ENTERPRISE AND CULTURE COMMITTEE

AGENDA

6th Meeting, 2006 (Session 2)

Tuesday 7 March 2006

The Committee will meet at 2 pm in Committee Room 1.

1. **Bankruptcy and Diligence etc. (Scotland) Bill**: The adviser will brief the Committee at Stage 1 on part 1 (Bankruptcy) of the Bill.

2. **Bankruptcy and Diligence etc. (Scotland) Bill**: The Committee will take evidence at Stage 1 from—

   Mr Mike Norris, Head of Policy, Insolvency Service, John Tribe, Centre for Insolvency Law and Policy, Kingston University London, Pat Boyden, Partner in Business Recovery Services, PricewaterhouseCoopers LLP, and Stephen Lawson, Member of the Technical Committee of R3-The Association of Business Recovery Professionals;

   Brian McVey, Director of Policy & Performance, Scottish Enterprise;

   Allan Wilson MSP, Deputy Minister for Enterprise and Lifelong Learning, Andy Crawley, Bill Team Leader, and Katrina McNeill, Policy Officer, Civil Justice and International Division, Scottish Executive Justice Department.

3. **Legislative consent memorandum on the Company Law Reform Bill**: The Committee will take evidence on memorandum LCM (S2) 2.1 on the Company Law Reform Bill, currently under consideration in the UK Parliament, from Allan Wilson MSP, Deputy Minister for Enterprise and Lifelong Learning, Joyce Lugton, Property Law Team Leader, Civil Law Division, Scottish Executive Justice Department and Laura Bailie, Development Department Charity Law Team, Scottish Executive.

4. **Subordinate legislation**: Allan Wilson MSP, Deputy Minister for Enterprise and Lifelong Learning, to move S2M-3953—

   That the Enterprise and Culture Committee recommends that the draft Renewable Obligations (Scotland) Order 2006 be approved.
5. **Subordinate legislation:** Allan Wilson MSP, Deputy Minister for Enterprise and Lifelong Learning, to move S2M-4044—

    that the Enterprise and Culture Committee recommends that the draft Scotland Act 1998 (Transfer of Functions to Scottish Ministers) (No.2) Order 2006 be approved.

6. **Bankruptcy and Diligence etc. (Scotland) Bill:** The Committee will consider a report from the Finance Committee on the financial memorandum for the Bankruptcy and Diligence etc. (Scotland) Bill, as well as issues emerging from evidence taken so far.

7. **Inquiry into business growth (in private):** The Committee will consider a revised draft report.

    Stephen Imrie  
    Clerk to the Committee  
    Tel. 0131 348 5207  
    enterprise.committee@scottish.parliament.uk

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The following meeting papers are enclosed:

**Agenda Item 2**

Submission from the Insolvency Service

Submission from Centre for Insolvency Law and Policy, Kingston University London


*A copy of this full report is available at:*


Submission from Patrick Boyden, PricewaterhouseCoopers LLP

Submission from R3-The Association of Business Recovery Professionals

Submission from Scottish Enterprise and Highland & Island Enterprise

**Agenda Item 3**

Legislative consent memorandum LCM(S2) 2.1

**Agenda Item 4**

Paper from the Clerk (including the draft Renewable Obligations (Scotland) Order 2006)

**Agenda Item 5**

Paper from the Clerk (including the draft Scotland Act 1998 (Transfer of functions to the Scottish Ministers) (No. 2) Order 2006)

**Agenda Item 6**

Report from the Finance Committee

[http://www.scottish.parliament.uk/business/committees/finance/reports-06/fir06-BankruptcyDiligence.htm](http://www.scottish.parliament.uk/business/committees/finance/reports-06/fir06-BankruptcyDiligence.htm)

**Agenda Item 7**

Draft report (private paper)

**Papers circulated for information only**

Clerk’s Bulletin, No 6 (2006)
BANKRUPTCY AND DILIGENCE ETC. (SCOTLAND) BILL

Enterprise and Culture Committee of the Scottish Parliament – Stage 1 scrutiny of the general principles of the Bankruptcy and Diligence etc. (Scotland) Bill

Written Submission of Mike Norris, Director of Policy, The Insolvency Service

The Insolvency Service

The Insolvency Service (IS) operates under a statutory framework – mainly the Insolvency Act 1986 – and Department of Trade and Industry (DTI) ministers determine the policy framework in which the IS operates. Ministers also set and review IS targets, which are announced in Parliament at the beginning of each financial year. The Inspector General and Agency Chief Executive reports to DTI ministers on the execution of policy, our progress against targets, and our plans and proposals for future developments.

The principal roles of the IS are to:

- administer and investigate the affairs of bankrupts, of companies and partnerships wound up by the court, and establish why they became insolvent;
- act as trustee/liquidator where no insolvency practitioner (IP) is appointed;
- take forward reports of bankrupts’ and directors’ misconduct;
- authorise and regulate the insolvency profession;
- advise DTI ministers and other government departments and agencies on insolvency, redundancy and related issues;
- assess and pay statutory entitlement to redundancy payments when an employer cannot or will not pay its employees;
- provide banking services for bankruptcy and liquidation estate funds; and,
- provide information to the public on insolvency and redundancy matters via our website, publications, Enquiry Lines.

Insolvency Service Operations

In England and Wales a network of Official Receivers (OR) undertakes the administration and investigation of bankruptcies and compulsory liquidations.

The OR is a civil servant who acts on directions, instructions and guidance from the Inspector General or, less often, from the Secretary of State. The OR is a statutory office holder and also an officer of the courts to which he or she is attached. The OR is therefore answerable to the courts for carrying out the courts’ orders and for fulfilling his/her duties under law.

There are 39 ORs managing offices across England and Wales, organised into 7 regional groups, each under a regional director.

The OR becomes receiver and manager when the court makes a bankruptcy order
against an individual. The OR becomes the first liquidator when the court makes a winding-up order against a company. The OR is responsible for protecting the assets of the insolvent person or company and will take immediate steps to collect or secure any assets or property of the bankrupt or the company. If no private sector IP is subsequently appointed the OR becomes the trustee of the insolvent person or remains the liquidator of the company.

The bankrupt or the company director(s) must give the OR information about their own or the company's affairs, dealings and transactions. The OR will interview them in person or by telephone. The OR will examine their business records and any other information about their financial affairs, and will make background enquiries of banks, accountants, solicitors and others who have had dealings with them.

In every case, the OR reports to creditors giving details of the assets and liabilities listed in the case. Depending on the nature and monetary value of the assets, the OR may arrange a meeting of the creditors to consider appointing an IP as a trustee or liquidator in their place.

If an IP is appointed as trustee or liquidator, the OR will hand over the administration to the IP. If no IP is appointed, the OR acts as the trustee or liquidator to sell assets, distribute the proceeds to creditors and complete the administration of the estate.

Whether or not the OR continues as trustee or liquidator, he or she remains responsible for investigating the insolvent's conduct and affairs.

In every bankruptcy (except where he/she decides it is unnecessary) and compulsory liquidation, the OR has a duty to investigate the affairs and causes of failure of the bankrupt or company and the conduct of the bankrupt or directors.

ORs have wide-ranging legal powers to acquire the information and documents they need, including the power to hold public examinations in court to obtain information.

The investigation may uncover:

- a criminal offence;
- a case for the disqualification of directors;
- a case for a bankruptcy restrictions order or undertaking.

ORs may consider that the disqualification of unfit directors would be appropriate in cases that either they or an IP has investigated. With permission from the Secretary of State, the OR will take and argue the case in court, or draw up an undertaking for the directors to agree that they will not act in the management of a company for a specified period.

Bankruptcy restrictions orders or undertakings, introduced on 1 April 2004, can impose the restrictions of bankruptcy for a period of 2-15 years.

ORs and IPs report to the IS Enforcement Directorate possible criminal offences. If the allegations are serious, cases are sent to a prosecuting or investigatory authority
such as the DTI's Legal Services Directorate or the Serious Fraud Office who will decide to prosecute if it is in the public interest.

**Personal Insolvency Levels in England and Wales**

There are two principal statutory procedures dealing with insolvent individuals in England and Wales, these are bankruptcy and individual voluntary arrangements (IVA). Whilst the administration and investigation of bankruptcies is briefly described above, IVAs are not.

IVAs were introduced by the Insolvency Act 1986 as an alternative to bankruptcy that provides greater flexibility to the debtor and better returns to creditors than bankruptcy. They are almost entirely administered by private sector IPs. Initially, IVAs were used predominantly by trading debtors; they are now used predominantly by non-trading debtors.

The following table shows the level of personal insolvencies in England and Wales over the last 10 years:

<table>
<thead>
<tr>
<th>Year</th>
<th>Bankruptcies</th>
<th>IVAs</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>1996</td>
<td>21803</td>
<td>4466</td>
<td>26271</td>
</tr>
<tr>
<td>1997</td>
<td>19892</td>
<td>4545</td>
<td>24441</td>
</tr>
<tr>
<td>1998</td>
<td>19647</td>
<td>4901</td>
<td>24549</td>
</tr>
<tr>
<td>1999</td>
<td>21611</td>
<td>7195</td>
<td>28806</td>
</tr>
<tr>
<td>2000</td>
<td>21550</td>
<td>7978</td>
<td>29528</td>
</tr>
<tr>
<td>2001</td>
<td>23477</td>
<td>6298</td>
<td>29775</td>
</tr>
<tr>
<td>2002</td>
<td>24292</td>
<td>6295</td>
<td>30587</td>
</tr>
<tr>
<td>2003</td>
<td>28021</td>
<td>7583</td>
<td>35604</td>
</tr>
<tr>
<td>2004</td>
<td>35898</td>
<td>10751</td>
<td>46650</td>
</tr>
<tr>
<td>2005</td>
<td>47287</td>
<td>20293</td>
<td>67580</td>
</tr>
</tbody>
</table>

**The Principal Enterprise Act Changes – in summary**

- Reduce the automatic discharge of nearly all bankrupts to a maximum of 12 months, with earlier discharge for some;
- Introduce Bankruptcy Restrictions Orders to protect the public and the commercial community from bankrupts whose conduct before and during bankruptcy has been found to be culpable;
- Introduce Income Payments Agreements as an administrative alternative to court-based Income Payments Orders, but with the same force, and both to run for a period of up to three years, irrespective of discharge;
- Limit to three years the period in which a trustee may deal with a bankrupt's interest in the sole or principal home of the bankrupt, the bankrupt's spouse or a former spouse before that interest revert to the bankrupt; and,
- Reduce the number of restrictions that are automatically imposed on undischarged bankrupts.
Policy Rationale

To put in place an individual insolvency regime that recognises the importance of small businesses to the economy reflects the current availability of credit to individuals and which will encourage both responsible risk-taking by entrepreneurs and the rehabilitation of debtors generally. To put in place effective counterbalances by ensuring that returns to creditors are maximized and that the public and commercial community are protected from the actions of the culpable minority.

Discharge Period

The changes to the discharge provisions of the Enterprise Act mean that those made bankrupt after 1 April 2004 will receive their discharge one year after the date of the bankruptcy order. This compares with the previous automatic discharge period of three years.

However, it should also be remembered that pre-Enterprise Act a number of bankrupts received their discharge after two years under the “summary bankruptcy” provisions. Those provisions principally related to cases where the unsecured liabilities were less than £20,000. The following table shows the level of summary cases in the 3 years prior to 1 April 2004:

<table>
<thead>
<tr>
<th>Year</th>
<th>Number of bankruptcy orders</th>
<th>Number of summary cases</th>
<th>Summary cases as % of bankruptcy orders</th>
</tr>
</thead>
<tbody>
<tr>
<td>2001-2002</td>
<td>23,426</td>
<td>6,123</td>
<td>26.03%</td>
</tr>
<tr>
<td>2002-2003</td>
<td>25,177</td>
<td>6,821</td>
<td>26.94%</td>
</tr>
<tr>
<td>2003-2004</td>
<td>29,633</td>
<td>7,905</td>
<td>26.61%</td>
</tr>
</tbody>
</table>

A bankrupt will not be discharged if there is a court order suspending his or her discharge. (These orders are generally made where the bankrupt has not co-operated with the OR or trustee in bankruptcy.)

In some cases the bankruptcy discharge period will be less than one year. This will only occur:

- where a bankrupt has fully co-operated with the OR and/or trustee;
- where creditors have not raised any matters relating to the bankrupt’s conduct and affairs which require further investigation; and
- where the OR has filed a notice stating that the investigation of the bankrupt’s affairs has been concluded or s/he thinks an investigation is unnecessary.

In the first year after the commencement of the discharge provisions the level of cases where automatic discharge occurred after less than 1 year is shown below:

<table>
<thead>
<tr>
<th>Year</th>
<th>Total no. of bankruptcy orders</th>
<th>Number of early discharge cases</th>
<th>Early discharge cases as % of bankruptcy orders</th>
</tr>
</thead>
<tbody>
<tr>
<td>2004-2005</td>
<td>37,562</td>
<td>15,693</td>
<td>42%</td>
</tr>
</tbody>
</table>
The average time to early discharge in that year was 6.8 months.

In the 10 months to 31 January 2006, early discharge notices were issued in 50.5% of bankruptcy cases, with an average time for early discharge of 7.1 months.

**Bankrupts’ Home**

The Enterprise Act sets a limit of 3 years on the period during which the trustee in bankruptcy can deal with a bankrupt's interest in a property, which is the sole or principal home of the bankrupt, the bankrupt's spouse or a former spouse. After this period it will revert back to the bankrupt (i.e. it will no longer form part of the bankruptcy estate) unless the trustee realises the interest or applies for an order of sale or possession or applies for a charging order over the premises in respect of the value of the interest.

The provisions seek to provide certainty to bankrupts and creditors as to the timescale within which the bankrupt’s interest in his or her home will be dealt with whilst providing sufficient time for the trustee to realise that interest for the benefit of creditors. Prior to the Enterprise Act that timescale was open-ended with the home being sold up to 10 or more years after the bankruptcy order.

Approximately 8.5% of bankrupts have an interest in a property that falls within their estate.

**Income Payments**

The Income payments regime is designed to ensure that bankrupts make an affordable contribution towards their debt. Prior to the introduction of the Enterprise Act the only effective vehicle to secure such payments was the income payments order (IPO). IPOs were only obtainable by application to the court and generally ceased on discharge from bankruptcy (effectively about 2 years 8 months in duration). The Enterprise Act sets out that IPOs will last for 3 years from the date of the IPO.

IPOs are generally not contested and can only be varied by application to the court.

The Enterprise Act introduced income payment agreements (IPA). An IPA establishes a legally binding written agreement between the bankrupt and the OR or trustee requiring the bankrupt (or a third party) to make specified payments to his trustee for a specified period. This will be enforceable in the same way as an IPO. An IPA must specify the period in which it is to have effect and that period can apply after a bankrupt is discharged but cannot extend to a date more than 3 years after the date of the IPA. An IPA may be varied in writing.

Over the last 6 years the following numbers of IPOs and IPAs have been obtained:

<table>
<thead>
<tr>
<th>Year Ended</th>
<th>Total</th>
<th>Bankruptcies</th>
<th>% Of Bankruptcies where obtained</th>
</tr>
</thead>
<tbody>
<tr>
<td>2001</td>
<td>2434</td>
<td>21961</td>
<td>11.1</td>
</tr>
<tr>
<td>2002</td>
<td>2396</td>
<td>23426</td>
<td>10.2</td>
</tr>
</tbody>
</table>
Bankruptcy Restrictions Orders/Undertakings

The pre-Enterprise Act regime did little to distinguish between the behaviour of bankrupts. Under the Enterprise Act provisions the majority of bankrupts will be discharged from bankruptcy, and therefore released from its restrictions, after a maximum of one year. But for the small minority of bankrupts whose conduct is dishonest, reckless or culpable there are now bankruptcy restrictions orders/undertakings.

A bankruptcy restrictions order (BRO) seeks to protect the public and commercial community from those bankrupts who have been dishonest, reckless or culpable. The BRO regime covers a wide variety of conduct of both traders and consumers. An order lasts between 2 and 15 years and imposes restrictions on:

- obtaining credit of more than £500 without disclosing status;
- trading in a name other than the one in which the bankruptcy order was made;
- acting in the management of a limited company, and
- acting as an insolvency practitioner or receiver and manager.

Breach of a BRO is a criminal offence.

The Enterprise Act provisions also brought in bankruptcy restrictions undertakings (BRU). BRUs were brought in as a result of the successful introduction of an undertakings regime for company director disqualification by the Insolvency Act 2000. They are intended for cases where the bankrupt accepts there was misconduct as a way of reducing the call on valuable court time. BRUs have the same force and the same effects as a BRO.

In the first year of operation from 1 April 2004 there were 22 (18 undertakings and 4 orders) cases where restrictions were applied, this low initial number was expected, as the provisions could not be applied retrospectively. The numbers of BROs and BRUs in the 10 months to 31/1/06 total 529 and are shown, by years, in the following table:

<table>
<thead>
<tr>
<th>Number of Years (rounded to nearest)</th>
<th>Number of Undertakings</th>
<th>Number of Orders</th>
</tr>
</thead>
<tbody>
<tr>
<td>2</td>
<td>3</td>
<td>2</td>
</tr>
<tr>
<td>3</td>
<td>37</td>
<td>12</td>
</tr>
<tr>
<td>4</td>
<td>111</td>
<td>12</td>
</tr>
<tr>
<td>5</td>
<td>116</td>
<td>27</td>
</tr>
<tr>
<td>6</td>
<td>56</td>
<td>32</td>
</tr>
<tr>
<td>7</td>
<td>37</td>
<td>16</td>
</tr>
<tr>
<td>8</td>
<td>14</td>
<td>16</td>
</tr>
<tr>
<td>9</td>
<td>8</td>
<td>4</td>
</tr>
<tr>
<td>10</td>
<td>4</td>
<td>6</td>
</tr>
</tbody>
</table>
The following table shows the breakdown of allegations in identified cases:

<table>
<thead>
<tr>
<th>Allegation</th>
<th>Year to date</th>
</tr>
</thead>
<tbody>
<tr>
<td>Accounting records</td>
<td>28</td>
</tr>
<tr>
<td>Preferences/Transactions at undervalue</td>
<td>100</td>
</tr>
<tr>
<td>Excessive pension contributions</td>
<td>0</td>
</tr>
<tr>
<td>Failure to supply goods or services</td>
<td>16</td>
</tr>
<tr>
<td>Trading at a time when knew/ought to have known he was unable to pay debts</td>
<td>10</td>
</tr>
<tr>
<td>Incurring debt without reasonable prospect of payment</td>
<td>220</td>
</tr>
<tr>
<td>Failure to account for loss</td>
<td>36</td>
</tr>
<tr>
<td>Gambling/rash and hazardous speculation/unreasonable extravagance</td>
<td>119</td>
</tr>
<tr>
<td>Neglect of business affairs contributing to the bankruptcy</td>
<td>13</td>
</tr>
<tr>
<td>Fraud</td>
<td>13</td>
</tr>
<tr>
<td>Non-co-operation</td>
<td>2</td>
</tr>
<tr>
<td>2nd time bankruptcy</td>
<td>2</td>
</tr>
<tr>
<td>Prosecutable matters</td>
<td>7</td>
</tr>
<tr>
<td>Other</td>
<td>37</td>
</tr>
</tbody>
</table>

BROs (and bankruptcy orders and IVAs) are recorded on the Individual Insolvency Register (IIR), so that members of public and the commercial community may find information about an individual’s financial status and conduct, and thereby make informed decisions. The IIR is searchable for free through the IS website.

In the 9 months to 31 December 2005 there were a total of 1,001,747 searches made of the IIR through the IS website. In addition, the IS provides daily downloads of the IIR to a number of commercial organisations such as the major credit reference agencies and some lenders.

**Stigma**

Research such as the EC’s Eurobarometer and the Global Entrepreneurship Monitor have identified the fear of failure and its consequences as a powerful disincentive to potential entrepreneurs. One of those disincentives was the large number of restrictions that automatically applied to an undischarged bankrupt. The Enterprise Act provided an opportunity to review that wide range of automatic and mandatory restrictions.

The Enterprise Act seeks to remove some unnecessary restrictions that automatically apply as a result of bankruptcy. The Act itself amends, for example, the position regarding disqualification from Parliament and the automatic restriction on bankrupts serving as a member of a local authority. In both cases, disqualification only occurs upon the making of a BRO.
The Enterprise Act also provides for an order-making power to maintain, repeal, amend or abolish other restrictions. An order removing or amending 23 further pieces of legislation will shortly be laid.

