Insolvency Service and director's own legal costs:

	Lower estimate (£m) – zero cases	**Middle estimate (£m) – 6 new cases and 10 current undertakings**	**Upper estimate (£m) – 16 new cases and 20 current undertakings**
Legal costs to IS (see paragraph 49)	0	6*(35,132+11,711) + 10*11,711 = £398,168 (£0.40m)	16*(35,132+11,711) + 20*11,711 = £983,708 (£0.98m)
Court costs (see paragraph 47)	0	6*885*4 days + 10*885*1 day = £32,125 (£0.03m)	16*885*4 days + 20*885*1 day = £74,340 (£0.07m)
Director's costs (same as IS – see paragraph 50)	0	0.40	0.98
Overall legal and court costs (subject to rounding on number of cases)	**0**	**0.80**	**2.00**

52. Consultation responses highlighted the potential for a higher investigatory burden falling on the State (Insolvency Service) from instances of free-riding amongst liquidators. That is, liquidators might decide not to pursue investigations for civil recoveries and wait for the Insolvency Service to decide whether to pursue a compensatory award first, hoping to then realise this award. However, since the compensation award will be awarded direct to creditors, this would result in a minimal or no fee for the insolvency practitioner, as he or she would not have spent time determining whether there is scope for a recovery, so the risk of this occurring is much less. They will only be able to charge a fee if they carry out the civil recovery themselves using their existing powers. We therefore do not think the risk of 'free-riding' is high and that the proposal will reduce the current level of civil claims brought by liquidators or administrators. No evidence exists on the likely number of cases of free-riding by liquidators.

Cost to the private sector

53. It is not expected that insolvency practitioners, lawyers, etc., will incur any ongoing costs (apart from the one off familiarisation costs identified above) from the proposal compared to the do nothing option, as all compensation award/undertaking will be taken through the Insolvency Service.

54. Compliant directors will not incur any costs either, as directors will have to be proven guilty of having engaged in misconduct and therefore disqualified, before a compensation award/undertaking can be made.

55. However those directors that choose to defend the compensation award proceedings would incur legal costs. As mentioned above, we have assumed that the defendant director's own legal costs will match those of the Insolvency Service.

Benefits of Option 1

Monetised impacts

56. It is difficult to estimate the compensation award that a court may make against a director or the compensation undertaking agreed between the SoS (Insolvency Service) and a director. It will be based on the damage caused to creditors and the evidence in the disqualification report. From a sample of 26 cases considered by debt recovery agents used by the Insolvency Service, they calculated a quantum of award averaging £132,000 a case. This would be paid by the miscreant director to creditors.

57. For the upper range of cases that might be taken forward for compensation awards, this would result in a benefit of £12,936k (98*£132,000), while the medium range figure would result in a benefit of £6,468k (49*£132,000). However, consultees and internal data from the Insolvency Service costs recovery suggest that a range of 10-20% of this amount may not be recoverable from directors despite the checks that are carried out on a director's ability to pay prior to commencing a case for a compensation award/undertaking. This might occur due to a change in the circumstances of the director during the process of seeking the award or maybe even expenditure incurred by the director in defending the proceedings. **This results in an upper range of award £11.64m per annum and a medium range of award of £5.50m and a lower range of £0m per annum depending on the number of compensation award cases taken forward.** These figures are undiscounted. The discounted figures are shown in the summary table in paragraph 60 below.

58. It is important to note that, while these compensation awards against miscreant directors are a cost to the directors, they are a benefit to creditors (insolvent estates). In effect, Option 1 allows for a benefit/transfer from miscreant directors to creditors (insolvent estates).

59. The main benefit of taking disqualification action is to prevent a director from being in a position to commit further unfit conduct. It therefore prevents a forced transfer of resources from creditors and others to the director, resulting from a breach of their obligations under the Companies Act. Because the benefit of this transfer to the director would occur as a result of a regulatory breach, we do not consider it in this analysis and the result of preventing the transfer is therefore a net benefit.

Summary table of monetised costs and benefits for the illustrative case (in present value terms over a 10 year appraisal period)

	£m Low (0 cases)	£m Middle (49 cases)	£m Upper (98 cases)
Compensation award to insolvent estates (creditors) – (see paras. 57 to 59) - Benefit	0	47.32	100.21
Cost to miscreant directors – see para. 51 (Payment of court costs and legal fees)	0	6.97	17.22
Investigatory costs to the Insolvency Service – see paras. 39 and 45	0	5.21	14.89

Total one-off familiarisation costs to the private sector (Insolvency Practitioners and Lawyers – see para. 35)	0.54	0.88	1.32
Net Present Value	**-0.54**	**34.26**	**66.78**

Non - Monetised benefits

These entail:

60. Deterrent effect – deterring other directors who otherwise might have been tempted to engage in misconduct. If directors believe there is a greater chance of them being held financially accountable for their actions, this may deter them from committing the misconduct in the first place, which may result in less losses to creditors and also fewer disqualifications resulting from any reduced misconduct.

61. Standards effect – helping to improve standards of company stewardship to the overall benefit to society. Again this relates to directors being aware of their responsibilities and the consequences of any wrongdoing they may undertake. If there is a greater chance of them being financially accountable for their actions, it may improve their overall behaviour in running a company, resulting in less loss to creditors.

62. Increase in trust of creditors and therefore incentivises risk taking. If both directors and creditors believe that directors will be held more financially accountable for their actions, and this results in better company stewardship, this may lead to increased trust and lending to the company, as creditors and directors both know that any wrongdoing could result in a compensation award being made as well as disqualification of the director.

63. In addition, as there will now be scope for a compensation award to be paid from directors to creditors, there is a greater chance that these monies can be used by the creditors to grow their own business or even help start a new business if the loss suffered due to the failed company also caused their company to fail too. This should help foster enterprise in the UK economy.

