MARSH

# ADVISER

## BOND CLAIMS AND HOW TO AVOID THEM

At a time when an unprecedented number of insolvency practitioners are facing bond claims, this Adviser considers what steps can and should be taken to avoid them.

Each year every insolvency practitioner is required to sign an Enabling Bond, the purpose of which is to compensate creditors for losses caused by the dishonest or fraudulent acts of an office holder. Very few read the Bond Deed in any detail, and consider it a regulatory necessity worthy of little if any detailed consideration.

Those insolvency practitioners who have taken the time to read the wording of the bond will be aware that although liability for claims is underwritten by the surety (an insurance company), primary liability sits with the insolvency practitioners themselves. For that reason, a successful bond claim can result in substantial monetary claims being made against dishonest insolvency practitioners.

### DEVASTATING EFFECT

The effect of a bond claim, no matter how unsubstantiated, can be devastating for even the most honest insolvency practitioner. It can prejudice the ability to renew bonding cover and can result in regulatory investigations that, even if they result in complete exoneration, can be a costly and unwelcome distraction from a busy professional practice.

It is therefore important to understand what circumstances can lead to bond claims and how they can best be avoided.

It is sometimes thought that those who face bond claims are criminals who have systematically stolen vast sums of money from the estates over which they have custody. Certainly, there have been such individuals; however, there are instances of claims having been made against insolvency practitioners who vehemently profess their innocence of any wrongdoing, and where the evidence of fraud is far from compelling.

### DUMPED TIME

Typically, such cases involve allegations of so-called "dumped time". Namely, time alleged to have been spent working on a case in circumstances in which no such work was, in reality, undertaken.

Time-dumping is more than mere inefficiency. It has sometimes been suggested by those facing bond claims that it is legitimate to record time spent by the office holder "thinking about a case" on holiday or in the shower, for example, or that recording extra hours is a method of "value billing". Ultimately, if fees have been authorised on a time cost basis, the time costs should accurately reflect the time that has genuinely been spent. The line between honesty and dishonesty should be clear. Consider the following:

> Eight-year-old Jimmy comes home from school with a note from his teacher that says, "Jimmy stole a pencil from the student sitting next to him." Jimmy's father is furious. He goes to great lengths to lecture Jimmy and let him know how upset and disappointed he is, and he grounds the boy for two weeks. "And just wait until your mother comes home!" he tells the boy ominously. Finally he concludes, "Anyway, Jimmy, if you needed a pencil, why didn't you just say something? Why didn't you simply ask? You know very well that I can bring you dozens of pencils from work." [1]

Insolvency practitioners who obtain a valid time cost resolution for fees are under no statutory obligation to meet minimum standards of efficiency, and if it takes longer to undertake any particular task than someone else might allege is reasonable, that is not, in itself, evidence of dishonesty. However, it ought to be possible to reconcile time records with work evident from the case files.

[1] Credit: Dan Ariely, The Honest Truth About Dishonesty: How We Lie to Everyone - Especially Ourselves (Book)

Such reconciliations are much easier if time records include a detailed narrative explaining which members of staff were engaged on what tasks, on what dates, and for how long.

## CHALLENGES TO FEES ARE INCREASINGLY COMMON

Completion of timely, comprehensive, and accurate time records serves as not only a good defence against allegations of time-dumping, it also makes commercial good sense. In a world in which challenges to fees are increasingly common, the ability to respond robustly with strong evidence of why work was undertaken, what was done, and how long it took can mean the difference between recovering fees that have been questioned and writing them off. This is particularly true if the fees are assessed by the court, in which case the judge will apply the principles of the Practice Direction on Office Holder Remuneration.

So where, one might ask, is the line drawn between dumped time and time costs that have been honestly recorded but appear to be higher than some might have expected? The answer is that even the layperson could spot the types of cases that typically give rise to investigations that lead to bond claims. Invariably, the costs in such cases are so wholly irreconcilable with the work undertaken that a defence to an allegation of time dumping becomes virtually impossible.

Examples of such cases arise when six figure fees are charged to estates in which there are few creditors, no contentious issues, and the only realisable asset comprises cash in the bank or a bank balance inherited from an earlier administration.

Even in these circumstances, it may be possible to refute allegations of time dumping, but any defence will be reliant on the quality of the underlying time records.

## MAINTAINING ACCURATE RECORDS IS VITAL

While none of the following suggestions for avoiding claims will be new to insolvency practitioners, it is worth emphasising that the best way to ensure a robust defence can be mounted to frivolous allegations of time-dumping is to maintain time records that are:

1. Entered contemporaneously.
2. Accurate.
3. Supported by detailed narrative, sufficient to identify the task that was actually undertaken.
4. Easily capable of reconciliation with work evident on case files.
5. Adequately reported to creditors.

At a time when insolvency appointments are thin on the ground, insolvency practices are inevitably facing unprecedented financial pressures, but the temptation to boost fees by dumping time should be avoided at all costs. Insolvency practitioners should be under no illusion that time-dumping is not akin to bringing a pencil home from the office: It is a fraudulent activity and is seen as such by successor practitioners, regulators, courts, and underwriters. That said, the honest office-holder should have nothing to fear as long as he or she maintains adequate records that will facilitate an immediate, robust, and comprehensive refutation of any allegations of impropriety, thereby nipping the risk of a bond claim in the bud at the earliest opportunity.

## PROXIES

Another issue can be the treatment of proxies.

Proxies need to be checked carefully to ensure they are valid (that is, fully completed, signed, and authenticated).

Proxies not lodged by the time specified in the meeting notice (or, for adjourned meetings, by mid-day on the preceding business day) are not valid for voting purposes and the insolvency practitioner (IP) has no discretion to allow any exceptions.

If an appointment can be shown to be invalid for any reason, then all fees will be challenged.

## PAYMENT OF REFERRAL FEES

The insolvency code of ethics says:

*"The special nature of insolvency appointments makes the payment or offer of any commission for or the furnishing of any valuable consideration towards the introduction of insolvency appointments inappropriate".*

However, there is nothing to prevent an IP from engaging the work referrer to carry out work to that will assist the officeholder either pre- or post-appointment. For example, they could be engaged to help with the preparation of the statement of affairs in a creditor's voluntary liquidation (CVL), or to assist with necessary tax work post-appointment. And, in the case of individual voluntary arrangements (IVAs), work referrers may well meet the debtor and prepare a pack of information about the debtor's assets, liabilities, and circumstances to assist the nominee in his work. For the statement of affairs and IVA examples, statements of insolvency practice (SIPs) require disclosure of these payments (SIP 8 for the CVL and SIP 3.1 for the IVA).

When considering engaging a referrer to carry out work, we would expect the IP to consider the following:

- Whether the work is necessary.
- Whether the work referrer is suitably qualified to carry out the work, and whether they are the most appropriate party to do so.
- Whether the proposed charge is fair and reasonable for the work undertaken.

Where an IP asks a work referrer to carry out work to assist the IP, we would always recommend that they issue a letter of engagement setting out the work to be undertaken and the cost of it, so that there's clarity around the purpose of the payment.

Again the crux of the matter is clear documentation.

While certainly not an exhaustive list, hopefully the above will give the innocent IP some assistance in ensuring that if they are ever the recipient of a bond claim, their records and procedures will be robust enough to ensure they have nothing to fear.

## CONTACT US

To discuss any of the issues profiled in this Adviser please contact simon.dodd@marsh.com or your usual Marsh representative.



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