Post-Enterprise Act Bankruptcy - An Easy Way Out?

There are no grounds to claims that bankruptcy has become an easy option under the Enterprise Act proposals. The IS view is that the argument often gets distorted by undue weight being given to the shorter discharge period, which may make bankruptcy more attractive to a minority, with little account taken of the still harsh effects of the system.

Bankruptcy still has a wide-ranging impact on the lives of those who enter it. They risk losing their homes; their possessions and they face severe restrictions on their finances, such as availability of bank accounts and their ability to obtain future credit, including mortgages.

If a bankrupt has surplus income, he or she is increasingly likely to be subject to an IPO or an IPA, which are not affected by early discharge and will continue to run after discharge for the full 3-year period and can be varied to take account of changing circumstances.

One criticism of the shorter discharge period has been the effect it will have on “after-acquired property”, that is property that comes into the bankrupt’s possession after the bankruptcy order and can be claimed by the trustee whilst the bankrupt is undischarged. The criticism being that by reducing the discharge period from 3 years to 1, creditors must lose out. In reality, such claims by the trustee are so rare that the real effect is negligible.

Post Enterprise Act bankrupts can also be subject to BROs if they represent a risk to the public or commercial community, placing restrictions on bankrupts for between 2-15 years. The previous system only allowed for criminal action against bankrupts where there was misconduct. BROs provide the IS with more flexibility in the way they deal with those who represent risk to public or commercial interest.

The OR continues to ascertain the facts in every case. The IS is experienced in identifying misconduct (having almost 20 years experience of disqualifying directors) and continues to prosecute bankrupts where appropriate. There remains, and always will, a degree of stigma and pain associated with bankruptcy, and the Enterprise Act does not alter that. By drawing a clear distinction between unfortunate, reckless and dishonest, the IS hope to focus stigma where it is most warranted.

Is the Enterprise Act Driving Numbers?

Some, mainly early, comment seemed to suggest that the Enterprise Act was the principal driver of bankruptcy numbers in England & Wales. However, whilst it would be nonsense to suggest it has had no effect, the available evidence points to the fact that it, and legislative change generally, is not the principal driver of bankruptcies.
Firstly, I would refer back to the previous section, which sets out why bankruptcy is not an easy way out of financial difficulties and that, having regard to the fact that a high proportion of bankrupts seek advice before going bankrupt, I feel it unlikely that they take that particular leap lightly.

Secondly, we should consider the levels of other indicators of financial problems in the UK and compare them against the 28% and 32% increase in bankruptcies in 2004 and 2005 respectively:

- Over the same two years, the numbers of IVAs increased by 42% and 89% respectively and IVAs have not been changed by the Enterprise Act;
- According to official DTI statistics, the numbers of sequestrations in Scotland increased by 51% from 2004 to 2005, sequestrations have not been changed by the Enterprise Act;
- I have not been able to obtain figures from Northern Ireland but recent increases in bankruptcies there have been broadly comparable to the bankruptcy increases in England & Wales. Their changes to bankruptcy based on the Enterprise Act are not yet in force.

Thirdly, the vast majority of other research, principally in the US, into the causes of rising bankruptcy numbers suggests that legislation is not the major determinant of bankruptcy numbers.

Mark M Zandi suggested that although the doubling of US exemption levels in the 1994 Bankruptcy Reform Act contributed to increased bankruptcy filings, their contribution was small. He drew on the experience of Canada and on econometric models of personal bankruptcy filings. Zandi highlights the predominant factors causing the increased filings as shifting loan standards and rising household debt burdens, or as he described it “easy credit” and “profligate borrowing”.

Professor Ausubel of the University of Maryland, in testimony before the Senate committee on bankruptcy reform, referred to a study by Capital One Financial Corporation (one of the largest issuers of credit cards in the US). That study concluded that 98% of the variation in the personal insolvency rate during 1987-96 could be explained by four factors:

- The increase in the number of credit card accounts;
- The household debt burden;
- Unemployment; and,
- Interest rates.

This is confirmed by Stuart Feldstein (President of SMR Research – a leading market researcher of consumer financial services) although he additionally gave decreased savings levels and the legal advertising of bankruptcy services as reasons.

Moss & Gibbs in their research say that, “tightening the bankruptcy rules might make sense if declining stigma and increased ease of filing were the main culprits for rising bankruptcy rates. But if the recent surge in consumer filings were instead the product of changes in the volume and distribution of consumer credit, then creditor-friendly bankruptcy reforms might actually lead to more lending (including more low end lending) and thus an increased number of bankruptcies in the future.”
I will not refer at length to the recent pilot study by John Tribe of Kingston University as he will no doubt be referring the Committee to it in some detail. However, he did say, “It seems on the whole that bankrupts have not been swayed by the reduced discharge period. Simply, they are insolvent and therefore have to seek redress to the bankruptcy procedure.”

Lastly, I would refer to work by both the DTI’s Operational Research Unit (ORU) and the Bank of England. The ORU are of the view that in their predictions of bankruptcy numbers, the most active component is total debt. The Bank of England, in their Financial Stability Report of June 2005 principally attribute the increasing numbers of personal insolvencies to the rise in household indebtedness and go on to say that it is unlikely that the recent rise in bankruptcies are due to the changes introduced by the Enterprise Act 2002, given that the upward trend in insolvencies was established before the change to legislation.

All of the above casts considerable doubt on the proposition that the Enterprise Act changes have been the principal driver of the recent increases in personal insolvencies.
Written Submission

Scottish Parliament, Enterprise and Culture Committee Meeting:
Tuesday 7th March 2006, 2pm.

Bankruptcy and Diligence etc (Scotland) Bill

Paper Title

The Bankruptcy Court Survey 2005 and the Enterprise Act 2002

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Introduction

1. I am a Senior Lecturer in Law at Kingston Law School, Kingston University, UK. I have been invited to address the Enterprise and Culture Committee\(^1\) of the Scottish Parliament as author the *Bankruptcy Courts Survey 2005 (BCS 2005)*\(^2\). Copies of the *BCS 2005* have been forwarded to the committee in advance of this paper. The committee is considering the Bankruptcy and Diligence etc (Scotland) Bill.\(^3\) This paper relates to Part 1 of the Bill only and is divided into two parts; (A) the *BCS 2005*, and; (B) The Enterprise Act 2002 and the Bankruptcy and Diligence etc (Scotland) Bill. This paper constitutes the six-page written submission that the committee requested in advance of the committee meeting.\(^4\) I apologise for unavoidably exceeding this limit.

A. The *BCS 2005*

2. In March 2005 the *Centre for Insolvency Law and Policy (CILP)*\(^5\), Kingston Law School, Kingston University, received £26,600 research funding to undertake two pilot studies. The funding was provided by the Insolvency Service, an executive agency of the Department of Trade and Industry. The first project, entitled, The *BCS 2005* reported in January 2006. The project consisted of a pilot study questionnaire of six bankruptcy courts in England and Wales (Birmingham, Cardiff, Croydon, Exeter, Newcastle and Reading). 955 respondents returned completed questionnaires giving an 11.5% response rate.

3. **The main conclusions of the *BCS 2005***

*Debtor associated:*
- The main cause of bankruptcy is bankrupt acknowledged credit misuse, followed by business failure.
- Males are the majority users of the bankruptcy regime.
- There is no definitive age range for the typical bankrupt.
- Debtors present the majority of bankruptcy petitions.
- The vast majority of bankrupts are not homeowners prior to bankruptcy.
- Bankruptcy does not affect employment.
- Knowledge of the Enterprise Act 2002 provisions and their effects is low amongst bankrupts.
- The majority of bankrupts feel morally at fault for their debt problems.
- A large majority of bankrupts did not know what level of indebtedness they were being released from.

*Creditor associated:*
- Bankrupts experience immense difficulties in obtaining bank accounts post discharge, which inhibits them from rehabilitation into the credit world.

\(^1\) Hereafter referred to as the committee.
\(^3\) Hereafter referred to as the Bill.
\(^4\) I am grateful to Hamish Anderson (Norton Rose), Michael Mulligan (Halliwells LLP), Professor David Graham QC (13 Old Square), and Lisa Colclough (Citizens Advice Bureau), for our discussions in relation to this paper. Any errors or omissions are those of the author, with whom sole responsibility must reside.
\(^5\) [www.kingston.ac.uk/cilp](http://www.kingston.ac.uk/cilp)
The non-monetary effects of bankruptcy are voluminous, but primarily feature dissatisfaction with lenders.

Procedure associated:
- Informal voluntary arrangements and individual voluntary arrangements are close second choice solutions for over-indebted individuals.
- Alternative routes to bankruptcy are explored prior to the bankruptcy route being pursued.
- Word of mouth and voluntary sector advice are the main information conduits for personal insolvency advice.
- Bankruptcy as an experience is overwhelmingly perceived as negative and stigmatising by bankrupts.
- Bankrupts sum up the bankruptcy process as being ultimately an efficient system.
- The one year maximum period before automatic discharge is deemed sufficient by bankrupts.

Profession/Advice associated:
- Communication and advice from Trustees in Bankruptcy is good according to bankrupts.
- Communication and advice from the Official Receiver is overwhelmingly good according to bankrupts.
- Bankruptcy jurisdiction within the County Courts is efficient and the supporting infrastructure is well maintained.
- On the whole lawyers are not involved in the bankruptcy process in terms of advice; the Citizens Advice Bureau is the main provider of personal insolvency advice.

4. Recommendations of the BCS 2005

a. Consider the division of bankruptcy into a two-tier system differentiating between entrepreneurially derived debt and consumer derived debt, perhaps under the headings of “business bankruptcy” and “personal bankruptcy”. (Paragraphs 5-7 below).

b. Formulate and enact a system of debtor and creditor education. In light of the recent dramatic growth in consumer debt levels reappraise the conduct of consumer debtors, but in particular lending institutions, focusing on the creditor’s responsibility and conduct regarding the consumer debtor’s personal over-indebtedness. (Paragraphs 8-11 below).

c. Whilst considering the division of the bankruptcy procedure between “business bankruptcy” and “personal bankruptcy” also consider eradicating the term ‘bankruptcy’ for non-culpable consumer debt cases. (Paragraphs 12-15 below).

5. A Procedure for dealing with two types of bankrupt

In the introduction to the Insolvency Service’s recent Improving Individual Voluntary Arrangements consultation paper, Mr. Desmond Flynn, Inspector General and Agency Chief Executive of the Insolvency Service observed that, “we have seen a large increase in the availability of credit and, as a consequence, increasing numbers of individuals with debt problems. Over time, non-traders have become the main users of the various debt solutions for individuals, including IVAs.” This is an interesting observation which begs the question for whom are we designing our personal insolvency laws? Should our personal insolvency laws be framed to “encourage entrepreneurship and responsible risk taking” or rather to assist consumer debtors? After all, “we appear to be moving towards the models present in the United States, Canada and Australia where consumer bankruptcies form a very significant majority of cases.” If we take bankruptcy, as distinct

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8 Ibid, at para 1.47

from the other available personal insolvency procedures, i.e. IVAs, who are the bankruptcy procedures main users? If they are on the whole consumer debtors should our bankruptcy laws be tilted towards their interests as opposed to the less common risk taking entrepreneur? Should there be separate regimes for both types of debtor? If the Insolvency Service does intend to move away from the "one-size-fits-all" approach, how might this be achieved as between the more common consumer debtors and their less prevalent relations, the risk taking entrepreneur? In Justice’s 1994 Agenda for Reform a proposal was mooted that would provide for a two-tier bankruptcy system. It is worth quoting the committee’s proposal in full:

“the ‘serious’ tier should perhaps have a less relaxed automatic discharge regime, buttressed by positive requirements that the debtor should be seen to make some effort to rehabilitate himself, e.g. by making regular payments out of income. The ‘non-serious’ tier could have little or no investigatory function, and could perhaps benefit from automatic discharges taking place in as little as 12 months. The term 'bankrupt' should be reserved for serious cases, and should indeed carry a degree of stigma, but the less serious cases could benefit from a new title such as 'enforcement restriction order.'”

6. The results of the BCS 2005 show that the characteristics of the average debtor are that they are pre-dominantly (over 49%) over-committed consumer debtors. It could be argued therefore that Justice’s ‘two-tier’ proposal is supported by primary source evidence. If bankrupts are on the whole consumer debtors should our insolvency laws be more focused primarily on resolving their difficulties? This ‘two-tier’ approach is far from a new idea. The Bankruptcy Act of 1849 drew a distinction for purposes of discharge between blameworthy and non-blameworthy bankrupts. The Cork committee also saw bankruptcy as a procedure that should be maintained only for the most serious cases, leaving other regimes to deal with less culpable bankrupts. A distinction must be made at this point between the culpability of the bankrupt and the type of bankrupt for the purpose of a multi-tier approach. The two issues are separate, namely a ‘two-tier’ approach to distinguish between consumer bankrupts and entrepreneur bankrupts and a ‘two-tier’ approach to distinguish between blameworthy and non-blameworthy bankrupts. The need for a division of treatment between types of bankrupt seems to be supported by evidence as presented in this survey, namely consumer bankrupts are the majority users and by at least one international organisation. The practical utility and cost implications of a two tiered approach may be prohibitive, but if the current bankruptcy laws are framed in such a way as to relegate the main user behind the current policy and political objectives of the political party in power, then the long term majority users will surely

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9 ibid, at para 1.2.
10 One learned commentator has observed that there should be no differentiation made between entrepreneurial debt and consumer debt; see: Ziegel, J. The Philosophy and Design of Contemporary Consumer Bankruptcy Systems: A Canada-United States Comparison (1999) 37, Osgoode Hall Law Journal, p.205. However, another learned commentator has observed, “This “one-size fits all” approach is misguided and at last there is encouraging evidence that the policymakers are moving towards a more discriminating treatment of different types of debtor.” (per Milman, D. Personal Insolvency Law, Regulation and Policy. Ashgate Publishing Ltd, 2005, at page 26).
12 The Cork Report (The Cork Report, Report of the Review Committee, Insolvency Law and Practice. 1982. Cmnd 8558. Hereafter referred to as Cork Report.) of course noted at paragraph 272 that, “the most urgent need of all is for the introduction of a simple, accessible and inexpensive procedure for dealing with the ordinary consumer debtor.” If anything this urgency has grown stronger. Their “Order forLiquidation of Assets” proposal was of course note adopted, see their paragraphs 588-588.
13 12 and 13 Vict, c.106.
suffer from an incoherent framework designed for short term policy objectives, not long term coherent law reform.

7. The Enterprise Act 2002 was the flagship statute of the Labour Government’s second term parliament.\(^{16}\) Combining both elements of competition law and insolvency law, the statute is lengthy and far reaching.\(^{17}\) It could be argued however, that by placing the insolvency provisions, and specifically those relating to personal insolvency within this act instead of within a separate new Insolvency Act 2003, has tilted the balance of our personal insolvency laws towards the entrepreneurial over committed individual whereas in fact the majority users of the system are consumer debtors. Perhaps the clothing of the provisions, i.e. within an Enterprise Act, with all the connotations as to entrepreneurship, investment, growth, etc, which that brings, as opposed to formulating the provisions and presenting them within a new Insolvency Act are just presentational matters. However, a corollary of placing the provisions within the Enterprise Act 2002 have been to give the impression that the new discharge provisions, for example, were intended for entrepreneurs but are being abused by consumer debtors. If one takes the totality of the new personal insolvency provisions, i.e. the Bankruptcy Restriction Order (BRO) and the Bankruptcy Restriction Undertaking (BRU) in addition to the reduced discharge period, one can see that the new provisions are about much more than just discharge. Unfortunately, the vehicle used to bring them onto the statute book appears to have given the public (and bankrupts) the impression that the discharge provisions, intended for entrepreneurial recovery, are open to use (and abuse) by all. If one takes these provisions in tandem with the BRO and BRU provisions one can see that this is clearly not the case. As a raft of provisions they are balanced, from a presentational perspective however their effects have been skewed. It is lamentable that apparent short-term political necessity can dictate long-term law reform activity. If a division is made between entrepreneurial bankruptcy and consumer bankruptcy perhaps the terms “entrepreneurial bankruptcy” and “consumer bankruptcy” could be used to differentiate between the two regimes. This approach must however be tempered with the considerations outlined below, namely that bankruptcy as a term of art should be removed from the insolvency lexicon for consumer debt cases.

8. Educational initiatives – Debtor and Creditor orientated\(^{18}\)

The idea of debtor education is not popular.\(^{19}\) In Bankruptcy – A Fresh Start, financial

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\(^{16}\) See further: Parker, A. The Financial Times. “‘Rescue’ bill could push up business failures.” (04/10/02); Eaglesham, J. The Financial Times. “Call for tougher ‘rogues charter’” (28/10/02) at page 4; Eaglesham, J. The Financial Times “Bill could multiply personal bankruptcies, peers warned.” (21/10/02) at page 4; Eaglesham, J. The Financial Times “Critics raise fears over bill to help bankrupts” (02/07/02) at page 2.

\(^{17}\) On the personal side the following changes were brought into force by the Enterprise Act 2002 on 1\(^{16}\) April 2004: s.263A IA 86 (fast track IVAs); s.279 IA 86 (reduction in the automatic discharge period); s.281A IA 86 (bankruptcy restriction orders); s.283A IA 86 (bankrupt’s home and IP activity); s.289 IA 86 (Investigation by the OR); s.310-310A IA 86 (Income Payments Orders and Income Payment Agreements); s.313A IA 86 (low value homes). On these provisions see further: Davies, S (Ed). Insolvency and the Enterprise Act 2002. Jordans, London, 2003, and Milman, op cit.


\(^{19}\) It is also not new. The 1969 Payne Committee report (Report of the Committee on the Enforcement of Judgment Debts. London, Cm 6909) unsuccessfully recommended a form of debt counselling.
counselling for bankrupts was mooted as a possible reform initiative. In *Productivity and Enterprise* it was noted that this proposal (as well as a number of others), "received little support and are not being taken forward at this time." In order to combat the rise in consumer debt one solution could be to facilitate a programme of debtor education or compulsory financial counselling. This could be undertaken both before problems arise in terms of personal over-indebtedness and post-bankruptcy discharge to help reduce the risk of a second bankruptcy. Ideally, credit responsibility should be taught at a much earlier stage than at the onset of insolvency or immediately after the consequences have come to fruition. Perhaps the incorporation of credit management awareness within general studies or citizenship qualifications undertaken during secondary education would provide one barrier to credit-misuse.

9. At the adult stage credit providers could be given a duty to supply to potential debtors a ‘Credit Responsibility Pack’ or a ‘Code of Good Financial Behaviour’ that outlined the problems of personal over-indebtedness and the possible outcomes of default. If the debtor does not read and sign the same and submit to a central register then their automatic discharge period could be delayed to take into account their earlier irresponsible approach to credit usage. Bankrupt debtors upon discharge could also be given the option of attending a ‘Credit Responsibility Day’ at which they are given education and advice to ensure that they do not repeat past financial mistakes.

10. It could be argued that the current growth in bankruptcy levels has been caused by at worst irresponsible lending practices and at best over generous lending practices of credit providers. The bankruptcy procedure and its effect must be viewed in the wider context of the whole credit system. Consumer debt has risen demonstrably in the last few years. As Roger Oldfield observed in the R3 9th Survey of Personal Insolvency, the Enterprise Act 2002 reform provisions were perhaps biased towards failed entrepreneurs, whereas the greatest area for concern perhaps lies with consumer debtors. The *BCS 2005* shows that this is still a truism. Just as society is concerned that if individual debtors become insolvent their culpability for putting themselves in that position should be investigated and in some cases punished, society is also concerned at the conduct of other parties (e.g. banks) whose actions contribute to the creation of that insolvent estate. This need was of course recognised by the Cork committee when they stated that society needs to be satisfied, “whether and to what extent the responsibility for the insolvency is attributable to someone other than the insolvent.” It is of course within the public interest to ensure that any such behaviour is identified and prohibited thus reducing the incidence of bankruptcy.

11. In relation to imprisonment for debt Johnson observed that: “those who have made the laws, have apparently supposed, that every deficiency of payment is the crime of the debtor. But the truth is that the creditor always shares the act, and often more than not shares the guilt of improper trust. It seldom happens that any man imprisons another but for debts which he suffered to be contracted in hope of advantage to himself, and for bargains in which he proportioned his profit to his own opinion of the hazard; and there is no reason why one should punish the other for a contract in which both concurred.”