64. Consideration had been given to improving communication and sharing information between the SoS and the officeholder as a standalone option, but this was will not have the same impact without the compensation awards. Improving the information gateway is very much fundamental in making sure the compensation awards mechanism works. The SoS or official receiver may have carried out a comprehensive investigation of the case and this evidence could be made more readily available to the officeholder. Wrongful and fraudulent trading cases, for example, can be difficult to evidence and take forward so any investigative material that is held by the SoS or official receiver could be of benefit to the officeholder if he/she is considering taking forward such a case. This will help in obtaining some form of financial redress for creditors.

Rationale and evidence that justify the level of analysis used in the IA (proportionality approach)

65. As previously stated, it is difficult to predict how many cases the SoS (Insolvency Service) will seek a compensation award in and the ability of the director to meet such an award. Therefore the analysis undertaken has mainly focussed on identifying the groups affected, describing the impacts and where possible quantifying the effect rather than trying to monetise all the costs and benefits. Monetisation of impacts has only been done when data was readily available. Where none has been available, quantification has been presented as an indicative breakdown.

Risks and assumptions

66. There are a number of potential risks involved with the preferred policy option of allowing the court or SoS to make or agree compensation awards. It may be that the individual concerned does not have the funds to pay any compensation award made. We would envisage before any compensation award is sought, that a check is carried out on the financial means of the individual concerned. There is also the option of pursuing the debt to bankruptcy in enforcing it, so we believe this risk will be adequately mitigated.

67. There is a risk that this will result in compensation orders being made for the benefit of the Crown (HMRC) as they are the major unsecured creditor in the majority of insolvencies. However there will be a provision to allow the court or SoS to determine who should be awarded the compensation award – this may be a particular creditor or class or group of creditors, taking into account what is equitable in all circumstances. This risk should also therefore be mitigated.

68. We envisage that compensatory awards will only be sought in the most serious of cases, where the misconduct by the director's has caused serious harm to creditors (so most likely to be cases in the middle and upper disqualification percentile). We are confident that this proposal will only be used in appropriate cases.

Direct costs and benefits to business calculations (following OITO methodology);

69. The recommended option will not impose any new regulatory burdens on businesses. The only businesses that might be affected by the proposals are IPs and lawyers. Neither of these groups will be imposed with any new regulatory burden that they will have to comply with. They would have to familiarise themselves with the proposals, and we have considered these costs in the IA, but this would be on a voluntary basis and will NOT be associated with any new regulatory burden on their profession. In addition, any familiarisation costs to business are indirect and therefore out of scope of OITO as stated in the Better Regulation Framework Manual[20].

70. It is a regulation on individuals who have already proven to be non-compliant with current laws and therefore is also considered to be out of scope of RRC as well as OITO.

Wider impacts

Specific Impact Tests:

a. **Competition Assessment** – the proposed policy should have no impact on competition as the legislative change represents another opportunity to obtain financial redress for creditors. This should not result in competition with insolvency practitioners to be the first to obtain financial redress for creditors as they should be able to proceed with any action they deem appropriate before the SoS. In addition, greater communication between IPs and the Insolvency Service should reduce any duplicate actions.

b. **Small Firms Impact Test** – there may be familiarisation costs for legal and other professional advisors dealing, together with insolvency practitioners. All appointment takers and advisors will need to be aware of these changes to be able to advise clients and some of these will be represented by small and medium sized firms. However, it is anticipated that any such familiarisation costs will be negligible. Also, some of the creditors who could also benefit from this proposal could also be small businesses. In addition, any compensation awards made will be against directors as individuals, not businesses.

c. **Justice** - The proposed policy will have no impact on Legal Aid, as it is not available to fund defended disqualification proceedings. However due to the likelihood of compensation awards being sought, cases are likely to be heard in Court. We have attempted to calculate the costs to the courts above.

[20] See page 40: www.gov.uk/government/uploads/system/uploads/attachment_data/file/211981/bis-13-1038-better-regulation-framework-manual-guidance-for-officials.pdf

d. **Sustainable Development** - The proposed policy will have no direct impact on sustainable development.

e. **Greenhouse Gas Assessment** - The proposed policy will have no direct impact on greenhouse gas assessments.

f. **Other Environment** - The proposed policy will have no direct impact on other environmental factors.

g. **Health** – The proposed policy will have no direct impact on health.

h. **Equality Impact Assessments** - The proposed policy will not have an adverse or disproportionate effect on any person as a consequence of race, ethnic origin, religion, gender or sexual orientation.

i. **Human Rights** – The proposed policy will have no impact on any human rights issues as the proposed change has no impact on compliant directors. Directors will have to be proven guilty of having engaged in misconduct and therefore disqualified, before a compensation award/undertaking can be made.

j. **Rural Proofing** - The proposed policy will have no direct impact on Rural Proofing.

Summary and preferred option with description of implementation plan

71. Our preferred option is to allow the courts and the SoS to make compensation awards against directors who have already been disqualified. We will also work to improve existing communication channels between insolvency practitioners and the Insolvency Service, so information already held by the Insolvency Service can be used more readily by insolvency practitioners when they are considering pursuing civil recovery action against a director using their existing powers. This will entail some changes to the internal workings of the Insolvency Service, so that we can pursue compensation awards where appropriate and liaison with MoJ and other court officials to implement the new procedure. We envisage this will occur as soon as parliamentary time allows for legislation to be considered and passed.

Title:

Protecting the market from the individuals who have been convicted overseas

IA No: BIS INSS004

Lead department or agency:

The Insolvency Service

Other departments or agencies:

Department for Business Innovation and Skills

Impact Assessment (IA)

Date: Published 25 June 2014

Stage: Final

Source of intervention: Domestic

Type of measure: Primary legislation

Contact for enquiries: Muhunthan Vaithianathar 020 7637 6515

Summary: Intervention and Options

RPC Opinion: N/A

Cost of Preferred (or more likely) Option

Total Net Present Value	Business Net Present Value	Net cost to business per year (EANCB on 2009 prices)	In scope of One-In, Two-Out?	Measure qualifies as
-£0.93m	£0	£0	No	N/A

What is the problem under consideration? Why is government intervention necessary?

