

Insolvency litigation funding – Past, present and future

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Insolvency Litigation Funding – Past, Present and Future

Professor Peter Walton talks about his recent report on the insolvency litigation funding market

Introduction

Insolvency litigation has a number of characteristics different to other types of litigation. Actions have traditionally been brought by insolvency office-holders with the dual goal of providing a return to unpaid creditors and to ensure that culpable behaviour is pursued. There is both a private and a public element to such litigation. Until the Jackson Reforms came into force for insolvency litigation in 2016, third party funding was relatively rare in the context of insolvency claims and most litigation which required financial support took advantage of the ability to recover conditional fee agreement (“CFA”) uplifts and after-the-event (“ATE”) insurance premiums from a losing defendant.

In both 2014 and 2016, I was commissioned by R3 to conduct research on how the insolvency litigation funding market was operating at those respective times. In 2019, the principal insolvency litigation funder in the UK, Manolete Partners plc (with the support of the ICAEW and IPA), asked me to conduct further research designed to identify how the market has evolved and to suggest recommendations for reform. The full report, *Insolvency Litigation Funding - in the best interests of creditors?* (“the Report”) is freely available online.

The Report

The Report considers the legal framework governing insolvency litigation and attempts an assessment of legal and practical issues affecting how insolvency practitioners (“IPs”) carry out their duty to act in the best interests of creditors. It also contains an examination and analysis of qualitative and quantitative data which consider: 1) the results of an online survey of IPs; 2) data kindly provided by Manolete Partners plc; and 3) the views of various IPs and other stakeholders who were interviewed.

In this article, it is intended to consider in outline some of the survey and stakeholder views in an attempt to assess what is currently happening in practice and to suggest how things might be improved.

Size of the Market

One headline figure in the Report is that the value of supported insolvency litigation being pursued is likely to have increased since Jackson. In 2016 it was estimated that claims to the value of approximately £1bn were being pursued using CFAs with about £100m being pursued by or with the support of funders. The Report estimates that in 2020 the value of insolvency claims being pursued using CFAs has dropped 20% to approximately £800m with claims supported by funders increasing 700% to approximately £700m. The total for claims being pursued with the support of CFAs or funders is estimated to be around £1.5bn.

Impact of Jackson Reforms

There was a general consensus amongst respondents to the survey that creditors receive a lesser return from legal action than they did before the Jackson reforms. Approximately 16% of respondents stated that they had stopped or decreased the amount of litigation work following Jackson with 15% stating that they had refused or decreased the number of cases taken on where

there were few or no assets available to fund litigation. Approximately 28% of respondents explained that they had started to use third party funders with a further 29% saying that they had increased their use of third party funders. About 36% had carried on using CFAs as before. There was very little evidence of the use of Damages Based Agreements (“DBAs”).

There is a widespread view that, for various reasons, there is less litigation at the lower end of the market which is often seen as uneconomic to insure by ATE insurers. There is a view that many IPs will try to settle claims before issuing proceedings and therefore before the need for adverse costs cover. One suggested consequence of this is that there are fewer cases which apply for ATE cover and when they do the cost is higher than it was pre-Jackson. The insolvency ATE market appears therefore to have decreased in numbers of claims insured with a consequential decrease in the number of active ATE insurers.

It was generally recognised that funders before Jackson were only offered claims which were difficult or which lawyers had refused to pursue on CFA terms. It was considered by a number of those interviewed that the market is now turned upon its head. Far more cases are offered to funders as a first step. Funders themselves are able to be more selective than before and usually prefer to take an assignment of an action rather than merely fund it.

Typical Mind Set of IP

Most, but by no means all, IPs have a working knowledge of options available to them such as CFAs, ATE insurance, third party funding and assignments of actions. Many IPs will not consider assigning a claim if it is straightforward and the defendant has enough assets to settle any likely award. In such cases, the IP will usually use lawyers on a CFA basis. In more complex cases, the IP has a difficult decision to make.

Decisions as to whether to use a funder or for the IP to litigate are generally decided on a case-by-case basis. The factors which inform the decision are usually: complexity, value, defendant solvency, legal advice and own work-in-progress (“WIP”) and personal costs position.

Many claims for less than £100,000 are now unlikely to be pursued by an IP unless they are very straightforward. If they are complex they may or may not appeal to a funder. Many IPs will still take on smaller actions and effectively fund the action internally on their own WIP and instruct lawyers on a CFA. Some will use their own firm’s money to cover expenses such as court fees. A very small number are more actively engaging as commercial funders. At the other end of the spectrum, some IPs are very risk averse and will not litigate without the support of a funder or ATE insurance to cover any possible adverse costs order.

Summary of Main Findings

- 1 The Jackson reforms had a significant impact upon the funding of insolvency litigation.
- 2 The overall value of claims being pursued using different forms of support (whether CFAs, ATE, funding or assignment) is likely to have increased since 2016 from approximately £1bn to nearer £1.5bn per annum.
- 3 IPs and their advisors are very aware of their duty to act in the best interests of creditors.
- 4 The funding and assignment market is still developing but has increased significantly in the past 4 years.

- 5 Many IPs are sophisticated users of funding and legal options whilst others remain inexperienced and are not yet fully informed of the options available to them.
- 6 Each case needs to be considered individually as to how its progress may result in the best result for creditors.
- 7 There is a potential lack of transparency with the identity and creditworthiness of some insurers and funders.
- 8 The funding and assignment marketplace is becoming more varied with some niche specialisms developing.
- 9 ATE (and other) insurers need to react to changes in the marketplace.
- 10 Government agencies including the Official Receiver and HMRC could do more to encourage the pursuit of culpable behaviour and to co-operate more with the private sector.

Recommendations for Reform

It is clear that things have moved on since 2016. CFAs and ATE insurance continue to be very important tools for IPs. Funding and assignments of actions are now an integral and important part of the system and ought to be considered by IPs when considering enforcing any cause of action. Despite these developments, it seems that the costs of CFAs and ATE on the one hand and Funding and Assignments on the other have remained high. Competition has not yet had the desired effect of maximising returns to creditors. This may be partly because the market is not yet operating in a fully-informed manner.

A number of observations may be made which may assist in ensuring that more is done to satisfy IPs' duty to act in the best interests of creditors. Guidance might be issued to IPs in the form of a Statement of Insolvency Practice or Guidance Note dealing with specific issues they need to consider when considering commencing litigation. That guidance might cover the following:

- 1 The need for IPs to be provided with guidance as to the options open to them when contemplating taking legal action;
- 2 That guidance needs to explain the benefits and risks of each option;
- 3 IPs need guidance on the due diligence they need to conduct when instructing lawyers on a CFA basis and when using ATE insurance to cover any adverse costs award;
- 4 Whether or not the funding market remains unregulated, IPs need to be made aware of the due diligence they need to carry out when working with a funder;
- 5 There is a need for a mechanism whereby IPs might be able to obtain multiple quotations from funders for supplying funding or taking an assignment.

In order to maximise returns to creditors a number of other changes might be considered:

- 1 The rules on DBAs could be amended to make them fit for purpose in an insolvency context;
- 2 The maximum percentage uplift on a CFA could be increased for insolvency litigation;
- 3 Bankruptcy office-holder actions should be made capable of assignment to mirror the position in corporate insolvency;

4 The Official Receiver should consider working more closely with the private sector and consider taking advantage of assigning (or otherwise realising) claims for the benefit of creditors;

5 The Secretary of State should consider liaising more closely with the private sector to apply for more compensation orders, in appropriate cases, under the Company Directors Disqualification Act 1986.

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