How to Fund Assetless Estates in Insolvency?

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The Problem (Legal)

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The Problem

- Why Care?
  - Insolvency representatives' (liquidators' tasks): take control over the debtor, secure and realize the assets (eg Fletcher 2009; Goode 2011)
  - IRs need to be skilled, and paid
  - Assetless Estates (ie insufficient assets to pay the IR)
  - Lack of incentives
  - The result: endanging the task of securing and realizing the assets
    - Entitlements not being enforced
    - Determine the causes of insolvency,
    - Conduct investigations
    - Lessons (stakeholders, society)
    - Bankruptcy gambling (ie delay the filing of an insolvency procedure to the extent that no assets will be left if their bets fail. If the gamble fails, it is unlikely someone will discover)

Outline

Explore Funding Mechanisms

1. Insolvency Estate Funding
2. State Funding
3. Not opening an insolvency procedure at all
4. ~~Third Party Funding~~

U.K., Germany, the Netherlands

Insolvency Estate Funding (1)

- IR’s fee paid from available assets (at the expense of creditors)
- Hourly fee
  - Asset size
  - Experience
- Creditors’ low recovery rates
  - U.K.
    - Creditors do not recover in 70% to 90%, recover 7% on average (Mokal 2001)
  - Netherlands
    - No recovery in 90%–92% for unsecured creditors in corporate insolvency (1996–2004) (Luttikhuis 2008)
    - Recovery rates 2.2%-4.9% (sole proprietors and companies), 0.6%-4.7% (consumer bankruptcies) (Statistics Netherlands 1992-2010)
    - U.S.
      - No distributions beyond payment of direct costs in 90% (Lawless/Ferris 2007)
      - <5% recovery rates (Herbert/Pacitti 1988)

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Insolvency Estate Funding (2)

- IRs suffer as well, eg Netherlands (Van Dijck et al. 2008, Van Dijck/Gramatikov 2010, Van Dijck 2013)
  - No full compensation in 32% (consumer bankruptcies), 61% (individuals with corporate activities), and 65% (corporate insolvencies)
  - Salary deficits of 1,000 or more in more than 40% of the cases
  - Substantial salary deficits >50% of the cases, exceed 10,000 in 10%-20% (corporate insolvencies)
  - Low hourly wages, ie 62 euro (mean), <40 euro in appr. 50% of the cases VERSUS lawyers' mean hourly wage of 153 euro - 212 euro

Insolvency Estate Funding (3)

Issues

- Performance
- Crowding-out
- Refusing appointments
- Excessive claims (compensating)

State Funding (1)

Two models

1. Winding Up

2. Specific Actions (Third Party Litigation Funding) - minor

State Funding (2)

Winding Up

- In England / Wales: Official Receivership (OR)
- Interim receiver (personal bankruptcy) or provisional liquidator (corporate insolvency). IP in case of sufficient assets
- In 2013: 42 ORs managing offices at 35 sites in 7 regions

Table 1: Case Administrations in England and Wales by Official Receivers (2004–2009)

Year	Case Administrations	
	Completed	*Uncompleted*
2004–05	28,972	37,758
2005–06	44,180	53,191
2006–07	53,819	69,863
2007–08	64,913	73,818
2008–09	64,801	87,733

Source: Guide to the Insolvency Service
http://www.insolvencydirect.bis.gov.uk/pdfs/guidanceleafletspdf/guidetoIS.pdf

State Funding (3)

Winding Up

- Financed through cross-subsidisation
- Self-financing
  - Since 1 April 2004: case administration fees = costs of case administration, but petition costs rise

Table 2: Insolvency Petition Deposits (2007–2011)

Date	Petition Costs		
	Debtors (Personal) Bankruptcy Petition	*Creditors (Personal) Bankruptcy Petition*	*Creditors Company Petition*
From 1 April 2007	£ 335	£ 400	£ 670
From 6 April 2008	£ 345	£ 415	£ 690
From 6 April 2009	£ 360	£ 430	£ 715
From 6 April 2010	£ 450	£ 600	£ 1,000
From 1 June 2011	£ 525	£ 700	£ 1,165

Source: The Insolvency Service, *Annual Report and Accounts 2010–11*, 17.