Under the current provisions of section 2 of the Company Directors Disqualification Act 1986 (CDDA), the Secretary of State is not allowed to make an application for an individual to be disqualified in cases where that individual has been convicted overseas – even if it is the case that the individual has re-located to the UK; presenting a strong possibility that he or she intends to resume their activities over here, which, in turn, represents a risk to the UK business market. Such an individual cannot be prevented from incorporating a UK company and being appointed as a director thereof. Action may only be taken if and when that individual causes harm.

What are the policy objectives and the intended effects?

To protect the market from those who have been convicted overseas of an offence in relation to a company by allowing the Secretary of State to seek their disqualification from acting in the management of a company in the UK.

What policy options have been considered, including any alternatives to regulation? Please justify preferred option (further details in Evidence Base)

Do Nothing: Although it is currently possible to cite the conviction as part of the evidence of misconduct (however, the court would not be bound to take it into account), any action taken against such an individual would have to be "after the event". This would be after an individual has been appointed a director of a UK company and caused possible harm/losses to UK businesses and individuals.

Option 1: Include overseas convictions and conduct explicitly as a factor to be taken into consideration by the court when determining unfitness within the proposed new iteration of Section 9 and Schedule 1 CDDA. As with the 'do nothing' option, such action will be, necessarily "after the event" and will not prevent the individual from causing harm in the first place – even though it might be anticipated.

Option 2: **(Preferred Option in conjunction with Option 1)**: Allow the Secretary of State to bring civil disqualification proceedings against any director who has been convicted overseas of a serious offence in connection with the promotion, formation or management of a company – preventive actions possible. In addition, overseas convictions and conduct would be included as a factor to be taken into account by the court when determining unfitness within the proposed new Schedule 1 of the CDDA.

Will the policy be reviewed? It will be reviewed. **If applicable, set review date:** April 2020

Does implementation go beyond minimum EU requirements?			N/A		
Are any of these organisations in scope? If Micros not exempted set out reason in Evidence Base.	**icro** o	**20** No	**mall** o	**edium** o	**arge** o
What is the CO_2 equivalent change in greenhouse gas emissions? (Million tonnes CO_2 equivalent)			**Traded:** N/A	**Non-traded:** N/A	

I have read the Impact Assessment and I am satisfied that (a) it represents a fair and reasonable view of the expected costs, benefits and impact of the policy, and (b) that the benefits justify the costs.

Signed by the responsible Minister: Jerry Dilott Date: 12 June 2014

Summary: Analysis & Evidence

Policy Option 1

Description: Include overseas conviction and conduct explicitly as a factor to be taken into consideration by the court when determining unfitness within the proposed new iteration of Section 9 and Schedule 1 of the CDDA 86.

FULL ECONOMIC ASSESSMENT

Price Base Year 2013	PV Base Year 2013	• Time Period Years • 10	Net Benefit (Present Value (PV)) (£m)		
			Low: -1.32	High: -0.54	Best Estimate: -0.93

COSTS (£m)	Total Transition (Constant Price)	Years	Average Annual (excl. Transition) (Constant Price)	Total Cost (Present Value)
Low	0.5	1	N/A	**0.5**
High	1.3		N/A	**1.3**
Best Estimate	0.9		N/A	**0.9**

Description and scale of key monetised costs by 'main affected groups'

Transitional costs to the Insolvency Service from producing the guidance, and to judges from reading it, are considered to be **negligible.**

Familiarisation costs to insolvency practitioners (IPs) are considered to be **£507k to £1.01m**, based on 1,372 IPs spending 1 to 2 hours reading the new guidance at an hourly rate of £375. Familiarisation costs to lawyers are expected to be in the range of **£31k to £307k**, based on 210-375 lawyers spending 1 to 2 hours reading the guidance at an hourly rate between £146 and £409.

Any familiarisation costs to business are indirect and therefore out of scope of OITO.

Other key non-monetised costs by 'main affected groups'

No other wider costs are expected.

BENEFITS (£m)	Total Transition (Constant Price)	Years	Average Annual (excl. Transition) (Constant Price)	Total Benefit (Present Value)
Low	0	N/A	Unknown	**Unknown**
High	0		Unknown	**Unknown**
Best Estimate	0		Unknown	**Unknown**

Description and scale of key monetised benefits by 'main affected groups'

No monetised benefits have been identified.

Other key non-monetised benefits by 'main affected groups'

This option is not likely to fully address the problem, because disqualification proceedings might be pursued only "after the event" and will not assist in preventing the individual from causing harm in the first place – even though it might be widely anticipated that this is his or her intention in coming to the UK.

Nevertheless, increased clarity and better understanding of factors to be taken into consideration by the court when determining unfitness might be considered as a benefit in itself and listing conduct in relation to overseas companies specifically will help signal this intention. That is by specifically mentioning overseas conduct, directors will be aware that miscreant behaviour overseas will not be overlooked if they set up a company in the UK and it subsequently runs into problems and enters insolvency.

Key assumptions/sensitivities/risks **Discount rate (%)** 3.5

The full extent of the benefits is unknown, but it is expected that this option will be less effective than Option 2 in achieving them.

BUSINESS ASSESSMENT (Option 8)

Direct impact on business (Equivalent Annual) £m:			In scope of OITO?	Measure qualifies as
Costs: 0	**Benefits:** Unknown	**Net:** 0	No	N/A

Summary: Analysis & Evidence

Policy Option 2

Description: Allow the Secretary of State to bring civil disqualification proceedings against any director who has been convicted overseas of a serious offence in connection with the promotion, formation or management of a company.

