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:** 16/04/14 **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[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.
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.

[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.

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 SELECT SIGNATORY: Jenny Willott Date: 14.06.2014

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.

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[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.

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.

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

[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.

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 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 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

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[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

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

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

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 estimat (£m)**
Costs to IPs (paragraph 57)	0.51	0.76	1.01
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

[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.

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 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.

Distributional impacts of assigning officeholder claims

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

[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

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 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.

<u>Wider Impacts:</u>

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.

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

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.

Sustainable Development - The proposal has no impact.