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20 Bankruptcy – A Fresh Start. Insolvency Service, DTI publication, April 2000, at paragraphs 7.19-7.21, noting the Canadian position where compulsory financial counselling is a condition of discharge (paragraph 4.8).
21 *Productivity and Enterprise*, at paragraph 1.5.
22 Bankruptcy itself is seen as a learning process by some bankrupt respondents to the *BCS 2005*; for example, one Birmingham respondent noted, “I would say that it [bankruptcy process] certainly got me back on my feet, enabling me to re-build my life and it has also taught me many valuable lessons.” (Birmingham ref: IH. verbatim)
23 Cork Report at paragraph 1735 (d).
24 Montagu, B. *Enquiries respecting the insolvent debtors bill, with opinions of Dr. Paley, Mr. Burke and Dr. Johnson*. London, 1815, at page 520-521.
This point was again taken up in 1972 when Ziegel observed; “the consumer bankrupt is not the sole author of his own misfortune. As often as not his creditors have substantially contributed to his difficulties by creating an environment in which the buy now, pay later syndrome has created the dominant characteristic of our consumer age.”

This is an extremely important point. Are irresponsible lending practices partly responsible for the position of consumer insolvents? Should creditors be educated? It is an axiom of modern society that we have markets in both consumer and commercial credit. As noted above, the market in consumer credit has grown manifestly, but this has not been matched by similar growth in the growth of regulation or temperance of lending practices. The respondents qualifying statements to questions 7 and 18 of the BCS 2005 both strongly suggest that individuals are being extended credit which they are financially in no position to repay.

12. Terminological Difficulties

The term ‘bankruptcy’ is a multi-faceted one which requires a brief exposition. The epistemological derivation of bankruptcy is, as Blackstone opines, derived from “the word bancus or banque, which signifies the table or counter of a tradesman and ruptus, broken; denoting thereby one whose shop or place of trade is broken and gone; though others rather choose to adopt the word “route”, which in French signifies a trace or track, and tell us that a bankrupt is “one who hath removed his banque, leaving but a trace behind.” Bankruptcy as understood in English legal parlance can be defined as a legal position or state and it exclusively applies to individuals. In a number of historical statutes, there have been defined ‘acts of bankruptcy’ and bankruptcy has been consequentially judicially defined as relating to the commission of such an act. For example, keeping house, fleeing the realm, and not paying one’s creditors, have all been characterised as acts of bankruptcy. If an individual is bankrupt, they are in a legal state or position, a normal characteristic of which is a complete inability to pay their debts. A number of consequences arise upon an incidence of bankruptcy, but what is important to this study is the effect the word has on people who become bankrupt.

26 See further: Hosking, P & Morgan, J. The Times. "Report accuses Lloyds TSB over lending practices." (10/05/05), where it is reported that, “an audit report written by the bank’s own officials accuses many branch staff of being motivated mainly to maximise their bonuses by giving loans, and of paying little attention to their customers’ circumstances.”
27 Milman at xxxiii.
28 See Cork Report, Chapter One.
30 Dufresne 1, 969.
31 Blackstone’s Commentaries, vol.II, 1829. See also; Cokes Institutes, 4 Inst 277. Honsberger opines that the word is derived from, “the Italian “banca rottata” which is literally “bank broken” or “bench broken”. The allusion is said to be to the custom of breaking the table or counter of a defaulting tradesman. This became the symbol of a trader’s failure” (see: Honsberger, J. The Nature of Bankruptcy and Insolvency in a Constitutional Perspective [1972] Osgoode Hall Law Journal, vol.10, no.1, 199-207, at page 203).
33 See for example; ex. p. Attwater, 5 Ch.D. 30.
34 For example, formal notice is given of the bankruptcy order in the London Gazette (Insolvency Rules 1986 6.34 and 6.46), the bankrupt’s property (as defined by s.283 and s.436 IA 86) vests in the Trustee in Bankruptcy; the Trustee in Bankruptcy will distribute the proceeds derived from those assets to creditors in
13. Responses to the BCS 2005, particularly replies to questions 7, 17, 18, and 19 denote that the term still attracts stigma in England and Wales. Indeed, there is also strong judicial comment to this effect, e.g. “it is not as if bankruptcy leads to the debtor's incarceration as it might have done 150 years ago. That is not to underplay the unpleasantness, seriousness and stigma of bankruptcy.”\textsuperscript{35} Perhaps in cases of consumer insolvency it might be appropriate to reappraise the use of the word bankruptcy if we are to truly relieve and rehabilitate individuals.

14. A renaming of the procedure under which these species of insolvent pass might be considered desirable. Perhaps a term such as, \textit{Personal Financial Protection Order (PFPO)} might be considered. This PFPO regime would be roughly analogous to the recently proposed \textit{Debt Relief Order} in that it would provide for a scheme in the alternative to bankruptcy for consumer debtors,\textsuperscript{36} however the PFPO regime would ostensibly be exactly the same as current bankruptcy regulations for debts under £100,000 for non-culpable bankrupts. This name change might reduce the attendant issues of stigma that bankruptcy as a term still manifests in English Society. The term bankruptcy is exhausted in the English language.\textsuperscript{37} It has through five centuries of use become burdened with negative preconceptions and terminological confusion and it unfortunately still retains connotations that are not conducive to current notions of relief and rehabilitation. One bankrupt respondent to the survey in replying to whether the bankruptcy system has met her expectations observed, “Yes, it's a dirty word and I feel very dirty so yes it has met my expectations.”\textsuperscript{38} As long as views such as this and those noted above in answers to questions 7, 18, and 19 are maintained then it is unlikely that we can move to a position were attitudes to the term and procedure are likely to change.

15. Whilst this suggestion simply involves the employment of a euphemism\textsuperscript{39} it does move us away from the historical connotations attendant with the term bankruptcy. Is the continued use of the term bankruptcy with its historical antecedents, in an environment where we are trying to make the attitude to and results of the bankruptcy system not anachronistic? As well as modernising procedures, should we not also modify the procedure’s name? If we are to retain bankruptcy as a term of art it should be used as the Cork committee intended\textsuperscript{40} and as history has used it, namely for the more serious cases of personal over-indebtedness where some form of miscreant behaviour is extant. The following division of use is therefore promulgated; retain bankruptcy in its current Enterprise Act 2002 state and as a term of art for serious cases of personal over-indebtedness (e.g. where BRO and BRU orders apply) on the one hand, and use the PFPO procedure for small consumer debt cases which are in effect now subject to the bankruptcy procedure.

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\textsuperscript{35} per Neuberger, J in \textit{West Bromwich Building Society v Crammer} [2002] EWHC 2618 (Ch), [2003] BPIR 783, at paragraph 48. See also, \textit{Coppard v Commissioners of Customs and Excise} (Transcript) 23 January 2001, at paragraph 30, where Judge Seymour QC notes, “there is, no doubt, a stigma attached to having been made bankrupt.”

\textsuperscript{36} See: \textit{Relief for the indebted – an alternative to bankruptcy – Summary of Responses and Government Reply}, Insolvency Service, November 2005.

\textsuperscript{37} I am grateful to Professor David Graham QC for this point.

\textsuperscript{38} \textit{BCS 2005: Birmingham ref: DO}.\textsuperscript{39} Just as Receiving Orders became synonymous over time with bankruptcy the PFPO might also suffer the same fate.

\textsuperscript{40} See \textit{Cork Report} at paragraph 554.
(B) The Enterprise Act 2002 and the Bankruptcy and Diligence etc (Scotland) Bill


As originally envisaged, and proposed to the Insolvency Service, the BCS 2005 survey was intended to progress as a pilot study which was very much in the nature of a ‘fishing expedition’. One function of the BCS 2005 was to ascertain whether the Enterprise Act 2002 had a demonstrable effect on the law of personal insolvency. For example, the following questions were put to bankrupt respondents to ascertain if the discharge provision changes had affected usage:

9. Were you aware that the automatic discharge period was reduced in 2004 from 3 years to 1 year before you began your bankruptcy experience?
10. How much of an influence did the reduction in the automatic discharge period from 3 years to 1 year have on your decision to go through the bankruptcy debt relief route?
13. Do you think one year before discharge is a sufficient time-period?
14. Should the automatic discharge be [longer or shorter than one year]?
15. What length of time do you think an individual should be adjudged bankrupt before they receive an automatic discharge?

Please see the full BCS 2005 at pages 67 to 75, 88 to 98, and 182 to 186 for full responses to these questions. In totality the reforms do not seem to have affected the users of the English and Welsh provisions, as bankruptcy appeared to be the only viable option for these over-indebted individuals.

17. **Bankruptcy and Diligence etc (Scotland) Bill – points for consideration**

**Barriers to entry**

The prohibitive cost of entry into the bankruptcy regime is highlighted by the BCS 2005 and has been cited by the Citizens Advice Bureau as an issue as regards the individuals who typically seek advice from them.

**Entrepreneurial Focus**

Do the reforms as envisaged truly help to rehabilitate the entrepreneur or are they more concentrated on administration and cost reform of the Scottish personal insolvency system? Would the insertion of a private residence exemption be more beneficial to the rehabilitation of entrepreneurs or to the promotion of entrepreneurial endeavour in the first instance?41

**Policy Objectives**

This BCS 2005 pilot project is now complete. A number of issues have presented themselves as being ripe for further research, e.g. (1) debtor education, (2) the credit environment, and (3) debtor advice. What are the primary aims of the Bill’s anticipated social policy changes? Are they to ensure a social culture of debt discharge for all insolvents both entrepreneurial and consumer in nature? If irresponsible lending practices are a major cause of personal over-indebtedness (this hypotheses will be tested in the expanded research – ‘credit environment’), this coupled with the reduction in the disadvantages of bankruptcy may lead to a position of unacceptable bad debt write off, i.e. people are incurring debt with no intention to repay.

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41 I am grateful to Hamish Anderson for this point.
18. **Particular Provisions of the Bill**

**s.1 of the Bill – amendments to s.54 of the Bankruptcy (Scotland) Act 1985**

This proposed change to the 1985 Act is analogous to the change to s.279 IA 86 that the Enterprise Act 2002 caused in relation to reduction in the automatic discharge period.

**s.2 of the Bill – amendment to s.56 of the 1985 Act**

This proposed change to the 1985 Act is analogous to s.281A IA 86 in relation to bankruptcy restriction orders and bankruptcy restriction undertakings.

**s.17 of the Bill – insertion of new s.39A into the 1985 Act**

This proposed change to the 1985 Act is analogous to s.283A IA 86 in relation to the bankrupt’s home and the activity/inactivity of the insolvency practitioners in relation to the debtor’s home.

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**John Tribe**

**Kingston Law School, Kingston University**

**28th February 2006**

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42 Hereafter referred to as the 1985 Act.
CILP
Centre for Insolvency Law and Policy

Bankruptcy Courts Survey 2005 – A Pilot Study
Final Report – January 2006

Insolvency Service Presentation
Monday 30th January 2006
Introduction

• Background to the BCS 2005
• An Experimental Pilot Study
• Methodology
• Excel/SPSS – small response inclusion
• Response rate: 11.5%

• This presentation – selected questions
<table>
<thead>
<tr>
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<th>Percentage Received</th>
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<td>2. Cardiff</td>
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<td>3. Croydon</td>
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<td>4. Exeter (initial)</td>
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<td>185</td>
<td>19.8%</td>
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<tr>
<td>Exeter (full)</td>
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<td>53</td>
<td>55%</td>
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<td>5. Newcastle</td>
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<tr>
<td>6. Reading</td>
<td>1210</td>
<td>125</td>
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<tr>
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<td>8306 (without Exeter Initial)</td>
<td>955 (without Exeter initial)</td>
<td>11.5% (12.3% with Exeter Initial)</td>
</tr>
</tbody>
</table>
1. What was the cause of your bankruptcy?

- Credit Misuse: 49%
- Failed Business: 16%
- Illness: 12%
- Divorce / failed relationship: 7%
- Redundancy: 6%
- Spouses' credit misuse: 3%
- Family problems: 3%
- Change in Income: 2%
- Tax debt: 2%
2. What other routes did you consider to relieve your indebtedness?

Qn 2

- Individual Voluntary Arrangement: 34%
- County Court Administration Order: 4%
- Informal arrangement with creditors: 11%
- Prior arrangement of payment: 4%
- Debt Management Schemes: 7%
- Suicide: 2%
- Doing Nothing: 2%
- No consideration of other routes: 5%
- Unknown: 2%
2a. How did you hear about these alternative solutions to bankruptcy?

Qn 2a

- Word of Mouth: 34%
- Insolvency Website/Internet: 25%
- Counselling Service/CAB: 14%
- Newspapers: 7%
- No Comment: 7%
- TV: 6%
- Mail Marketing: 4%
- Radio: 2%
- Not Applicable (VI or II): 1%
### Question 4

What has been the effect of the bankruptcy on your job?

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**Total/ Male/ Female**

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<td>30%</td>
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<tr>
<td>65%</td>
<td>61%</td>
<td>5%</td>
</tr>
<tr>
<td>70%</td>
<td>70%</td>
<td>4%</td>
</tr>
</tbody>
</table>

**Diagram**

[Bar chart showing the distribution of responses for different categories and total, male, and female counts]
5. What has been the effect of the bankruptcy on your family life?

Qn 5

- Negative: 39%
- No Effect: 30%
- Positive: 24%
- Divorce: 3%
- No Comment: 4%
6. What has been the effect of the bankruptcy on your present and or future borrowing habits?

Qn 6

- 37% Negative
- 25% No longer willing to borrow
- 19% Positive
- 7% Indifferent to borrowing in future
- 5% No longer able to borrow
- 5% Indifferent
- 2% No Comment

Legend:
- Negative
- No longer willing to borrow
- Positive
- Indifferent
- No longer able to borrow
- Indifferent to borrowing in future
- No Comment
7. Before you became a bankrupt, did you think that you would be treated differently as a bankrupt, if so how have expectations been met?
8. Who was your bankruptcy instigated by?

Qn 8

![Bar chart showing the percentage of bankruptcy cases instigated by creditors, self-petition, and unknown. The chart is divided into total, male, and female categories. The data includes percentages for each category.]

- Creditor: 11%, 1%, 4%, 2%
- Self-petition: 88%, 82%, 94%
- Unknown: 0%, 1%, 2%
9. Were you aware that the automatic discharge period was reduced in 2004 from 3 years to 1 year before you began your bankruptcy experience?

Qn 9

- Total: 63% Yes, 64% No, 61% No Comment
- Male: 36% Yes, 34% No, 38% No Comment
- Female: 63% Yes, 64% No, 61% No Comment
10. How much of an influence did the reduction in the automatic discharge period from 3 years to 1 year have on your decision to go through the bankruptcy debt relief route?
11. How were/are your relations with the Trustee (private sector) in relation to communication?

Qn 11

- **Good**: 57%
- **Indifferent**: 12%
- **Frequent**: 6%
- **Infrequent**: 2%
- **No Communication**: 3%
- **Don't understand the question**: 2%
- **No Comment**: 6%
12. How were/are your relations with the Trustee (private sector) in relation to advice?

Qn 12

- Good: 55%
- Bad: 10%
- Indifferent: 8%
- Objective: 4%
- Timely: 3%
- No advice given: 3%
- Don't understand the question: 1%
- Not given yet: 1%

Legend:
- Good
- Bad
- Indifferent
- Objective
- Timely
- No advice given
- Don't understand the question
- Not given yet
12a. How were/are your relations with the Official Receiver in relation to communication?

Qn 12a

- 73% Good
- 16% Infrequent
- 5% No Comment
- 3% Frequent
- 2% No Communication
- 1% Indifferent
12b. How were/are your relations with the Official Receiver in relation to advice?

Qn 12b

- Good: 77%
- Bad: 6%
- Indifferent: 10%
- Objective: 3%
- Timely: 3%
- Not given: 1%

LEGEND:
- Good
- Bad
- Indifferent
- Objective
- Timely
- Not given
13. Do you think one year before discharge is a sufficient time-period?

**Qn 13**

- **74%** Sufficient
- **14%** Too short
- **2%** Too Long
- **7%** Should be individually assessed
- **3%** No opinion
14. Should the automatic discharge be:

- Longer: 25%
- Shorter: 31%
- As it is: 11%
- Should be individually assessed: 6%
- No opinion: 27%
15. What length of time do you think an individual should be adjudged bankrupt before they receive an automatic discharge?
16. What in your opinion, are the non-monetary affects of bankruptcy?

- No comment: 26%
- Psychological distress/health issues: 3%
- Relief: 3%
- Embarrassment: 3%
- None: 5%
- Feeling a failure: 5%
- Effected relations between friends and/or family: 9%
- Can't get credit or standing orders: 9%
- Loss of confidence / self esteem: 12%
- Life being harder: 10%
- Ultimately made more responsible: 9%
17. Did you feel that you would be stigmatised by going through the bankruptcy process?
18. What did you think the consequences of bankruptcy would be?

- 25% Inability to get credit
- 14% No comment
- 12% Treated differently
- 8% Losing everything
- 8% Unknown
- 6% As they are
- 5% Relief
- 5% Inability to get a mortgage
- 5% Long-term financial instability
- 5% Humiliation
- 5% Problems with Employers
- 4% Life would not be the same again
19. Did you feel that by going into bankruptcy you were morally at fault?
20. How old were you at the date of your bankruptcy order?

Qn 20

- 36-45: 27%
- 26-35: 22%
- 46-55: 14%
- 56-65: 7%
- 66-75: 3%
- 16-25: 1%
- Unknown: 1%

21. Are you:

Qn 21

- 53% Male
- 47% Female

Total
22. What level of debt has your bankruptcy order relieved you from?

Qn 22

- £21,000-£30,000: 26%
- £10,000-£20,000: 17%
- £31,000-£40,000: 16%
- £41,000-£50,000: 14%
- £51,000-£60,000: 8%
- £61,000-£70,000: 5%
- £71,000-£80,000: 5%
- £91,000-£100,000: 3%
- Less than £10,000: 2%
- Unknown: 4%

Legend:
- £21,000-£30,000
- £10,000-£20,000
- £31,000-£40,000
- £41,000-£50,000
- £51,000-£60,000
- £61,000-£70,000
- £71,000-£80,000
- £91,000-£100,000
- Less than £10,000
- Unknown
25. If you were faced with a situation of personal over indebtedness again would you again go through bankruptcy or would you instead try and undertake a different route, such as:

- 27% Go through the bankruptcy process again
- 24% Go for an I.V.A.
- 19% Will not happen again
- 16% Go for an Informal Arrangement
- 9% Debt Management Schemes
- 5% No Comment
26. Have you had any experiences post your discharge that you can only ascribe to your past status as a bankrupt?

Qn 26

Total/ Male/ Female

- 66% No
- 14% Yes
- 14% Not yet
- 6% No Comment

(Bar chart showing distribution)
28a. Before you went through the bankruptcy process, did the fear of any possible consequences pray on your mind?

- Yes: 67%
- No: 30%

Total: 100%
28b. What were those possible consequences that you expected?

- Fear of long term credit problems: 14%
- Fear of the unknown: 6%
- Fear of repossession of goods: 6%
- Feared public knowledge of bankruptcy: 6%
- Feared job loss: 4%
- Feared eviction / losing home: 5%
- Fear of family reaction / implications: 4%
- Feared imprisonment: 5%
- No Comment: 14%
29. How would you sum up the bankruptcy process that you have been through to a friend or colleague?
31. Did you seek the advice of a solicitor before you commenced the bankruptcy process?

Qn 31

<table>
<thead>
<tr>
<th></th>
<th>Total</th>
<th>Male</th>
<th>Female</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>22%</td>
<td>26%</td>
<td>18%</td>
</tr>
<tr>
<td>2</td>
<td>77%</td>
<td>73%</td>
<td></td>
</tr>
<tr>
<td>3</td>
<td>82%</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
33. Did you seek advice from your local Citizens Advice Bureau or any other agencies?
34. Is there anything else that you would like to comment on in relation to the specific bankruptcy court that your bankruptcy order was made in?

- Praise for court &/or CAB: 68%
- CAB unhelpful when contacted: 12%
- Cost of process excessive for a bankrupt: 8%
- No other way out: 7%
- Difficult to get bank account: 5%
37. Employment Status:

Qn 37

- Employed: 40%
- Unemployed: 27%
- Unknown: 12%
- Retired: 11%
- Disabled: 4%
- Self-Employed: 4%
- Benefit: 4%
- Student: 1%

Legend:
- Employed
- Unemployed
- Unknown
- Retired
- Disabled
- Self-Employed
- Benefit
- Student
Pre and Post Enterprise Act 2002 responses to discharge
9. Were you aware that the automatic discharge period was reduced in 2004 from 3 years to 1 year before you began your bankruptcy experience?
10. How much of an influence did the reduction in the automatic discharge period from 3 years to 1 year have on your decision to go through the bankruptcy debt relief route?
13. Do you think one year before discharge is a sufficient time-period?