FULL ECONOMIC ASSESSMENT

Price Base Year 2013	PV Base Year 2013	• Time Period Years 10	Net Benefit (Present Value (PV)) (£m)		
			Low: -1.32	High: -0.54	Best Estimate: -0.93

COSTS (£m)	**Total Transition** (Constant Price)	Years	**Average Annual** (excl. Transition) (Constant Price)	**Total Cost** (Present Value)
Low	0.5	1	0	**0.5**
High	1.3		0	**1.3**
Best Estimate	0.9		0	**0.9**

Description and scale of key monetised costs by 'main affected groups'

Transitional costs to the Insolvency Service (IS) from producing the guidance and to judges from reading it are considered to be **negligible.**

Familiarisation costs to IPs are considered to be **£507k to £1.01m**, based on 1,372 IPs spending 1 to 2 hours reading the new guidance at an hourly rate of £375. Familiarisation costs to lawyers are expected to be in the range of **£31k to £307k**, based on 210 to 375 lawyers spending 1 to 2 hours reading the guidance at an hourly rate between £146 and £409.

Any familiarisation costs to business are indirect and therefore out of scope of OITO.

Other key non-monetised costs by 'main affected groups'

There will be no additional costs to the businesses and directors. If it was decided to take disqualification action following an overseas conviction, there would be a cost to the Insolvency Service in bringing such an action. However there is no data available on how much this would cost.

BENEFITS (£m)	**Total Transition** (Constant Price)	Years	**Average Annual** (excl. Transition) (Constant Price)	**Total Benefit** (Present Value)
Low	0	N/A	0	**0**
High	0		0	**0**
Best Estimate	0		0	**0**

Description and scale of key monetised benefits by 'main affected groups'

No benefits have been monetised in this impact assessment.

Other key non-monetised benefits by 'main affected groups'

There will also be non monetised benefits to creditors and the wider economy arising from the disqualification of a convicted director. These are associated with the prevention from future wrongdoing by an individual convicted overseas, who may wish to import serious misconduct into the UK. This wrongdoing could be both civil and criminal.

Key assumptions/sensitivities/risks **Discount rate (%)** 3.5

The main risk relates to obtaining information about an individual with a foreign corporate conviction as there is no central register containing such information. Intelligence would be needed to obtain this information, be it from other Government regulators, media reports, other businesses or private individuals. However we do not expect there to be many disqualification applications and this measure is preventative, to stop those with serious overseas convictions for company offences from coming to the UK to carry out the same or similar behaviour.

BUSINESS ASSESSMENT (Option 9)

Direct impact on business (Equivalent Annual) £m:			**In scope of OITO?**	**Measure qualifies as**
Costs: 0	**Benefits:** 0	**Net:** 0	No	N/A

Evidence Base (for summary sheets)

Introduction

The CDDA and Disqualification of Company Directors

The Company Directors Disqualification Act 1986 (CDDA) aims to maintain the integrity of the business environment. Those who become directors of limited companies should:

- Carry out their duties with responsibility; and
- Exercise adequate skill and care with proper regard to the interests of the company's creditors and employees.

The majority of directors do this effectively, but the CDDA is a powerful tool against those who abuse the privilege of limited liability. The CDDA applies not just to persons who are formally appointed as directors but to those who carry out the functions of directors.

If there is any unfit conduct in an insolvent company, then the liquidator, administrative receiver, administrator or official receiver has a duty to send the Secretary of State for Business, Innovation & Skills a report on the conduct of all directors who were in office in the last 3 years of the company's trading.

The Insolvency Service, on behalf of the Secretary of State has to decide whether it is in the public interest to seek a disqualification order against a director.

The proceedings are brought by The Insolvency Service on behalf of the Secretary of State for Business, Innovation & Skills or, usually in compulsory winding-up cases, by the official receiver at the direction of the Secretary of State. The matter is heard, and decided by the court, unless the Secretary of State accepts a disqualification undertaking from a director. An undertaking has the same legal effect as a court order, but negates the need to go to court.

The minimum period of disqualification is 2 years and the maximum 15 years.

If a company director is disqualified (by court order or by giving an undertaking), unless they have court permission, that person is disqualified for the period stated in the order or undertaking from:

- Being a director of a company;
- Acting as receiver of a company's property;
- Directly or indirectly being concerned or taking part in the promotion, formation or management of a company; or
- Being a member of or being concerned or taking part in the promotion, formation or management of a limited liability partnership.
- Acting as an insolvency practitioner (IP).

Problem under consideration:

1. Under section 2 of the CDDA, the court may make a disqualification order against a person who is convicted of an indictable offence (whether indictable or summarily) in connection with the promotion, formation, management, liquidation or striking off of a company, with the receivership of a company's property or with his being an administrative receiver of a company.
2. The disqualification order may be made:
    - by the court before which the person was convicted of the offence – as an ancillary order made upon sentencing, or
    - by any civil court having jurisdiction to wind up the company in relation to which the offence was committed - on the application of the Secretary of State.
3. What section 2 does not allow is for the Secretary of State to make an application for an individual to be disqualified in cases where that individual has been convicted overseas – even if it is the case that the individual has re-located to the UK; presenting a strong possibility that he or she intends to resume their activities over here, which, in turn, represents a risk to the UK market. This could be

based on intelligence received from any source, including other Governments, private individuals, media reports, etc., even though there is no central register containing such information.

4. Under the current legislation, such an individual cannot be prevented from incorporating a UK company and being appointed as a director thereof. Action may only be taken if and when that individual causes harm.

5. This situation is against the spirit of the CDDA, which is protective in function. Whereas the market can be protected from future corporate activity by an individual convicted of an indictable offence in the UK there is no such protection afforded against an individual who may wish to import serious misconduct into the UK.