State Funding (4)

Winding Up (more data)

Table 3: Secretary of State Fees (2007–2011))

Amount	Bankruptcy	Companies
First £ 2,000	Nil	N/A
First £ 2,500	N/A	Nil
Next £ 1,700	100%	100%
Next £ 1,500	75%	75%
Next £ 396,000	15%	15%
Balance	1%	1%

Source: The Insolvency Service, *Annual Report and Accounts 2010–11*, 18.

Table 4: Administration Fees and Costs

	2006–07	2007–08	2008–09	2009–10	2010–11
Compulsory Insolvency Cases	69,939	67,218	78,029	77,898	57,682
Case Administration Fee Income (£'000)	£ 103,673	£ 125,904	£ 145,284	£ 152,591	£ 141,821
Case Administration Costs (£'000)	£ 90,326	£ 125,555	£ 145,837	£ 149,981	£ 194,917

Source: The Insolvency Service, *Annual Report and Accounts 2010–11*, 20.

Not Opening an Insolvency Procedure (1)

- Section 26(1) German Insolvency Code (Insolvenzordnung / InsO):
  - ‘court shall refuse a request to open an insolvency procedure if the debtor’s assets are likely to be insufficient to cover the costs of the proceedings’
- Debtor / creditors / others may provide for costs, but no real advantages (Schmidt 2011)
- → Auflösung: loss of legal competence to act
- Average refusal rates of between 35%-46%, with substantial differences between courts (Haarmeyer/Beck 2007; Kallweit 2009; Hollinderbäumer 2013)

Not Opening an Insolvency Procedure (2)

Evaluation

- Company directors are in charge of winding up
- Creditors are left behind - debtor lost its legal competence
- Incentives to company directors to totally deplete company's assets
    - Large gap between existing assets and actually realized assets / claims in insolvency procedure (Haarmeyer/Beck 2007)
    - Creditors to miss out on tens of billions (Uhlenbruck 2010)
- In consumer bankruptcy (Germany)
    - 1,634 debtors successfully initiated consumer bankruptcy proceedings in 1999
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2.77 million over-in- debted households (Busch 2006)
    - Remedied with 2001 legislation: rise of 13,277 in 2001 to 71,435 in 2005
        - Resulted in proposals to reduce the work load

Third Party Litigation Funding (TPLF)

- TPLF: third party finances litigation (specific claims)
- Legal issues: control of the claims (maintenance and champerty)
  - In U.K.: creditors may receive share, may recover more than they would be entitled to based on the statutory scheme of asset distribution (Fletcher 2009, Parry 2001). First charge permissible (Re Exchange Travel, Katz v McNally [1997] 2 BCLC 579, CA)
  - In the Netherlands: returns to the estate (HR 21 December 2001, NJ 2005, 95 (Lunderstädt/De Kok); HR 21 December 2001, NJ 2005, 96 (Sobi/Hurks II))
- Research: funders left the market, have set high threshold (Veljanovski 2012)
- Success factors
  - Permissibility of success fees and contingency fees
  - Costs of litigation and if or how they are shifted (e.g. “loser pays”, “each pays his own”)
  - Potential size of the market
  - Culture?
  - Prerequisite: rewards for investor

Discussion

- Third Party Funding
  - Do not expect miracles to happen

- Insolvency Estate Funding
  - Vulnerable mechanism, particularly with high number of estates that lack assets

- State Funding
  - Self-financing, but cross-subsidization and increasing fees and uncompleted cases

- Not Opening an Insolvency Procedure
  - Reduces the burden on the judiciary, but introduces undesirable incentives

Conclusion

Pick Your Poison

Reference: Gijs van Dijck, How to Fund Assetless Estates in Insolvency? Assessing European Funding Mechanisms. *European Company and Financial Law Review*, 2014, 11(2), 135-148

(click here /https://pure.uvt.nl/portal/files/3982221/ecfr_2_2014_print_FINAL_van_Dijck_.pdf)

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