Qn 13 Pre

- Sufficient: 58%
- Too short: 17%
- Too Long: 17%
- No opinion: 8%

Qn 13 Post

- Sufficient: 90%
- So should be individually assessed: 3%
- Too short: 2%
- Too Long: 3%
14. Should the automatic discharge be [longer or shorter than one year]:
15. What length of time do you think an individual should be adjudged bankrupt before they receive an automatic discharge?

Qn 15 Pre

- Less than one year: 8%
- More than one year: 17%
- More than two years: 17%
- More than four years: 17%
- One year is sufficient: 17%
- No opinion: 24%

Qn 15 Post

- Less than one year: 24%
- More than one year: 6%
- More than two years: 6%
- More than three years: 2%
- More than four years: 3%
- One year is sufficient: 15%
- Should be individually assessed: 30%
- No opinion: 44%
Conclusions

Debtor associated:

- The main cause of bankruptcy is bankrupt acknowledged credit misuse, followed by business failure.
- Males are the majority users of the bankruptcy regime.
- There is no definitive age range for the typical bankrupt.
- Debtors present the majority of bankruptcy petitions.
- The vast majority of bankrupts are not homeowners prior to bankruptcy.
- Bankruptcy does not affect employment.
- Knowledge of the Enterprise Act 2002 provisions and their effects is low amongst bankrupts.
- The majority of bankrupts feel morally at fault for their debt problems.
- A large majority of bankrupts did not know what level of indebtedness they were being released from.
Conclusions

**Creditor associated:**

- Bankrupts experience immense difficulties in obtaining bank accounts post discharge, which inhibits them from rehabilitation into the credit world.

- The non-monetary effects of bankruptcy are voluminous, but primarily feature dissatisfaction with lenders.
Conclusions

Procedure associated:

• Informal voluntary arrangements and individual voluntary arrangements are close second choice solutions for over-indebted individuals.
• Alternative routes to bankruptcy are explored prior to the bankruptcy route being pursued.
• Word of mouth and voluntary sector advice are the main information conduits for personal insolvency advice.
• Bankruptcy as an experience is overwhelmingly perceived as negative and stigmatising by bankrupts.
• Bankrupts sum up the bankruptcy process as being ultimately an efficient system.
• The one year maximum period before automatic discharge is deemed sufficient by bankrupts.
Conclusions

Profession/Advice associated:

• Communication and advice from Trustees in Bankruptcy is good according to bankrupts.
• Communication and advice from the Official Receiver is overwhelmingly good according to bankrupts.
• Bankruptcy jurisdiction within the County Courts is efficient and the supporting infrastructure is well maintained.
• On the whole lawyers are not involved in the bankruptcy process in terms of advice; the Citizens Advice Bureau is the main provider of personal insolvency advice.
The main recommendations of the *BCS 2005* are:

1. Consider the division of bankruptcy into a two tier system differentiating between entrepreneurially derived debt and consumer derived debt, perhaps under the headings of “business bankruptcy” and “personal bankruptcy”.
The main recommendations of the *BCS 2005* are:

2. Formulate and enact a system of debtor and creditor education.
The main recommendations of the BCS 2005 are:

3. In light of the recent dramatic growth in consumer debt levels reappraise the conduct of consumer debtors, but in particular lending institutions focusing on the creditor’s responsibility and conduct regarding the consumer debtors’ personal over-indebtedness.
The main recommendations of the BCS 2005 are:

4. Whilst considering the division of the bankruptcy procedure between “business bankruptcy” and “personal bankruptcy” also consider eradicating the term ‘bankruptcy’ for non-culpable consumer debt cases.
The main recommendations of the BCS 2005 are:

5. It is further recommended that the BCS 2005 pilot study be expanded from its 6 court sample to a full study that encompasses 30 of the 136 bankruptcy courts in England and Wales to give a better impression of the treatment and experience of the bankruptcy court user.
Bankruptcy and Diligence, etc (Scotland) Bill

Submissions of Patrick Boyden

1. I am a partner in PricewaterhouseCoopers LLP having been admitted to partnership in 1994. I have been a licensed insolvency practitioner since 1987. From 1973 to 1978 I was an examiner in the Insolvency Service in Birmingham, dealing exclusively with bankruptcies (then under The Bankruptcy Act 1914). From 1979 until 1994, I was employed by predecessor firms of PricewaterhouseCoopers LLP, again dealing mainly with bankruptcies. My role with the firm is to lead the Personal Insolvency team, not just in the practicalities of case-handling, but to formulate strategy, and to comment upon changes in law and trends in personal insolvency and finance. I was responsible for the firm’s submission to the DTI on The Enterprise Bill, as a result of which I was quoted in Hansard, and have recently served on the Insolvency Service’s working party on the reform of Individual Voluntary Arrangements (‘IVA’s).

2. I have seen Stephen Lawson’s submission and have no comment, other than one of agreement, to make on his reciting of the major changes introduced by the Enterprise Act 2002.

3. The increases in bankruptcies and IVAs over the last three years have been significant and have resulted in much comment. In summary, the increases for the last three years (in percentage terms) have been:

<table>
<thead>
<tr>
<th>Year</th>
<th>Bankruptcies</th>
<th>IVAs</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>2003</td>
<td>15.35</td>
<td>20.46</td>
<td>16.40</td>
</tr>
<tr>
<td>2004</td>
<td>28.11</td>
<td>41.79</td>
<td>31.02</td>
</tr>
<tr>
<td>2005</td>
<td>31.73</td>
<td>88.74</td>
<td>44.87</td>
</tr>
</tbody>
</table>

4. At the end of 2005, Britons owed £1.148 trillion on their mortgages, personal loans and credit cards. This is almost double the amount owed on the first day of the 21st century and is increasing at the rate of £1 million every four minutes.¹

During 2005, nearly 80,000² individuals, a record, in the United Kingdom entered some form of statutory personal insolvency, approximately one every two minutes of the working day. This is also double the number that did so in 2000.³

¹ Bank of England
An estimated 55% of all credit cards in Western Europe are held by Britons, who owe an average of £3,304 on their cards and loans, well ahead of the Germans in second place who owe £2,037.4

In May 2003, Citizens Advice reported that well over a million people each year sought advice for debt problems, two thirds of which related to consumer debt. This was an increase of 47% in five years.5

In 1993, 70% of bankrupts were traders, in 2004, only 27% fell into that category. The majority of bankrupts in that year (77%) filed their own petitions, and the recent increases in bankruptcy numbers are almost entirely due to individuals taking that option, rather than one of their creditors doing it for them.6

5. There are a number of reasons for these increases, some marginal, some more significant. If there is one main reason, it is probably simply that Britons have taken on a large amount of debt – it is perhaps glib to say that insolvencies have doubled because consumer debt has also doubled over the last five years, but given that there will always be financial failure, it is likely to increase as lending increases.

I agree with Stephen Lawson that the Enterprise Act 2002 is not entirely to blame. It has been common practice in England & Wales to blame the Act, but bankruptcies were already increasing at a high rate before the Act came into force, and IVAs have increased at an even higher rate. IVAs were not changed at all by the Act (except for the ‘Fast Track IVA’ whose numbers are insignificant). In Northern Ireland and Scotland, personal insolvencies have also risen significantly, and neither jurisdiction was affected by the Act.

There was much comment at the time of the Act about it being a ‘debtor’s charter’ because of the shortening of the discharge period to a year or less. For the vast majority of bankrupts, this makes no difference whatsoever. Curbs on their power to borrow are in place through the credit reference agencies, and few have any desire to be company directors. The other restrictions of being bankrupt are insignificant and largely irrelevant to all but a few. A bankruptcy now is perhaps marginally ‘softer’ than under the previous law, but that may be set off by the threat of a bankruptcy restrictions order (‘BRO’). As these extend the above

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2 Bankruptcies, IVAs, sequestrations, Protected Trust Deeds in England, Wales, Scotland and Northern Ireland
3 Department of Trade and Industry (‘DTI’)
4 Datamonitor, December 2005
5 In too deep – CAB Clients’ experience of Debt (Sue Edwards, May 2003)
6 DTI
restrictions, which I have already indicated have little effect in the majority of cases, it is perhaps not much of a threat.

6. The comment about the introduction of the Act and the subsequent press interest in the rising figures have created a heightened awareness of personal insolvency. As it is the consumer debtor, as opposed to the trading community, which is suffering from financial difficulties, they do not have, or have not had, obvious access to those who may provide a solution. A builder may speak to his accountant; a clerical worker or unskilled manual worker probably does not know an accountant. In recent years there has been a growth in the number of concerns providing debt relief, either through informal schemes or through IVAs. Advertising on television, or on the internet, is widespread. Whereas in 1992, at the height of the last major recession, a consumer debtor would have struggled to find out who to contact for advice, nowadays a free phone number is often no more than a mouse click away. A search for ‘debt problems UK’ through Google will result in over 7 million results.

There is a strong feeling, especially within the personal finance industry, that this advertising, and the proliferation of debt advice companies, has materially contributed to the increase in IVA numbers. The increase in bankruptcies, as Mr Lawson says, is almost entirely down to those with no assets or income filing their own petitions as they do not suit IVAs.

7. Stephen Lawson rightly comments that for many, a bankruptcy would seem to be the better option, particularly in cases where assets were minimal and the only funds available to creditors were payments from income. An Income Payment Order (‘IPO’) cannot last for more than three years: in an IVA the industry norm is five years. Creditors in an IVA are far more critical of income & expenditure accounts than the Official Receiver will be as it is they who are directly affected. Moreover they have the power to vote down proposals if they are unhappy with the offer. For that reason, payments under an IPO are less onerous to the debtor than under an IVA. Nonetheless, individuals opt for an IVA, perhaps because they still view bankruptcy as having a stigma, but more probably because they are sold the IVA.

In summary, on the reasons for the increase, there has been an increased awareness amongst the British public of insolvency procedures, combined with a greater accessibility to those procedures. Along with the overall increase in consumer debt, these factors combine to produce the numbers we see now. The change in law on 1 April 2004 had little effect, although the perception that it was a softer option may have been an influence.

8. The profile of the average debtor is changing. The typical bankrupt is under 40, not self-employed, just as likely to be female as male, owes around £60,000 to personal finance and credit card companies, and has few or no assets. My fellow witness, John Tribe, will have
more detailed data\(^7\) on the profile of a bankrupt, but my own research into 6,500 IVA debtors in 2005 presents a similar profile, with the exception of availability of assets. By definition, IVA debtors have to offer something to their creditors, and usually that originates from income.

There is, unfortunately, little comparative data available from earlier years. However, in 1993, 60% of bankrupts were self employed; by 2004 that had fallen to 26\%, and is likely to be around 23\%\(^8\) in 2005. Statistics for the years 2002-2004 showed that whilst the 30-40 age group was the largest population of bankrupts, the 20-30 range was the fastest growing, its rate of increase being the only one that exceeded the overall increase in bankruptcies for those years.\(^9\)

9. The Insolvency Act 1986 first introduced the concept of the IVA, but it was largely aimed at individuals who had specific problems – traders and entrepreneurs perhaps. Its gestation was in the report of The Cork Committee in 1982\(^10\), which itself was based on data collected in prior years. Given that in 1974 there was only one brand of credit card available, and that debts owed to the provider were £38 million, it is perhaps unsurprising that no attempt was made to tailor insolvency law towards the consumer. There are now an estimated 1,300 different credit and store cards available, with debts of £56 billion.

The current Government issued its consultation document in 2002 based on a supposition that a relaxed bankruptcy regime would encourage entrepreneurship and lessen the stigma of bankruptcy. This was largely based on the regime in the USA. I quote below an extract from MBNA’s response to that consultation document\(^11\):

“MBNA is concerned that the legislation, as currently drafted:

- will open up the system to abuse - the legislation must ensure that bankruptcy is not an easy way out of consumer debt, and that debt continues to be repaid where it can be repaid;
- will lead to a significant increase in levels of bankruptcy. It is vital to ensure that trustees/the Official Receiver are still in a position to investigate individual bankruptcies effectively. MBNA is concerned that, as the number of bankrupts rise, the legislation includes safeguards against ‘rubber stamping’;
- will lead to increased costs for consumers, who will be required to cover the cost of unrecoverable personal bankruptcy losses both through higher costs for credit, and also potentially through higher consumer prices as retailers and lenders pass on increased credit costs to their customers;

\(^7\) Bankruptcy Courts Survey 2005 – A Pilot Study. John Tribe, Kingston Law School
\(^8\) DTI
\(^9\) Insolvency Service administrative data
\(^10\) Report of the Review Committee on Insolvency Law and Practice (Cmnd 1982)
\(^11\) MBNA Briefing Paper on the Proposals for Personal Insolvency in the Enterprise Bill
may in the future lead to obstacles being placed in the way of responsible and informed lending; for example, it is vital to ensure that details of personal bankruptcy remain on the file of the credit reference agencies for 6 years following bankruptcy to allow lenders to make informed decisions about granting credit and acting as responsible lenders.

As with the US, a much higher proportion of bankruptcies in the UK are personal rather corporate (there are twice as many personal as opposed to corporate insolvencies in the UK, and in the US, 97% of all insolvencies are personal insolvencies). The Government therefore appears to be considering measures which reduce the stigma of bankruptcy in order to stimulate the enterprise culture, which will predominantly impact on consumers rather than entrepreneurs.”

The Government dropped a particular clause which related only to the self-employed as it realised, in the weight of responses, that the nature of bankruptcy was changing. Otherwise, the proposed legislation entered the statute books largely unaltered, the only significant change being the necessary amendments to the law on the realisation of the matrimonial home.

10. The leniency, for want of a better term, of a country’s insolvency law is as much a social concern as an economic one. The DTI often comments, when asked about the rising numbers, that it is good that those who are experiencing uncontrollable debt have access to a range of solutions which avoids a continuing struggle. Until recently, France had no procedure available to non-traders akin to bankruptcy or the IVA: individuals owed the debt for life, and, indeed, beyond. As recently as 1805, bankruptcy was, in some circumstances in England and Wales, a capital offence. The USA has recently introduced changes designed to make bankruptcy more of a challenge. The difference between France and the USA is that the former has little in the way of credit card culture, whereas the USA probably leads the world. It is not coincidental that credit card usage in the UK is not dissimilar to that in the USA.

11. In 2002, the incidence of personal insolvency in the UK was in the order of 1 in 1,600 head of population; in the US it was 1 in 200. In 2005, the US figure is much the same; in the UK it is nearer 1 in 800. It is unlikely to reach US numbers as there are significant differences, not least of all the homestead exemptions, that apply in most states. Moreover, Chapter 13 schemes are frequently used to gain relief from foreclosure on property by means of a repayment schedule to clear mortgage arrears.

Nevertheless, short of reintroducing debtors’ prisons, it is hard to see what legislative changes can put the genie back in its bottle. As individuals increase their borrowing, more will be seeking relief from debt. As more find that relief, the stigma of insolvency will diminish further and whilst those of a certain generation would see bankruptcy as a very last resort, their children, or more likely their grandchildren, see it as a means to an end.
My research showed that 83% of those entering an IVA gave as their cause of failure ‘expenditure in excess of income’, with only 15% citing matrimonial difficulties or loss of income or employment as a cause. This finding is supported by other research, and indicates that debtors end up in difficulty because of the ‘drip’ effect of borrowing over a period, rather than a life event such as redundancy, ill health or divorce.

12. There are signs that consumer borrowing (other than on mortgages) is flattening out, but it still increased in 2005 at a rate of 9.3%. Consumer spending fell for the first time ever in the last quarter of 2005, and that should have an effect on overall debt. More individuals used debit cards, rather than credit cards, in the same period. It is possible that individuals simply cannot borrow any more, and with the tightening up of lending criteria by the major banks and lenders, debt may level out. It is likely though that insolvencies will continue to increase, possibly at the same rates as in 2005, for some time yet. Similar rates of increase in bankruptcies and IVAs that obtained in 2005 will produce over 100,000 personal insolvencies in England and Wales in this calendar year.

Patrick Boyden
Partner
PricewaterhouseCoopers LLP
Plumtree Court
London
EC4A 4HT
27 February 2006
1. **Personal Introduction**

I was admitted as a Solicitor in England and Wales in October 1969. I am a Licensed Insolvency Practitioner and was first authorised so to act in 1987. I do not accept appointments as office holder. I am a member of the R3 General Technical Committee. I am the author of Individual Voluntary Arrangements published by Jordans which, as the title suggests, is a textbook on Individual Voluntary Arrangements. I am a Deputy High Court Bankruptcy Registrar.

2. Unless otherwise indicated, any reference in these submissions to “the Act” is a reference to the Insolvency Act 1986 as amended and, accordingly, reference to Sections are, unless otherwise indicated, reference to Sections in the Act.

3. The relevant provisions of the Act with which these submissions are concerned were introduced by the Enterprise Act 2002 and came into force on 1 April 2004. With one exception, I do not propose to deal with transitional provisions.

4. The principal changes to the Act brought about by the Enterprise Act 2002 can be summarised as follows:–

   a. **Section 279 Duration**

      This provides that a bankrupt is discharged from bankruptcy at the end of a period of one year beginning with the date on which the bankruptcy commences. Previously the relevant period was three years. The Section contains provision for earlier discharge if the Official Receiver files with the Court a notice stating that investigation of the conduct and affairs of the bankrupt is unnecessary or concluded. If such a notice is given then the bankrupt is discharged when the
notice is filed. It is still possible for the Official Receiver or the Trustee to apply to the Court for the suspension of an automatic discharge. This is normally done when a bankrupt has been uncooperative.

b. **Section 281A Post-Discharge Restrictions**

Schedule 4A to the Act brings about a new regime whereby an application can be made to the Court by either the Secretary of State or the Official Receiver acting on a direction of the Secretary of State for a bankruptcy restriction order (BRO). The schedule sets out the grounds on which a bankruptcy restriction order can be made and largely go to issues of “behaviour” on the part of the bankrupt. An application has to be made within one year of the date on which the bankruptcy commences. If an order is made, then it will last for a minimum of two and a maximum of 15 years. Provision is made for the bankrupt to offer an undertaking to the Secretary of State.

One of the principal reasons for the introduction of BROs was to reassure the public about the risks posed by early discharge and the provisions are designed to provide a degree of balance in applying BROs to those bankrupts deemed not to have been “honest”. The effect of a bankruptcy restriction order can be summarised as follows:-

i. to prevent a person subject to such an order acting as a receiver or manager of a company;

ii. to extend to such a person the general prohibition relating to obtaining credit and doing business;

iii. to prevent the debtor from acting as an Insolvency Practitioner, and

iv. to prevent the person from acting as a director of a company or being directly or indirectly involved in the promotion, formation or management of a company without the leave of the Court.
c. **Section 289 Investigatory Duties of Official Receiver**
   These provisions in effect remove the previous mandatory obligation to investigate all bankruptcies and the Official Receiver is now able to conclude that such an investigation is unnecessary. This Section is clearly relevant as regards what is said above regarding early discharge.

d. **Section 283A Bankrupt’s Home Ceasing to form part of the Bankruptcy Estate**
   This introduces what is commonly known as a “use it or lose it” provision, whereby if appropriate action is not taken before the end of three years beginning with the date of commencement of the bankruptcy, to realise the bankrupt’s interest in a dwelling house which at the date of the bankruptcy was the sole or principal residence of the bankrupt, the bankrupt’s spouse or civil partner or a former spouse or former civil partner of the bankrupt, then such interest will cease to be comprised in the bankrupt’s estate and will re-vest in the bankrupt. Transitional provisions contained in the Enterprise Act impose a similar regime in respect of bankruptcies subsisting as at 1 April 2004 with the effect that the relevant three year period runs from that date.

e. **Sections 310 – 310A Income Payment Orders and Income Payment Agreements**
   Section 310A relating to Income Payment Agreements was introduced by the Enterprise Act and is designed to put into place a legally binding income payment scheme without the need for a formal court order. Both orders and agreements are capable of variation. Both can run for a maximum of three years and, obviously, may end after discharge. An application for an income payment order can only be made on application by the Trustee in Bankruptcy and must be made before discharge.

f. **Section 313A Low Value Home: Application for Sale, Possession or Charge**
This provision applies to a dwelling house with the same definition as in Section 283A and provides that if an application is made to the court for an order for possession of the property or for its sale or for a charge under Section 313, then the court must dismiss the application if the value of the interest is below the prescribed amount which currently is £1,000.

g. **Section 263A Fast Track Voluntary Arrangements**
This is yet another IVA variant available only to an undischarged bankrupt the main purpose of which is to allow, in a suitable case, the Official Receiver to put forward an IVA which, if agreed, will supersede the bankruptcy and lead to the annulment of the bankruptcy order. Unlike other IVA procedures, creditors have no right to propose modifications and no creditors’ meeting is held. Creditors are simply presented with the proposal and have the opportunity to vote for and against by way of a paper vote.