Rationale for intervention

6. There is little data available, anecdotal or otherwise on the extent of this problem. From informal enquiries of both Companies House staff and Insolvency Service staff, there were very few recollections of enquiries regarding overseas directors and them setting up operations in the UK. However this is more of a preventative measure and wishing to close a current lacuna in the law. By allowing for disqualification action to be taken against an individual with a serious overseas conviction in relation to a company, this measure intends to protect the UK market from the potential actions of that individual by restricting his involvement in the UK market.

7. Information asymmetries mean that directors have more information (including information on their background and potential misconduct patterns) than shareholders and creditors. And high transaction costs (for example from trying to conduct detailed background checks) can prevent them from protecting themselves and the company from potential misconduct, for example, if such checks only contained details of UK companies and directors, not actions carried out overseas.

8. It is plausible that directors convicted overseas of a serious offence in connection with the promotion, formation or management of a company may wish to replicate this pattern in the UK.

9. Currently, if a director is convicted of a criminal offence in relation to a company in the UK, such as fraudulent trading (under the Companies Act), Theft Act offences, Fraud Act offences, accounting records offences, contravening a disqualification order, acting as a director whilst bankrupt, misconduct in the course of a winding up, false statements, other Insolvency Act offences, etc., the court can make a disqualification order following the sentencing or the Insolvency Service (acting on behalf of the SoS) can request that the court make an order as a result of the criminal conviction. If a similar offence is committed overseas, then it isn't possible to seek such a disqualification order. The relevant director is free to come to the UK and set up a company and perhaps undertake the same type of behaviour over here.

10. Government action is therefore needed to prevent convicted directors from importing serious misconduct into the UK by disqualifying them, hence enabling optimal levels of risk-taking and investment in the market.

11. Policy Objective

12. To protect the market from those who have been convicted overseas of a serious offence in relation to a company by allowing the Secretary of State to seek their disqualification from acting in the management of a company in the UK, by amending legislation to enable the Secretary of State to apply for the disqualification of an individual who has been convicted overseas of an indictable offence (whether indictable or summarily) in connection with the promotion, formation, management, liquidation or striking off of a company, with the receivership of a company's property or with his being an administrative receiver of a company.

Description of options considered (including do nothing)

Option 1: Do Nothing (Least Favoured Option)

13. Although the legislation does not currently allow the Secretary of State to seek the disqualification of an individual, solely upon the basis of an overseas conviction, where the conduct leading to that conviction is germane to the conduct alleged where an application for disqualification is made under Sections 6 or 8 of the CDDA (for example where an individual had been convicted abroad for, say a land banking scam, and had come to the UK, set up a company to undertake a similar activity and that company was now the subject of disqualification action), it is currently possible to cite the

conviction as part of the evidence of misconduct. However, even if the conviction is drawn to the court's attention, as Section 9 and Schedule 1 of the CDDA are currently drafted[63], the court would not be bound to take it into account in determining whether that individual is unfit to be concerned in the management of a limited company or, indeed, the tariff of any disqualification imposed.

14. Furthermore, any action taken against such an individual would have to be "after the event", i.e. after the individual had caused harm to the market in the UK.

15. Stakeholders have made clear that they would support action to strengthen our disqualification regime to prevent directors who have been found unfit overseas being able to act as directors of UK companies. The power already exists in Part 40 of the Companies Act 2006 to recognise disqualification proceedings in other countries. However most other countries do not have disqualification regimes and that, therefore, could usefully be supplemented. Separately, research has been commissioned to look into disqualification regimes overseas and how the power in Part 40 could be used.

Option 1: Include overseas convictions and conduct explicitly as a factor to be taken into consideration by the court when determining unfitness within the proposed new iteration of Section 9 and Schedule 1 CDDA, comprising a broader outline of public interest factors to be taken into consideration (non-regulatory)

16. Although, generally, the view is that the current legislation is broadly fit for purpose, stakeholders would like to see more - and particularly more high profile use of the disqualification powers. There has been some recognition that the schedule of the matters on which disqualification action can be taken is outdated and whilst adding to it is not widely supported, a simpler rewrite with a new emphasis on, for example, track record would be popular (noting the view that previous possible misconduct should be taken into account, but perhaps not simple failure). It is already proposed that such a re-write will makes specific reference to breaches of legislation, both domestic and overseas.

17. Although such a re-write will render it explicit that the court must take any overseas conviction into account when determining whether an individual is unfit to be concerned in the management of a company, as with the "do nothing" option, such action will be, necessarily "after the event" and will not assist in preventing the individual from causing harm in the first place – even though it might be widely anticipated that this is his or her intention in coming to the UK. However by having conduct in respect of overseas companies specifically highlighted in legislation, as the basis for disqualification action may serve as a possible deterrent to a director exhibiting such behaviour.

Costs and benefits of Option 1

Costs to the public sector

18. Additional resource costs to the Insolvency Service to produce the guidance are expected to be negligible as they will be incurred as part of the business as usual operation of the Insolvency Service. The new guidance will be publicised using the Insolvency Service's current channels, that is IP guidance material and changes to disqualification guidance on their website. The additional costs of these are also likely to be negligible as changes and updates are part of its 'business as usual' resourcing.

19. Familiarisation costs to the judiciary are unknown but they are also expected to be negligible given the fact that judges are used to considering new published guidance on a regular basis and as their business as usual duties.

20. One might expect some familiarisation costs to the Insolvency Service and courts; however these are expected to be negligible. The proposed changes only extend current provisions, well known to both the Insolvency Service staff and judges, so no formal training will be required. The Insolvency Service's internal guidance material (the Enforcement Investigation Guide) will need to be updated, however it is a continuous process and should not be interpreted in terms of regulatory cost.

Costs to the private sector

[63] Please also see separate policy proposals for amending Section 9 and Schedule 1 CDDA

21. Costs to businesses are considered to be familiarisation costs incurred by IPs[64] and lawyers to ensure they are up to date with the guidance.

22. Costs to IPs are estimated to be £760k. We would anticipate familiarisation taking up to 1 to 2 hours of an IP's time based on the assumption that this change is not complex to understand and would only need to be understood once. There are currently 1,352 IPs who take case appointments and we have assumed an average hourly rate for an IP of £375 per hour. This is based on the average hourly charge out of an IP firm, at director/partner level.[65] Based on these figures, we would expect familiarisation costs to IPs to be in a range of £507k to £1.014m, with a mid point of £760.5k.

23. Familiarisation costs to lawyers are similarly expected to result from 1 to 2 hours spent in reading the new guidance. Whilst no hard data is available, officials from the Insolvency Service who deal with disqualification cases and lawyers instructed by directors, estimate that a third of defendants to proceedings under section 6 CDDA and all defendants to proceedings under section 8 CDDA seek legal advice[66], with a range of 1 lawyer per 1 to 2 disqualified directors. Including all lawyers instructed with respect to such proceedings by the Insolvency Service gives a range of 210 to 375 lawyers who might want to familiarise themselves with the new guidance. Guidelines for the judiciary indicate that legal professionals can charge between £146 and £409 per hour[67] depending on their grade and location. The opportunity cost therefore ranges from (210 lawyers x £146 x 1hrs to 375 lawyers x £409 x 2hrs), £30.7k to £306.8k with a mid point of £168.7k.

24. In general costs to IPs and lawyers will fall within their continuous professional development, as they will have to be aware of developments in regulations as part of their job. However, these are still considered additional costs in this impact assessment as the time spent on understanding new guidance could otherwise be spent on other professional activities (including other types of continuous professional development).

25. **Overall one off cost from this option is therefore expected to be £538k to £1.32m with a mid point of £929k.**

On going costs

26. It is not expected that the proposal will increase the number of cases that are in scope for an investigation from the Insolvency Service, as the same grounds of 'public interest' will still determine what constitutes misconduct and what doesn't. Therefore no on going costs are expected from this proposal either to the public or the private sector.

27. No other non-monetised costs are expected from this proposal.

28. It is not expected that the proposal will impose any additional costs on compliant directors (even ones convicted abroad) or their businesses, because changes in Section 9 and Schedule 1 CDDA could be practically applied only "after the event" - director's engagement in misconduct in the UK.

Benefits

29. No transitional benefits are expected from this proposal.

On going Benefits

30. This proposal will give more grounds to the Court to make a disqualification, increasing the chances that a director who has engaged in misconduct and has been convicted aboard will be disqualified. Having the possibility to do this is likely to increase public confidence in the enforcement regime.

31. This option is not likely to fully address the problem, because disqualification proceedings might be pursued only "after the event" and will not assist in preventing the individual from causing harm in the first place – even though it might be widely anticipated that this is his or her intention in coming to the UK.

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[64] Insolvency Practitioners (IPs) are professionals (usually either accountants, lawyers or those who hold professional qualifications relating to the insolvency regime) who are licensed, principally by their own "recognised" professional bodies to act as liquidators, administrators, administrative receivers and managers etc., when a company enters into any form of insolvency proceedings.

[65] See para 3.1 http://www.bis.gov.uk/insolvency/insolvency-profession/review-of-ip-fees

[66] The remainder choosing to undertake or to fight the proceedings without reference to legal advice

[67] https://www.judiciary.gov.uk/Resources/JCO/Documents/Guidance/guideline-hourly-rates-2010-v2.pdf

Option 2: Allow the Secretary of State to bring civil disqualification proceedings against any director who has been convicted overseas of a serious offence in connection with the promotion, formation or management of a company – (Preferred Option in conjunction with Option 1)

32. It is inconsistent that the Secretary of State can take steps under Section 2 of the CDDA to protect the market from the future activities of an individual who has been convicted in the UK of a serious offence in relation to a company but cannot do so where that individual was convicted overseas.

33. Although it is already proposed that, pursuant to a re-stated Section 9 and Schedule 1 of the CDDA, a serious overseas conviction will be a matter the court must take into account in determining whether an individual is fit to be concerned in the management of a company, this is a reactive measure that will only address cases where the convicted individual has re-located to the UK and gone on to (further) harm – it does not prevent him from causing such harm in the first place.

34. Amending the CDDA to allow the Secretary of State to bring civil disqualification proceedings against any director who has been convicted overseas of a serious offence in connection with the promotion, formation or management of a company will both address the current inconsistency and enable proactive action to be taken to prevent such an individual from using a UK registered company as a vehicle for causing further harm.

35. Even thought there is little data on the extent of the problem, anecdotal or otherwise (from informal enquiries of both Companies House staff and Insolvency Service staff, there were very few recollections of enquiries regarding overseas directors and them setting up operations in the UK), this is more of a preventative measure and wishing to close a current lacuna in the law. By allowing for disqualification action to be taken against an individual with a serious overseas conviction in relation to a company, this measure intends to protect the UK market from the potential actions of that individual by restricting his involvement in the UK market and making it clear that such action would not be tolerated here.

Costs and benefits of Option 2

Costs to the public sector

36. Costs to the public sector are estimated to be mainly resource costs to the Insolvency Service for taking any disqualification action where appropriate, producing the guidance and publicising it, and familiarisation costs to the judiciary.

37. No data is available on the cost of a disqualification application based on an overseas foreign conviction. Even as a comparison for disqualification following a UK conviction, there is no available data that is recorded or reasonably accurately known with any confidence. However as stated we do not expect to take forward many disqualification applications following an overseas conviction, with the measure being more of a preventative measure. The Insolvency Service's internal guidance material (the Enforcement Investigation Guide) will need to be updated, however it is a continuous process and should not be interpreted in terms of regulatory cost. The cost of updating the guidance should be negligible.

38. Familiarisation costs to the judiciary are unknown but they are also expected to be negligible given the fact that judges are used to considering updated legislation and published guidance on a regular basis and as their business as usual duties.