5. **Statistical Observations**
I anticipate that the bulk of relevant statistical information will be supplied to the Committee by the Insolvency Service. It is, however, common knowledge that the number of individual insolvency in England and Wales has increased significantly since the beginning of 2003 and that, since the beginning of 2004, there has been a quite dramatic increase in individual insolvency. It is, however, important to note that the most recent increase has related both to bankruptcy and IVAs and has happened at a time when there has been widespread concern as to the increased level in consumer debt.

6. **Comment**
It will be seen from the summary that I have set out above as regards the principal changes brought about by the Insolvency Act 1986, that they can be largely grouped into three specific areas which I will deal with in turn.

a. **Provisions relating to duration of the bankruptcy and matters relating to the bankrupt’s conduct.**
There is a commonly held view that bankruptcy has now been made “easy” and certainly it has to be said that the existing bankruptcy regime, as regards duration and the disabilities that go with being an undischarged bankrupt, are now less harsh than was previously the case under the Act and significantly less harsh than was the provision under the 1914 Bankruptcy Act as amended. This does not, however, mean that bankruptcy is necessarily an easy option. Irrespective of the duration of the bankruptcy, the bankrupt will still lose his property which forms part of his estate as defined by Section 283 of the Act. He is still liable for an income payment order or income payment agreement which will still last for three years. If his conduct is such, he will be liable to have a bankruptcy restriction order made against him.

Notwithstanding early discharge and the removal of bankruptcy disabilities, the former bankrupt may still, in practical terms, have difficulty in obtaining credit and a mortgage. The bankrupt still remains liable, even after discharge, to fulfil all the duties and obligations that he has to the Official Receiver and the Trustee.

One possible advantage to the bankrupt of the new provisions is that he will now be at risk for a shorter period of time as regards after-acquired property as dealt with in Sections 307 to 309 of the Act. After-acquired property cannot be claimed if the property interest devolves on the bankrupt after discharge. In practical terms, this probably does not prejudice creditor interest in that bankruptcy estates which benefit from after-acquired property are few and far between. The sort of asset which normally constitutes after acquired property would be a pools or lottery win or, more commonly, an inheritance. As regards the latter, most debtors who take advice prior to bankruptcy will ensure that those who are likely to confer benefits upon them by will, change their wills.

The shortening of the duration period has in a number of limited cases adversely affected debtors because a debtor who is discharged from
bankruptcy cannot promote an IVA in respect of the bankruptcy debts from which he is discharged from personal liability on discharge from bankruptcy.

It is understood that there have been a number of cases where bankrupts have obtained discharge before the end of the one year period. It is also understood that there have been a considerable number of applications for BROs and a considerable number of bankruptcy restriction undertakings have been given.

It is probably too early to judge the impact of the BRO regime. Only time will tell how effective it is and how practical it is to enforce the regime. One suspects, and this can only be a suspicion, that there will be a significant number of cases where persons subject to a BRO obtain credit in circumstances when they shouldn’t. In this respect, much will depend on the nature of enquiries that are made by lenders.

As regards the provisions relating to the management of limited companies, this again is something which is likely to be honoured in its breach having regard, under the old regime, to the not uncommon situation of an undischarged bankrupt hiding behind a third party and, in effect, through that third party controlling or actively managing a company. A not uncommon situation is a “husband and wife situation” whereby the husband being bankrupt carries on his former business through a limited company of which his wife or other relative or associate is the only director. Whilst some of these case have been detected and resulted in prosecution the feeling that one is left with in practice is the vast majority of persons have, frankly, “got away with it”, although in fairness one should point out that there is a widespread degree of ignorance as to the effect of bankruptcy and the law relating to shadow directors.
b. The Matrimonial Home
The recession of the early 1990s led to a large number of bankruptcies where there were no or minimal assets and the bankrupt’s interest in the matrimonial home was subject to a negative equity. Many of these cases were not dealt with at the time and left to fester. With the rise in property values, properties formerly subject to negative equity acquired not inconsiderable positive equities resulting in applications being made by Trustees for orders for possession and sale many years after the bankruptcy and many years after the bankrupt’s discharge. It is by no means uncommon to find cases where the bankruptcy order was made in 1991 or 1992 now coming before the court. One can readily understand the dismay that this has caused to many bankrupts (and hardship) especially where they were in ignorance of the correct legal position. Despite the fact that the Insolvency Service increasingly adopted the practice of explaining the position to bankrupts, many thought that their property was safe once they were discharged. The situation has, to some extent, been aggravated by virtue of the fact that debtors in this situation are unable to promote an IVA. This problem helped swell the mail received by Members of Parliament and, late in the day, the provisions that we now have as Section 283A and Section 313A found their way into the legislation. The proposals are to be welcomed and should mean that there should be no repetition of the problems that have arisen as of late unless, of course, during the three year period which now applies, there is a marked increase in the value of the debtor’s equity in the property. The existing legislation in fact gives little comfort to those subject to a pre 1 April 2004 bankruptcy because of the transitional provisions.

c. Fast Track IVAs
It is understood that the take up to date has been extremely minimal. The Insolvency Service are currently giving thought to the introduction of yet another form of IVA known, currently, as a simple IVA (SIVA). The proposals which have been tabled so far, for discussion, are eminently sensible and are largely aimed at consumer debt cases and
seek to introduce a simpler and less expensive procedure than that which exists as regards most IVAs under the current regime.

7. **The Increase in Personal Insolvency**

It is tempting to say that the increase in bankruptcy is as a result of the less harsh regime introduced by the 2004 Act. This may be correct to an extent but it is certainly not the whole of the story. The fact that running parallel with the increase in bankruptcies there has been an increase in IVAs, indicates that there has been an increase in insolvency generally and that cannot be attributed wholly to an easier bankruptcy regime. Probably the principal cause of the increase in personal insolvency is the increased level of consumer debt and the inability of many to cope with the debt that they take on.

It must, however, be recognised that, for many debtors, bankruptcy is now a far more palatable option than previously was the case, if only for the fact that the period of bankruptcy has been reduced to one year. If a debtor who has no capital assets to lose in a bankruptcy and whose employment is not in jeopardy is faced with the option of bankruptcy or an IVA, many will certainly opt for bankruptcy and, indeed, if given best advice by a professional adviser would certainly opt for bankruptcy. In bankruptcy, the bankrupt is entitled to retain a fairly wide category of assets as defined within Section 283 of the Act which includes, not only the traditional exempt property such as tools of trade and basic household equipment, but also virtually all types of residential tenancies and, as a result of amending legislation, virtually all pensions. If such a debtor is faced with a straight choice of bankruptcy or an IVA he may well opt for bankruptcy as, with an IVA, the creditors may well seek to force the bankrupt to realise for their benefit whatever tax free lump sum is available under any personal pension policy and, more to the point, will almost certainly seek contributions out of income at a higher rate and for a longer period of time than would be the case in bankruptcy. By way of simple example, a bankrupt who might have a surplus of £400 of income over expenditure per month might find that he would be subject to an income payment order at £200 - £250 per month for three years but in an IVA have

8.
creditors demanding up to £400 per month for five years with provision for annual review.

Indeed, it is not only the bankrupt with no capital assets who might now find himself “better off” bankrupt than in an IVA. If, for example, his only capital asset is his interest in the matrimonial home, then if the value of that interest is such that he can, often with family assistance, buy out the Trustee at an early stage then he too, commercially, will be better off in bankruptcy than in an IVA.

Notwithstanding this, it still needs to be recognised that many people, for a variety of reasons, wish to avoid bankruptcy and promote IVAs even though, in pure commercial terms they might, in the short term, be better off in bankruptcy.

Unquestionably, there has been a considerable increase in the level of debtor petitions. My own experience of this is not only in advising debtors but largely in dealing with debtor petitions when sitting as a Deputy Registrar. Whereas a year or so ago on an average day when sitting, one might have had four or five debtor petitions to deal with, now it is not uncommon to have at least 20 per sitting. Whilst one cannot generalise it is, nevertheless, my experience that the overwhelming majority of these petitions are by people who have no capital assets whatsoever, are on low income or unemployed, frequently have suffered a recent relationship breakdown and have incurred a level of consumer debt that they simply cannot cope with. Frankly, I find it disturbing, to say the least, to see how much people on low income can, in fact, borrow from banks and credit card companies. I recently dealt with a case where a single mother with three children and living on benefit had total credit card liabilities of some £80,000 spread between approximately 20 different credit cards. Quite how this situation arose, I do not know.

Another interesting feature that I at least have observed is that, whereas in the past many, if not most, debtors filing their own petition where “middle-aged” and were doing so as a result of business failure, there is now a
disturbing increase in the number of debtors in their 20s and early 30s and whose liabilities have nothing to do with business but are just credit card and similar liabilities. There is, therefore, the suggestion that some may adopt a hedonistic lifestyle, not on the basis of buy now and pay later but acquire now and file later.

Dated this 28th day of February 2006

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Stephen Lawson

Senate Court
Southernhay Gardens
Exeter
EX1 1NT
COMMENTS ON THE
BANKRUPTCY AND DILIGENCE ETC. (SCOTLAND) BILL

SCOTTISH ENTERPRISE AND HIGHLAND AND ISLANDS ENTERPRISE

This paper is offered by Scottish Enterprise (SE) and Highlands & Islands Enterprise (HIE) as a contribution to the debate on the likely impact of the changes contained in the Bankruptcy and Diligence etc. (Scotland) Bill. The paper is presented in advance of the Enterprise & Culture Committee’s evidence session as part of the Stage 1 scrutiny of the general principles of the Bankruptcy and Diligence etc. (Scotland) Bill.

Rather than commenting on the technical details of the Bankruptcy Bill, we wish to limit our comments to those aspects of the proposed Bill which are of greatest relevance to the Enterprise Networks’ remit: the wider issues of the potential impact on growing businesses and economic development.

Our comments focus on three particular questions arising from consideration of the Bankruptcy Bill:

i) that inadequacies in Scotland’s Bankruptcy legislation has acted as a constraint on business growth;

ii) that the current three-year period of sequestration is too long and prevents people from moving on – including preventing entrepreneurs from forming new businesses; and

iii) that Scottish businesses are being put at a competitive disadvantage with businesses in England and Wales, due to recent changes in the Bankruptcy legislation there.

While making these comments, it is recognised that the legislation needs to balance various issues, including the different needs and interests of all of those affected by a debtor’s inability to pay. There is also a need to protect against abuse of the system by unscrupulous debtors and to provide sufficient safeguards for debtors with no income and no assets.

The Degree to which Bankruptcy Law affects Growing Business

In recent months, SE carried out a wide-ranging review of business growth issues, as part of the preparation of our new Growing Business Strategy, completed in late 2005. A briefing on this activity was given earlier, as part of our submission to the Enterprise & Culture Committee’s Inquiry on Business Growth. Likewise, HIE’s written submission to the Enterprise & Culture Committee’s Inquiry on Business Growth also contained comments relevant to these issues.

While much of this work focused in the kinds of interventions undertaken by agencies like SE and HIE, there was little direct evidence in the research we conducted to suggest that Bankruptcy legislation was a major constraint on the growth of business on Scotland.
What constraints there are on business growth relate more to the wider business environment that supports business related to issues such as

- access to development finance and investment;
- the labour market, in terms of access to a skilled workforce;
- the effectiveness of communications networks, including web, telecommunications and transport linkages;
- the physical infrastructure, in terms of the availability of property and the efficiency of the property market; and
- the quality of business support that is available, both from private-sector and public sector providers.

Other determinants of growth are more ‘internal’ to businesses, relating to how effectively Scottish companies address key issues such as

- Leadership
- Innovation
- Marketing – including Internationalisation
- Workforce Development

Reflecting this, SE and HIE have developed a range of interventions, both to address key issues within Growing Businesses and to improve the environment that supports Growing Businesses. Crucial to this are the important role played in terms of the development of Scotland’s key industries, and the exploitation of key synergies at the local level, in SE’s area through the development of a stronger “metropolitan region” perspective.

An important part of the environment that supports Growing Business is the regulatory system. This includes taxation, regulation, and the operation of other elements of public policy, such as planning. The Bankruptcy Bill will form part of this environment.

Reflecting this, SE sees no clear effect arising from Bankruptcy Legislation in terms of the impact on the performance of Growing Businesses. In our view, the internal performance issues for businesses and wider business environmental factors are far more significant as determinants of business growth performance. Generally speaking, the legislative environment for Growing Business in Scotland, as part of the UK, compares favourably with other countries.

The Effects of Bankruptcy Legislation on Entrepreneurship

As is recognised in the legislation, most bankruptcies – and much of the recent increase in the number of bankruptcies – are personal, rather than corporate. It is more likely, therefore, that any effects arising from bankruptcy legislation will be in terms of the impact on the behaviour of individuals rather than businesses.

This is likely to occur if the Bankruptcy Legislation acts to deter individuals from starting further businesses, following the failure of a previous venture. This may take effect if the legal constraints on re-entering the market are over-stringent.
They may also occur for social reasons – for instance if the perception of being involved in a failed business venture makes it harder to start another business, because of difficulties in appearing ‘credible’ to potential funders, customers or employees, because of negative attitudes towards business failure and/or personal bankruptcy.

While there is evidence that fear of getting into debt is perceived as a significant barrier to business start-up, there is little to suggest that a fear of bankruptcy – or worries over its consequences – is a significant element of this. Nor is there evidence that these barriers are any greater in Scotland than elsewhere in the UK. In the 2003 Household Survey of Entrepreneurship, among those thinking of starting a business “Fear of getting into debt” was mentioned by 25% of respondents as a barrier that might stop people from starting a business; but this was behind “Getting the Finance for the business” (41%) – the biggest perceived constraint – and compared with only 12% for “the chance that your business might fail”. This compares with similar figures in England, of 39% for getting the finance for the business and 23% for fear of getting into debt. Therefore, it is unlikely that bankruptcy regulations, or perceptions over their impact are likely to be a major cause of Scotland’s long-standing low business birthrate.

Where there may be an effect, however, is in terms of the ability of entrepreneurs to recover from personal bankruptcy, following a failed business venture.

There is considerable evidence that start-up by “repeat” entrepreneurs is a significant feature of “entrepreneurial dynamism”. A disproportionate amount of the benefits arising from entrepreneurship are derived from those entrepreneurs who start more than one business – the so-called ‘serial’ entrepreneurs.

For instance, a study sponsored by SE in 2003, by a team from the Universities of Nottingham and Stirling, found that around 43% of entrepreneurs in the sample had started more than one business. Of these, 18.6% were defined as “serial” entrepreneurs, who started a sequence of more than one business; 24.9% were defined as “portfolio” entrepreneurs – entrepreneurs running, or holding stakes in, multiple businesses simultaneously.

This research suggested that portfolio and serial entrepreneurs tended to run larger, more sophisticated businesses than “novice” (first-time) entrepreneurs, with higher sales, larger employment and better growth performance. The reported employment growth was more significant for ‘portfolio’ entrepreneurs (71% over five years), compared with both ‘serial’ entrepreneurs (24%) and ‘novice’ entrepreneurs (24%).

The average sales revenue of businesses owned by portfolio entrepreneurs (£1.4m) was significantly higher than for serial entrepreneurs (£334,000) and novice entrepreneurs (£208,000). As the research suggested, it is the learning and “search” skills that the portfolio entrepreneurs employ that make the biggest difference to their enhanced performance. This includes learning from previous ventures that have failed.

The attempt, through the reforms contained in the Bankruptcy Bill, to assist in the ability of entrepreneurs to ‘recover’ and get back into business more quickly following a personal bankruptcy is therefore likely to assist in the process of generating more ‘serial’ and ‘portfolio’ entrepreneurs. For this reason, it is Scottish Enterprise’s and HIE’s view that the attempts to modernise the bankruptcy process – for instance by reducing the period of sequestration to one year is likely to have a beneficial impact on the economy, by acting to stimulate both entrepreneurship and business growth.
This impact is likely to be helped by wider evidence of an improving environment for entrepreneurship in Scotland. For instance, the latest Global Entrepreneurship Monitor (GEM) Survey reports a reduction in the gap in terms of “Total Entrepreneurial Activity” between Scotland and the rest of the UK\(^5\). This accompanies evidence of an improvement in the attitudes to entrepreneurship in Scotland in recent years, where attitudes to entrepreneurs in Scotland are now broadly in line with those in England\(^6\) – in marked contrast with the evidence in the 1990s\(^7\).

This suggests the ‘social’ effect of personal bankruptcy may also have lessened for entrepreneurs in Scotland, as the more negative attitudes towards entrepreneurs seems to have improved, compared with other parts of the UK.

**Are Scottish businesses being put at a competitive disadvantage with businesses in England and Wales?**

In our view, the objective in the Bankruptcy Bill of achieving parity with the regulatory regime in England and Wales is likely to have a positive, if small, effect. Greater consistency in legislation with the rest of the UK is likely to be of benefit to business in Scotland – particularly growing businesses more likely to be competing in markets outside Scotland.

However, given our view that the impact in terms of bankruptcy regulations on the growth performance of businesses is small, we would argue that this effect is likely to be low in the short- to medium-term. Since most of the impact will be in terms of personal bankruptcy, any impact will be mostly in terms of the effects on entrepreneurship, which would occur over the longer-term.

**Conclusions**

In the view of the Enterprise Networks, the principles underlying the changes in Scotland’s bankruptcy regulations, reflected in the Bankruptcy and Diligence etc. (Scotland) Bill, are sound. In principle, the objective of seeking to modernise the system, balancing the need to support the recovery of debtors while discouraging unscrupulous behaviour is valid, as is the attempt to reduce inconsistencies between the approach in Scotland and the rest of the UK. However, it should be recognised that the impact in terms of businesses growth is likely to be relatively small, occurring only over the longer-term. The main reason for this is that bankruptcy legislation is a comparatively small issue in terms of the overall environment for business growth.

Where there may be an effect is on the degree of repeat entrepreneurship. Given the importance of entrepreneurship and of business start-up as economic development priorities for Scotland, these effects may turn out to be more significant in Scotland than elsewhere. For this reason, Scottish Enterprise and HIE strongly support the attempt to improve the regulations by assisting the recovery of debtors from bankruptcy, for instance by reducing the period of sequestration from three years to twelve months. This is likely to assist the process of encouraging repeat entrepreneurs to move on, establishing additional businesses.

February 2006
NOTES


3 Paul Westhead, Deniz Ucbasaran, Mike Wright and Frank Martin. Habitual Entrepreneurs in Scotland, Scottish Enterprise 2003. See http://www.ent.stiacr.uk/research1.html#top

4 Westhead et al. (2003) pp 14-15


Enterprising and Culture Committee
6th Meeting 2006 (Session 2)
Tuesday, 7th March 2006

Legislative Consent Memorandum on the Company Law Reform Bill

Background

1. The Company Law Reform Bill is a bill under consideration in the UK Parliament and was introduced into the House of Lords on 1 November 2005. As it is a bill that makes provisions applying to Scotland for purposes which lay within the competence of the Scottish Parliament, or which will alter that legislative competence or the executive competence of the Scottish Ministers, a legislative consent memorandum has been lodged by the Scottish Executive on 15 December 2005. This is attached at Annex A. The Parliamentary Bureau has referred the legislative consent memorandum to the Committee.

General procedure for dealing with legislative consent memoranda

2. Chapter 9B of Standing Orders sets out the procedures for the consideration of a legislative consent memorandum. For any bill under consideration in the UK Parliament which meets that criteria specified in paragraph 2, a Scottish Minister shall lodge a motion (legislative consent motion) seeking the consent of the Scottish Parliament for the relevant provisions in the relevant Bill.

3. The Scottish Ministers must lodge a legislative consent memorandum which sets out a draft legislative consent motion and explains the background to the relevant bill. The Parliamentary Bureau refers the memorandum to the relevant lead Committee and, if the relevant bill makes provisions for subordinate legislation, to the Subordinate Legislation Committee (SLC). The SLC shall consider the relevant provisions of the relevant Bill and make a report to the lead Committee under Rule 9B.3.6.

4. The lead Committee must consider the legislative consent memorandum, and any report from the SLC, and make a report on its views to the Parliament no later than 5 sitting days before the Parliament shall consider the legislative consent motion.