39. One might expect some familiarisation costs to the courts, however these are expected to be negligible as very few cases, if any, are expected to be taken to court.

Costs to the private sector

40. Costs to businesses are considered to be familiarisation costs incurred by IPs[68] and lawyers to ensure they are up to date with the new legislation and associated guidance.

41. Costs to IPs are estimated to be £760k. We would anticipate familiarisation taking up to 1 to 2 hours of an IP's time based on the assumption that this change is not complex to understand and would

[68] Insolvency Practitioners (IPs) are professionals (usually either accountants, lawyers or those who hold professional qualifications relating to the insolvency regime) who are licensed, principally by their own "recognised" professional bodies to act as liquidators, administrators, administrative receivers and managers etc., when a company enters into any form of insolvency proceedings.

only need to be understood once. There are currently 1,352 IPs who take case appointments and we have assumed an average hourly rate for an IP of £375 per hour. This is based on the average hourly charge out of an IP firm, at director/partner level.[69] Based on these figures, we would expect familiarisation costs to IPs to be in a range of £507k to £1.014m, with a mid point of £760.5k.

42. Familiarisation costs to lawyers are similarly expected to result from 1 to 2 hours spent in reading the new legislation and guidance. Whilst no hard data is available, officials from the Insolvency Service who deal with disqualification cases and lawyers instructed by directors, estimate that a third of defendants to proceedings under section 6 CDDA and all defendants to proceedings under section 8 CDDA seek legal advice[70], with a range of 1 lawyer per 1 to 2 disqualified directors. Including all lawyers instructed with respect to such proceedings by the Insolvency Service gives a range of 210 to 375 lawyers who might want to familiarise themselves with the new guidance and laws. Guidelines for the judiciary indicate that legal professionals can charge between £146 and £409 per hour[71] depending on their grade and location. The opportunity cost therefore ranges from (210 lawyers x £146 x 1hrs to 375 lawyers x £409 x 2hrs), £30.7k to £306.8k with a mid point of £168.7k.

43. In general costs to IPs and lawyers will fall within their continuous professional development, as they will have to be aware of developments in regulations as part of their job. However, these are still considered additional costs in this impact assessment as the time spent on understanding new legislation and guidance could otherwise be spent on other professional activities (including other types of continuous professional development).

44. **Overall one off cost from this option is therefore expected to be £538k to £1.32m with a mid point of £929k.**

Non monetised costs

45. As mentioned previously, from what information we have been able to obtain, we do not expect many disqualification applications, with the measure being more preventative, to stop those with serious overseas convictions for company offences from coming to the UK to carry out the same or similar behaviour.

46. There could be a cost to directors convicted abroad, who are now operating in a compliant way in the UK, who could potentially now be disqualified and costs to the businesses, from removing and replacing the director convicted overseas. However the intention is that the proposed legislative change will only be on account of serious foreign convictions after the legislation comes into effect and will not be retrospective.

47. People applying for a directorship might incur costs related to familiarisation. This might also put them off from becoming directors in the UK only for those cases where the director is convicted abroad. However this is the intended effect of the policy. It aims to protect the UK market from the potential actions of individuals with serious overseas corporate convictions by making it clear that such action would not be tolerated here. Directors or potential directors should be aware of their duties and responsibilities prior to becoming a director and therefore this measure isn't expected to increase those costs.

Benefits

48. As mentioned above, it is very difficult, due to the lack of formal evidence, to estimate the number of disqualification cases that will be taken forward based on serious overseas corporate convictions. However, for illustrative purposes, we have undertaken a 'break even' analysis to estimate the number of disqualifications which would be required to be brought in order to justify the one-off familiarisation costs to IPs and lawyers contained within this proposal.

49. The main impact of taking disqualification action against company directors is the protection of future creditors from that director engaging in further misconduct. The calculations below show the negative impact upon creditors that will be prevented if additional directors are disqualified.

50. The main benefit of taking disqualification action is to prevent a director from being in a position to commit further unfit conduct. It therefore prevents a forced transfer of resources from creditors and

[69] See para 3.1 http://www.bis.gov.uk/insolvency/insolvency-profession/review-of-ip-fees

[70] The remainder choosing to undertake or to fight the proceedings without reference to legal advice

[71] https://www.judiciary.gov.uk/Resources/JCO/Documents/Guidance/guideline-hourly-rates-2010-v2.pdf

others to the director, resulting from a breach of their obligations under the Companies Act. Because the benefit of this transfer to the director would occur as a result of a regulatory breach, we do not consider it in this analysis and the result of preventing the transfer is therefore a net benefit.

51. When a company fails, the debt left in the company is money that would otherwise be with the company's creditors. The money due to the creditors has been appropriated elsewhere, due to the misconduct of the director.

52. In 1999, the NAO undertook a study which quantified the benefits from disqualifying unfit directors[72]. The monetisation of benefits was based on the average debt left in failed companies where there was unfit conduct by directors and the percentage of directors of failed companies who were likely to be involved in a further company failure. The monetisation of impacts explained below is based on this methodology, although internal data from the Insolvency Service has refined and updated the NAO data in respect of average deficiency, which due to changing economic and credit conditions is estimated to be much greater than in the NAO study.

53. According to this internal data from the Insolvency Service, in 2012-13, the average deficiency in failed companies where one or more directors have been disqualified was **£1.5m**[73] and the estimated probability of subsequent business failure[74] (during a period of disqualification of average length (5.5 years), if that director had not been disqualified) is **7%**. The average benefit of a disqualification is therefore around £100k (£1.5m*0.07).

54. The one off costs identified (familiarisation costs to IPs and lawyers) are estimated to be between £538k and £1.32M, with a mid point of £929k. Therefore to cover these costs, over a 10 year appraisal period, the number of disqualifications, based on serious overseas convictions, required to neutralise the (net) familiarisation costs identified has been estimated to be:

    (a) 15 disqualifications over 10 years for the upper level of the familiarisation costs (£1.32m).

    (b) 11 disqualifications over 10 years for the mid point of the familiarisation costs (£929k).

    (c) 6 disqualifications over 10 years for the lower level of the familiarisation costs (£538k).

55. However, we do not expect many disqualification applications based on overseas convictions. This is due to informal soundings obtained from Companies House and Insolvency Service staff that very few queries have been received regarding the actions of overseas directors, and their subsequent operations in the UK. This measure is more a preventative measure, and we have therefore not quantified any monetised benefits from this proposal.

Wider (unquantified) benefit

56. Additional benefits might be expected due to a deterrent effect: discouraging directors with serious overseas convictions from coming to the UK and undertaking further misconduct. As mentioned previously this measure is about prevention, as potential directors of UK companies with serious overseas convictions will know that they will be stopped from operating UK companies and exhibiting the same behaviour in the UK as they carried out overseas.

Rationale and evidence that justify the level of analysis used in the IA (proportionality approach);

57. This is considered to be a **low-risk, low- impact intervention** and therefore the analysis undertaken has mainly focused on identifying the groups affected, describing the impacts and where possible quantifying the effect rather than trying to monetise all costs and benefits. Monetisation of impacts has only been done when data was readily available. Where none has been available, quantification has been presented as an indicative breakdown to justify the (net) quantified, one off costs of the proposal.

58. The main data constraint in this impact assessment related to the likely number of per annum disqualification applications following an overseas conviction of a potential UK director. Hard data has been almost impossible to find on the potential number of individuals with overseas convictions who might wish to operate a company in the UK, but anecdotally we expect it to be very low.

[72] http://www.official-documents.gov.uk/document/hc9899/hc04/0424/0424.pdf

[73] The original NAO calculation used a much lower figure but economic and credit conditions have changed – deficiencies are now greater

[74] Based on a calculation developed as part of the NAO methodology

Therefore, the impact of bringing additional proceedings against such individuals has been presented illustratively for Option 2.

Risks and assumptions:

59. It is considered that the risk that option 2, the preferred option, will not deliver the desired benefits will be negligible as the key to this option is the clarity it will deliver as to the effect of an individual with an overseas conviction for a corporate offence being liable to disqualification action. If such an individual's behaviour is deemed a threat to the UK market, then the SoS can apply for a disqualification order based on the overseas conviction, thereby protecting the market before the individual could cause harm. The main risk relates to obtaining information about an individual with a foreign corporate conviction as there is no central register containing such information. Intelligence would be needed to obtain this information, be it from other Government regulators, media reports, other businesses or private individuals. Analytical assumptions have already been covered in the relevant sections.

Direct costs and benefits to business calculations (following OITO methodology);

60. The preferred option will not impose any new regulatory burdens on businesses. The only businesses that might be affected from the proposals are IPs and lawyers. Neither of these groups will be imposed with any new regulatory burden they will have to comply with. They might want to familiarise themselves with the proposals, and we have included this cost in the IA, but this would be on a voluntary basis and will NOT be associated with any new regulatory burden on their profession. In addition, any familiarisation costs to business are indirect and therefore out of scope of OITO as stated in the Better Regulation Framework Manual[75].

61. On this basis, this proposal is considered to be **outside of the scope of OITO**.

Wider impacts

62. Specific Impact Tests:

a. Competition Assessment – the proposed policy will have no impact on competition as the legislative change represents a protection for the market from the potential actions of an individual with an overseas corporate conviction.

b. Small Firms Impact Test – there will be familiarisation costs for legal and other professional advisors dealing, together with insolvency practitioners. Some of these will be represented by small firms. However, it is anticipated that any such familiarisation costs will be negligible.

c. Justice - The proposed policy will have no impact on Legal Aid, as it is not available to fund defended disqualification proceedings. As the number of disqualifications expected under this proposal is expected to be minimal, any other effect will be marginal.

d. Sustainable Development - The proposed policy will have no direct impact on sustainable development.

e. Greenhouse Gas assessment - The proposed policy will have no direct impact on greenhouse gas assessments.

f. Other Environment - The proposed policy will have no direct impact on other environmental factors.

g. Health – The proposed policy will have no direct impact on health.

h. Equality Impact Assessments - The proposed policy will not have an adverse or disproportionate effect on any person as a consequence of race, ethnic origin, religion, gender or sexual orientation.

i. Human Rights – The proposed policy will have no impact on any human rights issues as the legislative change will only be on account of foreign convictions after the legislation comes into effect. If a disqualification application is subsequently made, then the individual will have the right to defend themselves.

j. Rural Proofing - The proposed policy will have no direct impact on Rural Proofing.

[75] See page 40: www.gov.uk/government/uploads/system/uploads/attachment_data/file/211981/bis-13-1038-better-regulation-framework-manual-guidance-for-officials.pdf

Summary and preferred option with description of implementation plan

63. Although the Secretary of State can make an application for an individual to be disqualified in cases where that individual has been convicted of an indictable offence in the UK, if the offence was overseas, he cannot make such a disqualification application – even if it is the case that the individual has re-located to the UK, presenting a strong possibility that he or she intends to resume their activities over here, which, in turn, represents a risk to the UK market. Under the current legislation, such an individual cannot be prevented from incorporating a UK company and being appointed as a director thereof. Action may only be taken if and when that individual causes harm.

64. The preferred option is to legislate to remove this lacuna and allow the Secretary of State to bring a disqualification application where an individual has been convicted overseas of a serious corporate offence. This could protect the UK market before any potential harm has occurred.

65. It is therefore intended to legislate as soon as parliamentary time allows amending the CDDA to allow the Secretary of State to bring a disqualification application where an individual has been convicted of a serious offence in connection with the promotion, formation or management of a company.

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