5. There is no set template for the Committee’s consideration of the legislative consent memorandum relating to this bill. However, in general terms, the Committee should take evidence from the Minister during today’s meeting and scrutinise the legislative consent memorandum attached as Annex A from the following perspectives:

   • consider the general merits of the relevant provisions contained within the bill identified within the legislative consent memorandum;
   • consider whether there is justification for the Sewel convention to apply for each of these provisions;

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1 This can be found at: [http://www.scottish.parliament.uk/business/legConMem/pdf/CompanyLawMemo.pdf](http://www.scottish.parliament.uk/business/legConMem/pdf/CompanyLawMemo.pdf)
• consider any points raised by the Subordinate Legislation Committee in its consideration of the legislative consent memorandum;
• make any comments on the draft legislative consent motion contained within the legislative consent memorandum;
• consider making a recommendation to the Scottish Parliament to grant consent to the UK Parliament to pass the bill.

Views of the Subordinate Legislation Committee

6. At its meeting on 7 February 2006, the Subordinate Legislation Committee considered a provision in the Company Law Reform Bill which confers on the Scottish Ministers powers to make subordinate legislation. The SLC submitted its report to the Enterprise and Culture Committee under Rule 9B.3.6 of Standing Orders. The SLC considered the single provision in Clause 469 of the Bill. The SLC reports that it is content with the proposed use of delegated powers contained therein.

Action

7. To complete the consideration referred to in paragraph 5 above, members are asked to:

• Consider the merits of the five relevant provisions in the bill identified by the Executive in the legislative consent memorandum (Annex A, paragraphs 13-33);
• Consider whether it is appropriate to use the Sewel convention for each of these five provisions;
• Consider the points raised by the Subordinate Legislation Committee (paragraph 6 above);
• Consider the wording of the draft legislative consent motion—
  “That the Parliament agrees that the relevant provisions of the Company Law Reform Bill, introduced in the House of Lords on 1st November 2005, which will legislate in devolved areas in respect of sole traders, accounting standards and audit for charitable companies; and which will alter the executive competence of the Scottish Ministers to allow them to issue guidance to regulatory enforcers and to specify companies to be audited by the Auditor General, should be considered by the UK Parliament.”
• Agree whether to make a specific recommendation to Parliament to give its consent to the UK Parliament as set out in the draft legislative consent motion.

8. Furthermore, as the actual report to be produced by the Committee would follow the Committee’s considerations on the bullet points above, Members are asked to delegate drafting and publication to the Convener and clerk without the need to discuss a draft as part of a future Committee meeting.

Stephen Imrie
Clerk to the Committee
The draft motion, which will be lodged by the Deputy First Minister and Minister for Enterprise and Lifelong Learning, is:

“That the Parliament agrees that the relevant provisions of the Company Law Reform Bill, introduced in the House of Lords on 1st November 2005, which will legislate in devolved areas in respect of sole traders, accounting standards and audit for charitable companies; and which will alter the executive competence of the Scottish Ministers to allow them to issue guidance to regulatory enforcers and to specify companies to be audited by the Auditor General, should be considered by the UK Parliament.”

Background

1. This memorandum has been lodged by Nicol Stephen, Deputy First Minister and Minister for Enterprise and Lifelong Learning, under Rule 9B.3.1(a) of the Parliament’s standing orders. The Company Law Reform Bill was introduced at Westminster on 1 November 2005. It is predominantly concerned with matters outwith the legislative competence of the Scottish Parliament. The Bill can be found at:


2. The Legislative Consent Motion supports the Partnership Agreement and in particular the Scottish Executive’s commitment to working with the UK Government to maximise the conditions for economic growth in Scotland.

3. The Bill follows a wholesale review of company law. It seeks to ensure that British business operates within a legal and regulatory framework that promotes enterprise, growth, investment and employment. In order to deliver this, the Bill has four key objectives:

   - To enhance shareholder engagement and a long-term investment culture
   - To ensure better regulation and a “Think Small First” approach
   - To make it easier to set up and run a company
   - To provide flexibility for the future.

4. Over time company law can become outdated and there is a real risk that the legal framework can become divorced from the needs of business – in particular the needs of smaller private businesses. The legal framework can become an obstacle to ways that companies want and need to operate in an evolving business environment. For example, entrepreneurship could be stifled as start-up companies find themselves weighed down by regulation and denied access to capital. In an increasingly globalised economy where companies have more freedom to choose their place of incorporation the UK Government wishes to ensure that the UK does not lose out as a location for business. The reform programme is intended to address the separation of business need and legal framework.
5. The purpose of this memorandum is to outline the terms of the five provisions in the Bill that are subject to the consent of the Scottish Parliament, by virtue of the Sewel Convention, because they apply to Scotland and are for devolved purposes, or alter the executive competence of the Scottish Ministers. The relevant provisions are as follows:

- Provision on sole traders
- Conferment of a power on the Lord Advocate
- Applicable accounting framework (prohibition for charitable companies)
- Audit (for charitable companies)
- Scottish public sector companies: audit by the Auditor General for Scotland

Consultation

6. In March 1998, the DTI launched a long-term fundamental review of company law. An independent Steering Group led the Company Law Review (CLR); its aim was to develop a simple, efficient and cost effective framework for British business in the twenty-first century. The CLR presented its Final Report to the Secretary of State for Trade and Industry on 26 July 2001.


8. Both White Papers, and some other formal consultation documents, have included Regulatory Impact Assessments. In addition, DTI sent questionnaires on the most significant proposals to a sample of public and private companies, both large and small. Focus groups, and other forms of informal consultation, were also held with representatives of small companies. There was further consultation on likely costs and benefits of the proposals.

9. The five provisions in the Bill are minor and technical in nature. While they have not generally been subject to consultation outwith the exercises mentioned above, both the Lord Advocate and Audit Scotland have been consulted on the provisions relating to them and have expressed support for them. There has also been a public consultation on the accounting regulations for charities which referred to the ability of Scottish charitable companies under a certain income threshold to opt to have an accountants report instead of an audit.

Financial Implications

10. DTI estimates, based wherever possible on input from stakeholders, indicate that the total direct benefits of the company law reform measures in the UK could be of the region of £160 million to £340 million per year. In addition to these direct benefits, company law reform has the potential to improve performance across the economy as a whole.

11. Against these savings there are a few areas where the Bill will introduce new or stricter regulatory requirements. These are almost exclusively confined to public/quoted
companies. These costs are estimated to amount in total to between £2 million and £11 million per year throughout the UK.

12. The five proposed provisions in the Bill are expected to have neutral or marginal cost implications in Scotland.

Provisions in the Bill for which Consent is Sought

13. The following paragraphs describe the specific provisions for which consent of the Scottish Parliament is sought and provide background on their application in Scotland.

Provisions on sole traders

Clause 794 Name containing inappropriate indication of company type or legal form
Clause 795 Name giving misleading indication of activities
Clause 796 Savings for existing lawful business names

14. **Policy Intent** To extend to Scotland a new provision to regulate the trade names of sole traders. The objective is to protect the consumer from a company trading under a misleading name.

15. **Background** At present, the Secretary of State for Trade and Industry may direct a company to change its registered name if it gives so misleading an indication of the nature of its activities as to be likely to cause harm to the public. In practice, this power is used 5 - 10 times a year. Most of the cases occur where the name misleadingly implies some sort of official approval or connection, for example, a name that suggested the company "certified" accountants when the only certificate was, in practice, no more than a receipt.

16. But there is no control relating to trading names which are misleading, even though the likelihood of harm to the public comes from the name being used in trading rather than its appearance on the register of company names. The Bill therefore includes a new offence of trading under a name that gives so misleading an indication of the trader's activities as to be likely to cause harm to the public. This proposal would apply to any person carrying out business in the UK except for individuals if they trade either alone or in partnership under their surnames augmented only by their forenames and/or initials.

17. The regulation of sole traders is devolved. If the Bill did not extend to sole traders operating in Scotland, then the consequence would be that - in the absence of equivalent provision being made in a Scottish Bill - Scottish consumers would not be as well protected against sole traders trading under misleading names as consumers in England and Wales.

18. **Advantages of utilising this Bill** This is a technical matter limited to extending a new provision on sole traders to Scotland. It is the simplest way of ensuring that Scottish consumers are protected against sole traders using misleading trading names.

Conferment of a power on the Lord Advocate

Clause 496 Guidance for regulatory authorities: Scotland
19. **Policy intent** To confer a new power on the Lord Advocate enabling the Lord Advocate to issue guidance to regulatory enforcers on a reserved matter.

20. **Background** The Bill will introduce a new offence of deliberately making a false audit report. This would be reserved. It is, however, proposed that guidance should be issued to regulatory enforcers about how they are to exercise their functions in a case which constitutes both an offence and grounds for non-criminal enforcement. This proposal is modelled on section 130 of the Financial Services and Markets Act 2000. It requires the consent of the Scottish Parliament because it confers a power in a reserved area on a Scottish Minister since the guidance for Scotland would be issued by the Lord Advocate.

21. **Advantages of utilising this Bill** It is sensible for the power to issue guidance to be associated with the provision creating the offence. Clearly, it would be a decision for the Lord Advocate as to whether such guidance should be issued.

**Applicable accounting framework (prohibition for charitable companies)**

Clauses 368 Individual accounts: applicable accounting framework
Clause 376 Group accounts: applicable accounting framework

22. **Policy Intent.** To extend to Scotland the prohibition on charitable companies producing individual or group accounts in accordance with International Accounting Standards.

23. **Background** Currently the Companies Act 1985 provides that a company may prepare Companies Act individual or group accounts or may opt instead to produce accounts which comply with international accounting standards (IAS). English and Welsh charitable companies are however barred by the Companies Act 1985 (International Accounting Standards and other Accounting Amendments) Regulations 2004, from producing IAS accounts because they are not deemed to be a suitable form for them because they are designed for large companies and are therefore not appropriate for charities that are generally much smaller than their commercial counterparts. The relevant provision in this Order does not, however, apply to Scottish charitable companies. The Company Law Reform Bill will restate the provisions on IAS accounts, and it is proposed that it should extend the prohibition to Scottish charitable companies.

24. **Advantages of using this Bill** It is essential that the prohibition preventing charitable companies producing IAS accounts is extended to Scotland as the form is not suitable for charities and could conflict with the provisions in Charity Law. It is particularly important that the legislation that charities must follow is clear because many charities are run by volunteers who do not necessarily have a legal or accounting background. Using this Bill is the clearest and most straightforward way to set out the Company law requirements in relation to IAS individual and group accounts for Scottish charitable companies.

**Audit (for charitable companies)**

Clause 454 Small companies: conditions for exemption from audit
Clause 455 Companies excluded from small companies’ exemption
Policy Intent  To ensure the application in Scotland of the simplified provisions exempting small charitable companies from having an audit and allowing them to have an accountants report instead of an audit.

Background  Under the Companies Act 1985 charitable companies with a gross income of under £90,000 a year are exempt from having an audit. The Act also allows charitable companies with an income of between £90,000 and £250,000 to have an accountants report instead of an audit. The Company Law Reform Bill intends to make the provisions relating to audit clearer for small companies and charities to understand and will do so by restating the provisions in a simplified and clearer form. This will not change the legal effect of the provisions but will merely make it easier to understand.

Contents of directors’ report: statement as to disclosure to auditors

Policy Intent.  To extend to Scotland the exemption for charitable companies taking advantage of the audit exemption from the requirement for the directors of a company to make a statement in the director’s report about the disclosure of information to auditors.

Background.  The provision requiring a statement about the disclosure of information to auditors was inserted into the Companies Act 1985 by the Companies (Audit, Investigations and Community Enterprise) Act 2004. It provides an exemption for small companies exempted from having an audit but does not give charitable companies which do not have to have an audit the same exemption. It is now felt that the 2004 Act should have extended the exemption to charitable companies and so in addition to restating the current provisions the Bill will extend the exemption to charitable companies.

Advantages of using this Bill.  The provisions will ensure that charitable companies in Scotland are not disadvantaged compared to their counterparts in England and Wales. If the provisions in the Bill do not include Scotland the current provisions will continue to apply. These are extremely unclear. The nature of charities means they are often run by volunteers and so it is important that their responsibilities are clearly laid out. Using this Bill will provide the most straightforward way of setting out the Company Law requirements for Scottish charitable companies.

Scottish public sector companies: audit by the Auditor General for Scotland

Policy Intent  It is proposed that a power should be conferred on the Scottish Ministers to allow them to specify, by order in the Scottish Parliament, relevant companies that would be required to have their accounts audited by the Auditor General for Scotland (AGS).

Background  The requirement for the accounts of Scottish statutory public bodies to be audited by the AGS is included in the founding legislation of the bodies concerned,
amended where necessary by the Public Finance and Accountability (Scotland) Act 2000 (the PFA Act). The PFA Act also sets out the accountability arrangements and audit requirements in respect of bodies where accounts are required by any enactment or prerogative instrument to be audited by the AGS. However, the arrangements for the audit of accounts in relation to companies, including Scottish public bodies or their subsidiaries established as companies, is a reserved matter by virtue of section C1 of Part II of Schedule 5 to the Scotland Act 1998. To date the requirements of the relevant UK legislation (the Companies Acts) has not allowed for the AGS - or the Auditors General for the other parts of the UK - to audit the accounts of companies.

32. Provisions elsewhere in the Company Law Reform Bill would allow for the statutory audits (i.e. the audit of accounts) of companies now to be undertaken, where considered appropriate, by the Auditors General. Provisions also allow for non-profit making companies to be exempted from the audit requirements in the Companies Acts provided that any such companies are specified by order as being subject to public sector audit. Specifying companies that would be required to have their accounts audited by the AGS would have the effect of bringing such companies within the scope of the PFA Act. It was considered therefore, in consultation with the Department for Trade and Industry and the Treasury that it would be appropriate for such specification to be undertaken, as necessary, by the Scottish Ministers and approved by the Scottish Parliament.

33. Advantages of utilising this Bill The inclusion of the order-making power in the Bill would close a gap in the arrangements for public sector audit in Scotland and give powers to the Scottish Ministers and Scottish Parliament in this reserved area.

Scottish Executive
15 December 2005
ENTERPRISE AND CULTURE COMMITTEE

SSI Cover Note

SSI title and Number: The Renewable Obligation (Scotland) Order 2006 (SSI/2006/draft)

Type of Instrument: Affirmative – Standing Orders Rule 10.6.1

Date Laid: Thursday, 2nd February 2006

Committee Meeting: Tuesday, 7th March 2006

Date circulated to members: Thursday, 2nd March 2006

Enterprise and Culture Committee deadline to consider SSI: Monday, 13th March 2006

Purpose of the instrument: The purpose of the Order is set out in paragraphs 1 to 5 of the Explanatory Note (page 38)

Minister to attend the Enterprise and Culture Committee: Allan Wilson MSP, Deputy Minister for Enterprise and Lifelong Learning

SSI drawn to Parliament’s attention by the Subordinate Legislation Committee: The Subordinate Legislation Committee considered the instrument on Tuesday 7th February 2006 and agreed that no points arose on it.

Affirmative Instrument – Procedure

1. The Enterprise and Culture Committee has been designated the lead Committee and is required to report to the Parliament by Monday, 13th March 2006.

2. The draft Order was laid on Thursday, 2nd February 2006. Under Rule 10.6.1(b) the Order is subject to affirmative resolution before it can be made, it is for the Enterprise and Culture Committee to recommend to the Parliament whether the Order should be approved.

3. The Subordinate Legislation Committee considered the draft Order on Tuesday 7th February 2006 and agreed that no points arose on it.

4. Allan Wilson MSP, Deputy Minister for Enterprise and Lifelong Learning has, by motion S2M-3953 (set out in the agenda), proposed that the Committee recommends that the Committee recommends the approval of the Order. Mr Wilson will attend in order to speak to and move the motion. The debate may last for up to 90 minutes.
5. At the end of the debate, the Committee must decide whether or not to agree the motion, and report to the Parliament accordingly. Such a report need only be a short statement of the Committee’s recommendations.
ENTERPRISE AND CULTURE COMMITTEE

SSI Cover Note

SSI title and Number: The Scotland Act 1998 (Transfer of Functions to the Scottish Ministers etc.) (No. 2) Order 2006 (SSI/2006draft)

Type of Instrument: Affirmative – Standing Orders Rule 10.6.1

Date Laid: Thursday, 23rd February 2006

Committee Meeting: Tuesday, 7th March 2006

Date circulated to members: Thursday, 2nd March 2006

Enterprise and Culture Committee deadline to consider SSI: Monday, 17th April 2006

Purpose of the instrument: The purpose of the Order is set out in paragraphs 2.1 to 2.4 of the Explanatory Note (page 1)

Minister to attend the Enterprise and Culture Committee: Allan Wilson MSP, Deputy Minister for Enterprise and Lifelong Learning

SSI drawn to Parliament’s attention by the Subordinate Legislation Committee: The Subordinate Legislation Committee considered the instrument on 28th February 2006 and agreed that no points arose on it.

Affirmative Instrument – Procedure

1. The Enterprise and Culture Committee has been designated the lead Committee and is required to report to the Parliament by Monday 17th April 2006.

2. The draft Order was laid on Thursday 23rd February 2006. Under Rule 10.6.1(b) the Order is subject to affirmative resolution before it can be made, it is for the Enterprise and Culture Committee to recommend to the Parliament whether the Order should be approved.

3. The Subordinate Legislation Committee considered the draft Order on 28th February 2006 and agreed that no points arose on it.

4. Nicol Stephen MSP, Deputy First Minister and Minister for Enterprise and Lifelong Learning has, by motion S2M-4048 (set out in the agenda), proposed that the Committee recommends that the Committee recommends the approval of the Order. Allan Wilson MSP, Deputy Minister for Enterprise and Lifelong Learning will attend in order to speak to and move the motion. The debate may last for up to 90 minutes.
5. At the end of the debate, the Committee must decide whether or not to agree the motion, and report to the Parliament accordingly. Such a report need only be a short statement of the Committee’s recommendations.
ENTERPRISE AND CULTURE COMMITTEE

6th Meeting 2006 (Session 2)

Tuesday, 7th March 2006

Report from the Finance Committee on the Financial Memorandum for the Bankruptcy and Diligence etc. (Scotland) Bill

Background

1. A Financial Memorandum for the Bankruptcy and Diligence etc. (Scotland) Bill was introduced in the Parliament on 21 November 2005.

2. Under Rule 9.6.3 of Standing Orders the Finance Committee must consider the Financial Memorandum and made a report on its views to the lead committee (Enterprise and Culture) for the Stage 1 consideration of a bill. The report from the Finance Committee to the Enterprise and Culture as on the Financial Memorandum on the Bankruptcy and Diligence etc. (Scotland) Bill is attached at Annexe A.

Written and Oral Evidence

3. The oral and written evidence received by the Finance Committee as part of its consideration of the Financial Memorandum is available on the Finance Committee website at:

http://www.scottish.parliament.uk/business/committees/finance/reports-06/fir06-BankruptcyDiligence.htm

Action

4. The Enterprise and Culture Committee, as the lead committee for the Bankruptcy and Diligence etc. (Scotland) Bill, will be required in due course to consider and report on the Financial Memorandum (attached at Annexe B) and shall, in preparing its Stage 1 report, take into account any views submitted to it by the Finance Committee.

5. At this stage, members may wish to note the views of the Finance Committee and to use these in any discussion or questioning of witnesses, particular the minister.

Stephen Imrie
Clerk to the Committee
Finance Committee

Report on the Bankruptcy and Diligence etc. (Scotland) Bill

The Finance Committee reports to the Enterprise and Culture Committee as follows—

Introduction

1. Under Standing Orders, Rule 9.6, the lead committee in relation to a bill must consider and report on the bill's financial memorandum at stage 1. In doing so, it is obliged to take account of any views submitted to it by the Finance Committee.

2. This report sets out the views of the Finance Committee on the Financial Memorandum of the Bankruptcy and Diligence (Scotland) Bill, for which the Enterprise and Culture Committee has been designated by the Parliamentary Bureau as the lead committee at Stage 1.

3. The Committee agreed to adopt level 3 scrutiny in considering the Bill, which involved seeking written evidence from organisations financially affected by the Bill, then taking oral evidence from selected key organisations and the Executive Bill Team.

4. The Committee took oral evidence from representatives of the Accountant in Bankruptcy (AiB) and of the Scottish Court Service (SCS) at its meeting on 31 January. The relevant extract of the Official Report of the meeting can be viewed by clicking here. The Committee then took evidence from the Bill team on 7 February, which can be viewed by clicking here.

5. In addition to receiving written submissions from the AiB and SCS, the Committee also received submissions from the Committee of Scottish Clearing Bankers (CSCB), the Credit Services Association (CSA), the Institute of Chartered Accountants of Scotland (ICAS), the Registers of Scotland (RoS) and the Society of Messengers-At-Arms and Sheriff Officers. This evidence is set out in the Annex to this report, along with the correspondence and supplementary evidence submitted to the Committee from the Scottish Executive Justice Department.

6. The Committee would like to express its thanks to all those who submitted their views.

Objectives and the Financial Memorandum

7. The objectives of the Bill are to:

   • modernise the legal framework for personal bankruptcy and diligence to strike a better balance between the rights of debtors and creditors;

   • support business risk, thereby promoting an entrepreneurial culture and
supporting economic growth; and

- modernise the law of floating charges to remove existing uncertainties and improve transparency in arrangements, thereby supporting both secure lending and business risk.

8. The Bill is substantial, consisting of 16 parts, and reasonably complex (a glossary of terms is available here). The provisions of the respective parts of the Bill and the associated costs are summarised below:

- Part 1 of the Bill introduces a number of provisions relating to personal bankruptcy including reducing the period of bankruptcy from three years to one, streamlining the bankruptcy process including reducing court involvement and introducing increased transparency in and monitoring of protected trust deeds. It is proposed that the AiB would lead in implementing these reforms.

- Part 2 of the Bill deals with the arrangements for recovering debts secured against the circulating assets of a trading business, establishing a Register of Floating Charges under the management of the Keepers of the Registers of Scotland.

- Part 3 establishes a new non-departmental public body, the Scottish Civil Enforcement Commission, to regulate and supervise court messengers who enforce court rulings on diligence.

- Parts 4 to 16 provide for a broad range of arrangements (or forms of diligence) for enforcing decisions of the court in respect of debt which are administered by the Scottish Court Service.

9. The Financial Memorandum estimates that the overall cost of the implementation of the Bill on the Scottish Administration will amount to £1,681,787 in 2006/07, £2,137,263 in 2007/08 and £2,936,438 in 2008/09 and in subsequent years. This is made up of:

- Part 1 - Bankruptcy - £1.442 million in 2006/07 and then £537,000 per annum thereafter for administration by AiB. This includes initial and ongoing staffing and training costs. In relation to staffing costs, the Executive has formally notified the Committee of an inaccuracy in the FM which suggests 34 new staff will be required where this should read 25 (the notification letter is attached at in the Annex. In terms of savings, an estimated £102,213 per annum is expected to be recovered from student loans, which will no longer be able to be written off in bankruptcy. In addition, annual savings of £60,000 are expected to arise from the movement of business from the Court of Session to the sheriff courts.

- Part 2 - Floating Charges - Costs of £375,000 in 2006/07, £412,500 in 2007/07 and £75,000 in 2008/09 and subsequent years have been estimated for maintenance of the new Register of Floating Interests.
• Part 3 - Enforcement - Costs of £27,000 in 2006/07, £868,000 in 2007/07 and £632,000 per annum are estimated for staffing and administration costs for the new Commission. Savings of £32,000 per annum from 2007/08 are expected to arise in the court system. As the Commission is to be an NDPB it will be funded by the Executive.

• Parts 4 to 16 - Diligence - Costs of £141,725 in 2007/08 and £566,900 in 2008/09 and subsequent years are expected for administration within the SCS, including staffing and judicial time, plus £10,000 for IT as a one-off in 2007/08. From 2008/09, it is estimated that between £193,500 and £1,935,000 per annum will be required for administration of an Information Disclosure Scheme (an average of £967,500 has been used to estimate the overall cost of the bill detailed above).

10. In relation to the Scottish Executive’s role in implementing the Bill, additional costs of £363,251 per annum from 2007/08 are anticipated for implementation, including staffing and programme costs. Further details on how these estimates are broken down between staffing costs, IT costs and other infrastructure can be viewed within the Financial Memorandum itself.

11. In terms of the costs to creditors, the Financial Memorandum states that debtors and creditors will not be significantly affected as these parties already bear the costs of any formal enforcement used.

Summary of evidence

Estimated increase in applications for bankruptcy

12. Many of the estimated costs in the FM in relation to bankruptcy are based on a projected 25% increase in debtor applications for bankruptcy. The submission from the Committee of Scottish Clearing Bankers queries whether this figure ‘is too conservative in light of many of the experiences in other jurisdictions and, therefore, whether the projected costs to the taxpayer are reliable’. The Credit Services Association submission also suggests that the changes proposed in the Bill are likely to lead to an increase in the number of bankruptcies.

13. The Scottish Executive Bill team contested the assumption that the provisions of the Bill would make bankruptcy ‘softer’ noting that according to the UK Insolvency Service to be no evidence that the changes brought in by the UK Enterprise Act had caused an increase in personal insolvencies¹. The AiB, Gillian Thompson, stated in oral evidence that there had been a 52% increase in bankruptcies in January 2006 in advance of the implementation of the Bill and that this is likely to be economy-driven. The AiB went on to state that ‘that [25%] figure was based on an assumption that this year’s situation may be a blip. That was our initial thought, but we are now simply not sure about that...We are not as yet entirely clear about

¹ Official report 31 January 2006 (FI Col 3386)
what we are seeing this year\(^2\).

14. In oral evidence Executive officials suggested a cautious approach was taken when estimating the cost of the Bill stating that 'If anything, we have tended to err on the side of caution on figures in the Bill. In some cases, we have made worst case scenario assumptions to ensure that, as far as possible, we do not underestimate costs\(^3\).

15. The Committee is not reassured that the estimate of a 25% increase in the number of debtor applications for bankruptcy is a conservative estimate.

**Protected Trust Deeds [PTDs]**

16. ICAS' submission suggests that due to a lack of detail in the Bill on areas such as the role of Protected Trust Deeds it cannot comment on the financial implications of the Bill. The Bill lays down a framework for the AiB's administration of bankruptcy applications, however many of the specifics of this role will only become apparent once the detail of the Bill which is to be contained within subordinate legislation becomes available. For example the Scottish Executive launched its consultation on the role of Protected Trust Deeds on 20 January 2006, the detail of which will be introduced within regulations.

17. The AiB submission states the AiB provided an ‘initial estimate’ on the impact of trust deeds but that any additional funding would require cover from the Justice Department. The AiB then stated in oral evidence that ‘The figures that we have provided for the financial memorandum do not take account of those issues [PTDs] because the Executive has not yet brought out policies on them...Obviously, we will produce additional funding requirement figures as the policy is determined.’\(^4\).

18. When asked to comment on the lack of provision within the FM for the use of PTDs and the associated cost, Executive officials stated that ‘The bill provides only an enabling power-the proposal is to proceed by way of regulation. The financial memorandum, therefore, does not deal with our assessment of the impact of protected trust deed reform’\(^5\).

19. The Scottish Executive issues guidance on the preparation of Financial Memoranda which states that in relation to bills where the detail will be contained within subordinate legislation that the FM should contain a broad indication of the likely financial implications. The Committee is concerned that the Executive is not conforming to its own guidance and would reiterate that subordinate legislation is part of the parent bill and a range of costs must be given in the FM.

20. Should the Bill be passed, the Committee would appreciate a written update

\(^{2}\) Official report 31 January 2006 (FI Col 3387)  
\(^{3}\) Official report 7 February 2006 (FI Col 3391)  
\(^{4}\) Official report 31 January (FI Col 3381)  
\(^{5}\) Official report 7 February (FI Col 3392)
from the Executive following Parliamentary approval of all subordinate legislation introduced by the Bill detailing the overall estimated cost of the Bill including those detailed in subordinate legislation to allow the Committee to compare this cost with the estimate detailed in the FM.

21. A lack of information on the likely costs associated with subordinate legislation has impacted on the Committee's consideration of a number of pieces of legislation in the past. The Committee is frustrated that this problem persists, despite the Committee writing to the Minister for Parliamentary Business and publishing comments on this matter within its submission to the Subordinate Legislation Committee’s inquiry into the regulatory framework in Scotland.

**Scottish Civil Enforcement Commission**

22. The new Commission is intended to regulate and supervise officers of court, the people who enforce court rulings on diligence. Officers of court (also known as sheriff officers and messengers-at-arms) are self-employed private contractors commissioned by the SCS. It is intended that the creation of this new NDPB will be funded by the Executive and will cost £900,000 to establish and £632,000 per annum thereafter. This is set against existing costs for the regulation process of approximately £15,000.

23. At present the Society of Messengers-At-Arms and Sheriff Officers (SMASO) currently sets a code of ethics for officers and trains officers for professional examinations. Fees charged by officers are currently regulated by government statute. Misconduct cases are currently dealt with by judges and sheriff principals.

24. In oral evidence, Executive officials provided details of the role of the proposed Commission stating that—

The Commission will appoint, regulate and supervise the conduct of court enforcement provision. That is currently done in a fairly haphazard and ad hoc way...Most important, in addition to that supervision, enforcement and regulation role the commission will have a broader remit to increase awareness about enforcement...The Commission will have a significant public information role in research, evaluation and impact assessment, in providing information and advice, and in mounting publicity campaigns to make people aware of their rights and responsibilities.

25. Members of the Committee questioned Executive officials on the basis for the decision to establish a Commission. Executive officials noted that there had been a 'unanimous agreement in the consultation responses that a commission is an appropriate policy response'. Officials elaborated later in the session stating that 'It is clear that a suitably independent and
transparent means by which [officers of court's] conduct can be scrutinised is important, so that public confidence in what they do is maintained'.

26. In contrast to the suggestion in oral evidence that it is important that the commission should be independent, the Executive’s policy paper on the commission lists as a disadvantage of the chosen approach the ‘perception by some that NDPB model does not guarantee independence’. The Committee is therefore unclear as to why the Executive prefers the option of creating an NDPB if the independence of the proposed commission is of such importance.

27. Members of the Committee asked Executive officials whether bringing the regulation of officers of court ‘in-house’ within the Justice Department would be a more cost effective alternative. Officials suggested that establishing a commission was not necessarily a more expensive option. However the Executive’s policy document states that a disadvantage of establishing a commission is that it would be ‘More costly than other options under consideration’. The Committee is therefore concerned that the Executive appears to be proposing the least cost-effective means of regulating officers of court.

28. When questioned as to whether the Executive had considered whether regulation by such a Commission could be financed by banks and other financial institutions, Executive officials stated ‘we do not consider asking them to pay for this particular piece of work to be a realistic option. That just will not happen’. He went on to argue that—

the public already pay for the cost of debt in various ways...Our proposal is part of a much wider Executive strategy that is designed to improve understanding of debt, financial management and financial education. In that context, our view is that there is a need for a high-profile body to front this aspect of debt management in Scotland.

29. The Committee has previously expressed strong concerns in relation to the number of quangos established since devolution and the associated cost to the taxpayer both within its consideration of the 2006/07 Budget Process at Stage 2 and its consideration of the FM for the Commissioner for Human Rights (Scotland) Bill. In this context, the Committee is not convinced that the reasons provided in oral evidence by the Executive Bill team justify the establishment of a commission which will cost £632,000 per annum.

30. The Committee has specific concerns in relation to the tangible benefits of spending such substantial sums of public money on publicity campaigns and on ensuring that the Commission is of a suitably high-profile. In addition, the Committee is not convinced that the option of creating an NDPB is the correct one and that further exploration of the possibility of providing ‘in-house’ regulation or requiring financial institutions to fund...
regulation either by a commission or by other means should be considered.

**Information disclosure scheme – estimated number of applications**

31. The Bill proposes the establishment of an Information Disclosure Scheme administered by the SCS. The Scheme would grant power to the courts to require disclosure of information on the debtor to the creditor. It has been estimated by the Department of Constitutional Affairs that an individual information request will cost approximately £100-£150. The creditor (including local authorities seeking to recoup taxes or rates) will be required to meet this cost and will only recover this fee if they successfully recover debt.

32. Table 4 of the FM (p.105) suggests that the Scottish Executive estimate the cost of the scheme to be in the region of £193,500 - £1,935,000 per annum, depending on numbers of applications but that costs will be offset ‘at least in part’ by fees charged to applicants. However the FM also suggests that, should demand exceed 50,000 applications the annual running costs will be approximately £9.7million per annum with an additional one-off infrastructure cost of £1.89 million plus programme costs of £500,000 over 2-3 years.

33. Executive officials explained in oral evidence that the reason for the wide range of anticipated numbers of applications and associated costs was essentially because it was difficult to predict the level of uptake of the scheme by creditors in advance of the introduction of the scheme as ‘dialogue on the detail of any scheme or proposal are at a very early stage’.

34. Whilst the Committee appreciates that the Executive has endeavoured to provide the Committee with the broadest range of costs, the Committee is concerned that there should be such uncertainty as to the nature of the scheme, the likely level of uptake from organisations such as local authorities and the associated costs.

**Information disclosure scheme – financial burden on local authorities**

35. The costs of the scheme on creditors, such as local authorities attempting to claim overdue council tax and business rates, have not been estimated in the FM. The submission from the Committee of Scottish Clearing Bankers suggests that the potential initial outlay of £100-£150 per application for information from the scheme may be a significant burden on local authorities. The submission states that 'it is not clear that this will be sufficiently attractive to local authorities'.

36. Members of the Committee asked Executive officials whether there would be flexibility within the operation of the scheme to allow for a variation in the level of fees per application £100-150 prove to be a prohibitive sum. Executive officials responded stating that ‘As we develop the details, we will

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12 Official report 7 February 2006 (Fl Col 3404)
be happy to take into account the needs of various stakeholders to ensure that the outcome you suggest is reached.\textsuperscript{13}

37. The Committee welcomes this commitment from the Executive.

Conclusions

38. In considering the Bankruptcy and Diligence etc. (Scotland) Bill, the Committee’s strongest concern is in relation to the proposal to establish the Scottish Civil Enforcement Commission. On the basis of the concerns outlined above [paras 23 to 29], the Committee believes that the Executive should give serious consideration to whether the establishment of the Commission is the best value option for the regulation of officers of court.

39. The Committee’s concerns have also focused on the concerns raised by a number of organisations as to the whether an estimated 25% increase in applications for bankruptcy is a realistic figure [paras 12 to 15]. The Committee considers it likely that the actual increase could be significantly higher and is therefore concerned that the AiB will require additional funding to administer these additional applications.

40. The Committee also wishes to express concern that costs associated with certain provisions within the bill, such as the reform of Protected Trust Deeds [paras 16 to 22], have not been provided within the FM as the Executive considered providing figures to accompany the relevant subordinate legislation would suffice. As a result, members have not been provided with the opportunity to scrutinise the total estimated cost of the Bill at Stage 1. The Committee is concerned that the Executive is not conforming to its own guidance and would reiterate that subordinate legislation is part of the parent bill and a range of costs must be given in the FM.

41. Finally, the Committee has expressed concern as to the uncertainty of the level of uptake and associated costs of the Information Disclosure Scheme, as the specifics of the nature of the scheme have not yet been finalized [paras 30 to 33]. The Committee is in a difficult position in relation to the disclosure scheme as it is being asked to scrutinise figures for required funding which will potentially fall between £193,500 and £9.7 million per annum. The Committee would have appreciated more specific estimates within the FM and figures to substantiate the Executive’s claim that the scheme will be, at least in part, self-financing.

42. The Committee recommends to the lead Committee that the issues highlighted in this report, particularly in relation to the proposal to establish the Scottish Civil Enforcement Commission, be raised with the Minister.

\textsuperscript{13} \textit{Official report 7 February 2006 (Fl Col 3408)}
FINANCIAL MEMORANDUM

INTRODUCTION

684. The Policy Memorandum which is published separately explains in detail the policy intention of the Bankruptcy and Diligence etc. (Scotland) Bill. The purpose of this Financial Memorandum is to set out the costs associated with the reform measures introduced by the Bill, and as such it should be read in conjunction with the Bill and the other accompanying documents.

685. This Memorandum considers the financial effect of the reforms in the Bill. In doing so, the approach taken has been to err towards a higher rather than a lower cost. The figures are based on:
- assumptions made by three Executive agencies—
  - Accountant in Bankruptcy (“AiB”),
  - Registers of Scotland (“RoS”), and
  - the Scottish Court Service (“SCS”),
- estimates of demand made by the Scottish Executive, and
- estimates of demand made by third parties who would be affected by these proposals.

Areas of reform

686. There are four main areas of reform:
- encouraging re-start and improve public protection by modernising the laws of bankruptcy,
- supporting business risk by modernising floating charges,
- creating a new public body, the Scottish Civil Enforcement Commission, to regulate the new court messenger profession, and
- striking a better balance between the needs of creditors and debtors by modernising the laws of diligence to create a modern approach.

Methodology and overview

687. The Executive has consulted widely on the likely impact of reform, and responses have informed the estimated costs set out in this Memorandum.

688. The costs of this Bill will largely fall to the Scottish Administration as discussed below. Any new impact on creditors and debtors will not significantly affect such interests, as they already bear the costs of any formal enforcement (including sequestration) they choose to use. It was for that reason not considered necessary to undertake a regulatory impact assessment in relation to the bankruptcy, enforcement and diligence reforms.

689. The Scottish Executive will incur administrative costs when implementing the proposed reforms. Those costs include the production of guidance and regulations,
publicity and debt advice materials, and research and consultancy costs. They will be met from existing and planned direct running cost and programme budgets. The Executive estimates these costs at £253,251 per annum for staff and administration, and £110,000 per annum in programme costs. 690. The Scottish Executive will redesign the debt advice and information package (DAIP) which will be used more widely in sequestration and diligence, with increased print runs. The estimated additional cost of producing the DAIP is £42,800 per annum, and that is included in the £110,000 estimate for programme costs.

**BANKRUPTCY**

691. Our key proposals are to:
- reduce the bankruptcy period to 1 year for all bankruptcies,
- protect the public and business interests through the introduction of bankruptcy restrictions orders and undertakings being placed on potentially fraudulent or culpable debtors,
- continue to require debtors to contribute towards their bankruptcy debts where possible,
- reform restrictions and disqualifications on debtors,
- streamline the bankruptcy process and reduce court involvement,
- take bankruptcy proceedings out of the Court of Session and consolidate them in the sheriff courts, and
- require creditors to provide debtors with a debt advice and information pack.

**Costs on the Scottish Administration**

692. The AiB will lead on implementing the bankruptcy reforms. AiB estimate the cost to them in 2006/07 of £1.442 million. This comprises:
- £457,000 staffing costs for some 34 additional staff,
- Staff training is estimated at £20,000,
- £40,000 running costs, and
- £925,000 for IT capital investment.

693. Thereafter AiB anticipate an additional sum of £536,732 per annum will be required to administer the new regime made up of staffing costs of around £530,000 and training at around £7,000.

694. Student loans will no longer be written off in bankruptcy, and the Executive therefore expects to secure a receipt as a result of additional payments made by student loan debtors. Table 1 shows the amounts that have been written off on student loans in the period 1991 to 2004 for illustrative purposes.

*Please note paragraphs in Annexe B are numbered as they appear in the Scottish Executive’s memorandum.*
Table 1*

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<th>Year</th>
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<th>Avg Debt</th>
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<td>£770.70</td>
<td>£385.35</td>
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<td>8</td>
<td>£6,870.65</td>
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<td>13</td>
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<td>432</td>
<td>£1,821,329.86</td>
<td>£4,216.04</td>
</tr>
<tr>
<td>2004</td>
<td>289</td>
<td>£1,333,752.64</td>
<td>£4,615.06</td>
</tr>
</tbody>
</table>

Grand Total 1684 £5,831,048.61 £3,462.62

* Figures based on data in the SE “CLASS” case management system up to 30 August 2004, the latest available date.

695. The amount of the additional payments made in future to the student awards agency will vary according to circumstances, including:
- number of future sequestrations,
- amount borrowed, and
- the type of loan.

696. For example, payments are made over the agreed length of the loan, and that period is determined by the date and type of the loan agreement. It is therefore difficult to provide an accurate recovery figure. It is, however, possible to provide an estimate for additional future payments recovered over the length of loans using the amount of debt written off to 2004.

697. The Executive expects a recovery rate of 70% on each loan made since 2001 as these are repaid over 40 years, and 44% for each loan made on or before 2001 as these are repaid over 25 years. Applying these percentages to the above table gives us a total recovery of pre 2001 balances of £747,280 over 25 years and total recovery of post 2001 balances of £2,892,878 over 40 years. This represents an annual recovery rate of £102,213.

698. Bankruptcy reform will generate savings for the SCS as a result of business moving from the Court of Session to the sheriff courts, and from the sheriff courts to the AiB.

*Please note paragraphs in Annexe B are numbered as they appear in the Scottish Executive’s memorandum.*
Business moving from the Court of Session to the sheriff courts will not generate any significant saving, but business moving from SCS to AiB will. The Executive estimate an annual saving of £60,000 based on a reduction in the number of debtor petitions in the sheriff court. Current numbers are 1500 debtor petitions in the sheriff court per annum, but sequestrations are increasing and we have assumed 2000 petitions per annum in calculating this estimate.

Costs on local authorities

699. The Executive’s bankruptcy reforms will have no cost implications for local authorities.

Costs on other bodies, individuals and businesses

700. The bankruptcy reforms will not have a detrimental financial impact on individuals and businesses. These are progressive measures which will improve the current position of those facing bankruptcy by reducing the bankruptcy period and reforming future restrictions on business and personal financial activity following a sequestration.

701. The Bill also extends the provision of the debt advice and information pack to improve debtor protection in bankruptcy as well as increase the chances of debt recovery. The cost of issuing this Pack will be met by local authorities and any other creditor. The Executive will meet the costs of the production of the pack and it will be the costs of postage that will be for local authorities and other creditors. It is not considered that this will be onerous, as most local authorities and other creditors issue debt information as part of good practice in debt recovery.

FLOATING CHARGES

702. Our key proposals are to:

- introduce a new register of floating charges, and
- reduce the need for double registration of charges.

Costs on the Scottish Administration

703. RoS will require to develop and then maintain the new Register of Floating Charges. The costs of this are detailed below in paragraphs 705 to 709. RoS currently maintain 15 public registers on a self-financing basis regulated by section 9 of the Public Finance and Accountability (Scotland) Act 2000. In terms of this section, income received (principally registration and information provision fees) is applied to meet the Agency’s expenditure. The Keeper of the Registers of Scotland’s financial objectives are subject to Ministers’ directions on the basis that, taking one year with another, income is sufficient to meet expenditure. Registration and information provision fees for the current registers are set by statutory instrument and this is also proposed for the new register.

Please note paragraphs in Annexe B are numbered as they appear in the Scottish Executive’s memorandum.
704. Given this operating basis, development and maintenance of the Register of Floating Charges will, over time, be financially neutral for RoS. Subject to Ministers’ directions, the Keeper anticipates that the development and maintenance costs should be met from fee income generated by the new register, with development costs being recouped over the initial 5 years of operation.

705. The main components of development costs will be firstly those of running a project to develop a detailed design and specification for the register and to take the initiative through to implementation; and, secondly, RoS’ IT supplier’s charges for developing the register system and interfaces. RoS advise that it will not be possible to put final figures to these costs until further work has been done on the outline format and requirements for the register. As an indicative range, they estimate that a figure between £500,000 and £750,000 is a realistic forecast.

706. It is anticipated that development work will begin as soon as the Bill is enacted and that the cost to RoS will be spread between financial years 2006/07 and 2007/08, with the new register being commenced either in the later part of calendar year 2007 or in 2008.

707. Ongoing maintenance of the register will involve IT support costs. Again, it is not possible at this stage to give a detailed cost as this is subject to commercial confidence as it is subject to an ongoing tendering process. These costs can be provided to the Committee on a confidential basis on request. Assuming the register is commenced part way through 2007/08 then (say) half that annual cost would be incurred in that year and a full year’s support cost in each succeeding year.

708. Running costs other than IT support will include staff costs and also a contribution to RoS’ general overheads. These will be partially dependent on registration volumes. At present Companies House in Edinburgh register approximately 7,000 floating charges and memoranda of satisfaction in respect of floating charges annually. The intake for the new register is likely to be higher for two reasons. First, in the new register, Notices of Proposed Charge – which have no current equivalent – will be registered in some instances. Second, in the situation where an English registered company grants a floating charge intended to extend to assets situated in Scotland, this will be registrable in the new register whereas at present it is not registered with Companies House in Edinburgh (although registrable in Cardiff). It is not possible to accurately forecast the effect of these two factors on register intakes however it thought that overall annual registration volume will be of the order of 10,000.

709. Until more detailed design of the registration process has taken place it will not be certain how labour intensive a typical registration will be and therefore the amount of staff resource required. Based on the experience of their other registers and an annual turnaround of around 10,000 notices and documents, RoS’ best estimate at this point is a yearly running cost of around £75,000. This assumes that the notices and documents are created and communicated on paper. The possibilities of electronic communication of electronic documents and notices, and of automation of parts of the registration process will be considered and are likely to reduce administrative costs. As with IT support costs,

Please note paragraphs in Annexe B are numbered as they appear in the Scottish Executive’s memorandum.
it is anticipated that half of these costs will be incurred in the later part of 2007/08 and a full year’s costs in each succeeding year.

**Costs on local authorities** 710. The Executive’s floating charge reforms will have no cost implications for local authorities.

**Costs on other bodies, individuals and businesses**

711. The proposals have no cost implications for individuals.

712. The proposals have a minor impact on those bodies and businesses that provide finance and credit to companies on the security of floating charges. Positive impacts will arise from the actual document being registered in the new register – as opposed to the brief particulars currently registered at Companies House. This allows for authentic extracts to be produced from the register and so reduces the importance of preserving the original. The new registration process is also expected to assist in e-enabling the creation and registration of floating charges.

713. Registration fees will be payable for the registration of Notices of Proposed Charge, floating charges and other documents in the new register. It is expected that notices and new charges will normally be presented by the creditor although in many case the registration fee (together with other costs incurred in the creation of the charge, such as legal expenses) may be indirectly paid by the company. It is anticipated that a discharge of a floating charge will normally be presented by the company, which will pay the registration fee. As with memoranda of satisfaction at present, it will be at the company’s option whether it procures and registers a discharge.

714. As the register will be run on a cost recovery basis, registration fees will be calculated once there is greater certainty as to the costs of developing and maintaining the register. Assuming indicative costs to RoS as discussed above and recovery of development expenditure, the registration fee would be of the order of £30. At present a registration fee of £13 is payable to Companies House. As indicated above the current and proposed registration processes are not directly comparable as at present only brief particulars of the charge are registered.

**SCOTTISH CIVIL ENFORCEMENT COMMISSION**

**Costs on the Scottish Administration**

715. The Bill will provide for a new non departmental public body (NDPB) called the Scottish Civil Enforcement Commission to oversee all enforcement matters. It will register, regulate and supervise the work of the new unified sheriff officer profession to be called “messengers of the court”. The Commission will also have a public education and research role to improve public awareness of enforcement issues including diligence and debt recovery.

*Please note paragraphs in Annexe B are numbered as they appear in the Scottish Executive’s memorandum.*
716. We have estimated costs for the Commission based on an assumed launch date of April 2007. The anticipated costs of the new body have been calculated with that date in mind, taking into account the detailed budgets of recently established public bodies of comparable size and function. We estimate an annual running cost of £632,000 with an additional start up cost in year 1 of £248,500. Table 2 shows estimated costs.

Table 2

<table>
<thead>
<tr>
<th></th>
<th>2006/07</th>
<th>2007/08</th>
<th>2007/08 One Off Start up costs</th>
<th>Annual thereafter</th>
</tr>
</thead>
<tbody>
<tr>
<td>Staffing costs</td>
<td>27,000</td>
<td>388,000</td>
<td>0</td>
<td>400,000</td>
</tr>
<tr>
<td>Recruitment, travel and expenses</td>
<td>0</td>
<td>31,000</td>
<td>31,000</td>
<td>31,000</td>
</tr>
<tr>
<td>Accommodation</td>
<td>0</td>
<td>66,000</td>
<td>35,000</td>
<td>66,000</td>
</tr>
<tr>
<td>Professional services</td>
<td>0</td>
<td>42,000</td>
<td>13,000</td>
<td>42,000</td>
</tr>
<tr>
<td>Printing, office equipment, stationery and IT</td>
<td>0</td>
<td>19,000</td>
<td>140,500</td>
<td>19,000</td>
</tr>
<tr>
<td>Research, education and training</td>
<td>0</td>
<td>74,000</td>
<td>29,000</td>
<td>74,000</td>
</tr>
<tr>
<td>TOTAL</td>
<td>27,000</td>
<td>620,000</td>
<td>248,500</td>
<td>632,000</td>
</tr>
</tbody>
</table>

717. Staffing costs assume a board of seven plus two ex officio members and a chief executive with 10 further staff comprising policy, professional services and administration. Salaries will be based on civil service pay scales and agreed remuneration arrangements for boards. We have assumed an initial staffing cost of £27,000 in 2006/07 to recruit the senior posts and admin support to assist in establishing the body. Staffing costs thereafter are £400,000 per annum with a lesser amount in 2007/08 as some staff will not be in place for the full financial year.

718. Recruitment, travel and expenses have been budgeted annually at £31,000 with additional start up recruitment costs of £31,000 in 2007/08. This also includes assumptions about the recruitment of messengers of the court on an annual basis by way of national advertising. Accommodation costs of £66,000 per annum are based on costs incurred by the Risk Management Authority, which is of a comparative size to the Scottish Civil Enforcement Commission. A full location review will be undertaken and it is assumed that there will be opportunities for sharing of services and costs with other organisations. We have made provision for some refitting of £35,000 in 2007/08 once accommodation has been secured.

Please note paragraphs in Annexe B are numbered as they appear in the Scottish Executive’s memorandum.
719. It is envisaged that the Commission will buy in a number of services rather than employ staff directly. Such services include finance and audit, human resources, legal services and media monitoring. The annual cost of £42,000 includes payments to those asked to carry out inspection and investigation activities under the proposed disciplinary arrangements. In 2007/08, we have assumed an additional one off cost of £13,000 to pay for professional fees attributable to finding and securing accommodation.

720. Office running costs including printing, stationery and IT have been provided for at £19,000 per annum. However, significant start up costs of £140,500 will be incurred in 2007/08 to purchase office furniture, IT equipment, telecommunications and new identity cards for messengers of the court. Given the strong emphasis on equal opportunities for the Commission and its work, we have budgeted for comprehensive staff and Board training in this area as well as more general training and development amounting to £21,000. We have also made provision for a significant research budget of £53,000. This is because the two key areas of research on informal debt collection and equality impact assessment will be challenging. Academic scrutiny of this area is new and will demand a challenging and more costly methodology to elicit results. This sum also includes provision for a public information campaign associated with the Commission’s broader education role. Start up costs in this area of £29,000 have assumed an initial level of training for board and staff as well as the cost of an overhaul of the professional qualification.

721. The Commission is likely to generate some initial modest cost savings on the Scottish Court Service and courts group given the abolition of the existing Advisory Council and current judicial appointment and disciplinary arrangements. We estimate these savings as £15,000 per annum. The Commission will have powers to charge messengers of the court a registration fee, estimated to bring in an income of £17,000. This is an estimate based on a fee of £100 per commissioned officer per annum.

722. The costs of the Scottish Civil Enforcement Commission will be met from existing departmental resources.

Costs on local authorities

723. The Executive’s enforcement reforms will have no cost implications for local authorities.

Costs on other bodies, individuals and businesses

724. Our proposals for the regulation of the court officer profession will have an impact on those currently practicing as officers. This will be a regulatory impact (through secondary legislation) rather than a financial cost. We expect that the content of any regulations will be a matter of good practice and will include standard arrangements for financial accounting and managing potential conflicts of interest, and most firms will be able to adopt the new arrangements with no difficulty.
725. Arguably, the improvements in regulation and the public work of the Commission will increase professional and public standing leading to new clients and a more profitable sector. Most officers are employed by firms whose business interests include debt recovery. Our proposals will impose new regulatory arrangements on businesses under which new messengers of the court can operate. These are not yet available but will be subject to separate regulations. We have planned for a transition period to enable any changes to be made and the profession and their associated business interest will be consulted as our proposals are implemented.

726. The proposals will have a positive financial impact on the professional body of Sheriff Officers and Messengers at Arms as compulsory membership will increase fee income. Many officers do not subscribe at present, but those officers who do, pay around £450 per annum to their professional body. It is hoped that the benefits of scale may result in a reduced fee overall, and a higher income for the body, meaning the actual financial impact on individual officers of the proposed Commission fee will be negligible.

DILIGENCE

727. Our key proposals are:

- the abolition of adjudication for debt and its replacement with the new diligences of land attachment and residual attachment,
- the reform of inhibition,
- the reform of diligence on the dependence,
- new diligences of money attachment and interim attachment,
- reform of earnings arrestment,
- reform of arrestment and forthcoming,
- abolition of maills and duties and sequestration for rent,
- wider application of time to pay arrangements as part of diligence,
- to bring admiralty law in respect of arrestment in line with other UK law, and
- to facilitate the development of the information disclosure scheme in line with UK developments.

Costs on the Scottish Administration

728. The reforms are likely to have a significant impact on the work of the SCS. A number of diligences are being abolished and created with resulting impacts on the number of cases coming before the courts. It is difficult to estimate the exact number of cases which will result as some of the arrangements, such as land attachment and money attachment, are being made available for the first time. Therefore the analysis is based on estimates and an underpinning assumption that our reforms will have the desired effect and make diligence more open and transparent, as well as easier to use for creditors.

729. For example, it is envisaged that the new diligence of land attachment will be popular, but will not lead to significant numbers of sale applications. Land attachment will be added to the remedies available following a warrant from the court and therefore

Please note paragraphs in Annexe B are numbered as they appear in the Scottish Executive’s memorandum.
will not impose an additional burden on the courts initially. An application at a second stage to sell attached property will place an increased workload on the court who will need to deliberate the merits or otherwise of the case. It is expected the new diligence of money attachment will be popular, but this will be available on a warrant and will not have an immediate increased impact on the courts. There is likely to be an increase in time to pay applications as these are being made more widely available. The reform of diligence on the dependence may lead to fewer applications, but an increase in the cost of these newly contested applications.

730. Table 3 sets out the estimated increase in staff and judicial time and costs associated with the diligence proposals per annum from 2008/09 with part year in 2007/08.

Table 3

<table>
<thead>
<tr>
<th>Bill Proposal</th>
<th>Assumed number of new applications</th>
<th>Additional staff costs (£)</th>
<th>Additional judicial costs (£)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Land attachment</td>
<td>1000</td>
<td>87,000</td>
<td>62,000</td>
</tr>
<tr>
<td>Residual attachment</td>
<td>1000</td>
<td>62,000</td>
<td>44,000</td>
</tr>
<tr>
<td>Interim attachment</td>
<td>200</td>
<td>6,200</td>
<td>4,400</td>
</tr>
<tr>
<td>Money attachment</td>
<td>5000</td>
<td>155,000</td>
<td>110,000</td>
</tr>
<tr>
<td>Time to pay</td>
<td>4200</td>
<td>28,400</td>
<td>7,900</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>11,400</strong></td>
<td><strong>338,600</strong></td>
<td><strong>228,300</strong></td>
</tr>
</tbody>
</table>

731. Overall, the Executive has estimated costs to SCS of £566,900 per annum resulting from our proposals. This includes additional staff resources as well as training and other infrastructure requirements and there will be an additional one-off cost of £10,000 for reprogramming court IT systems. It is thought an implementation date for the majority of our diligence proposals will be summer 2007. However, the Executive is prepared to consider a more phased approach in the light of the complexity of the task involved and the resources available.

732. The most significant resource impact on the SCS will be the introduction at a later stage of an “Information Disclosure Scheme”. Whilst the information requests will themselves be self financing with creditors paying a small fee for the information, there will be significant costs in establishing the supporting infrastructure to operate a scheme. Detailed thinking on a scheme is at an early stage and implementation of any scheme will be informed by a working group of key interests across the UK. We will consult on the detail of any scheme and are likely to conclude that a limited pilot would be helpful in informing any final model.

733. It is difficult at this stage to estimate the costs of the scheme because of the differences in enforcement between Scotland and England. However, the Department for Constitutional Affairs (DCA) in their White Paper Effective Enforcement suggest an
individual information request to cost in the region of £100 to £150. It is proposed that
the creditor will meet the costs of the information disclosure request at the point of
application, but this will be recoverable from the debtor against whom decree is granted
when enforcement is successful. DCA expect the initial England and Wales infrastructure
and set up costs in respect of the courts to be £500,000 with a similar sum attributable to
Her Majesty’s Revenue & Customs and Department of Works and Pensions.

734. It is difficult to estimate the likely take up of the new scheme in Scotland and to
consider the detailed cost implications. The Executive has considered that the costs to the
courts in Scotland will be proportionately larger compared to England and Wales due to
the number of different ways in which diligence operates. For example, demand for
information disclosure will be higher in Scotland as warrants for recovery are available
across a range of diligences and will be more popular than the English model where
separate applications are required for each form of diligence. The court system in
England and Wales has already been subject to a high degree of centralisation for the
administration of diligence including shared information. The timescale for this is long
term with a scheme not becoming established until 2009/2010. In the meantime, Table 4
shows potential costs based on 3 possible levels of take up to illustrate the impact of
proposals on the likely resources required. These potential costs will be offset at least in
part by fees charged to applicants.

Table 4

<table>
<thead>
<tr>
<th>Take up – applications per month</th>
<th>Costs per application</th>
<th>Total cost of scheme</th>
</tr>
</thead>
<tbody>
<tr>
<td>1,000</td>
<td>£16.13</td>
<td>£193,500 p.a.</td>
</tr>
<tr>
<td>5,000</td>
<td>£16.13</td>
<td>£967,500 p.a.</td>
</tr>
<tr>
<td>10,000*</td>
<td>£16.13</td>
<td>£1,935,000 p.a.</td>
</tr>
</tbody>
</table>

* Where demand exceeds 50,000 p.a. there will be one-off infrastructure set up costs of: £1.89 million and
programme costs of £500,000 over 2-3 years.

Costs on local authorities

735. Local authorities involved in the recovery of council tax and rent arrears will be an
important creditor affected by the Bill proposals. However, as indicated under diligence
more generally, the cost of action is recoverable through the diligence process where it is
successful.

736. The Bill also extends the provision of the debt advice and information pack to
improve debtor protection as well as to increase the chances of debt recovery. The cost of
issuing this Pack will be for local authorities (and any other creditor). However, again the
costs will be incurred only where a diligence route is adopted which is a matter of choice
for local authorities and others. Such costs which are essentially postage costs are
recoverable in the event of
successful diligence.

737. The Bill extends the circumstances under which the debt advice and information pack will be issued to debtors before the process of diligence has begun. This is the case in all attachments currently and will be extended to the new diligences introduced by the Bill. Whilst these pre-decree costs are not recoverable, our proposals regularise good practice in this area. Most local authorities in practice issue a “final warning letter” to debtors prior to court action. Many also have partnership arrangements with the money advice sector whereby information and advice on debt management is already incorporated in materials being issued. Accordingly, we expect local authorities to incorporate this new requirement into existing arrangements or replace existing with reference to the pack. Therefore the costs to local authorities will be marginal over and above current costs. The Scottish Executive will meet the costs of the production of the Pack (see paragraph 690) and it will be the costs of postage that will be for local authorities and other creditors.

738. The proposal for an “information disclosure order” will also impact on local authorities who will make use of the new arrangements to recover debt. The Executive expects that the costs of any new arrangements for creditors to be recoverable and for the cost of seeking a disclosure to be modest given the scheme is self financing. The information provided will improve the likelihood of a successful recovery. It is for local authorities and others as creditor to consider the costs of any diligence against the chances of successful recovery.

Costs on other bodies, individuals and businesses

739. The diligence proposals aim to create a better balance between the interests of creditors and debtors in debt recovery. It is recognised that in some cases our proposals will increase the costs of recovery for creditors. For example, the introduction of new time to pay arrangements mean that there may be a small delay in creditors being able to execute diligence, but a final opportunity for debtors to make arrangements to pay before a court decree increases the chances of recovery for creditors. Similarly, the extension of the use of the debt advice and information packs means creditors will be required to post out advice to debtors at a small cost, but the availability of this advice may result in a realistic payment regime being agreed and sustained. These costs can however be recovered from debtors where diligence has been successful.

740. However, some proposals work in the interests of debtors more directly. For example protection of the minimum balance for debtors subject to bank arrestment reduces the amount available for creditors but also protects debtors from genuine hardship which could only exacerbate their situation. It is more likely to lead to the genuine “can’t pays” being supported via debt arrangement scheme solutions rather than diligence, which is our overall policy intention. Essentially, resort through the courts is not a compulsory or sole route to debt recovery. Individuals and businesses can choose not to pursue debts in this way but recover debts on a more informal basis or promote debt management arrangements like the Debt Arrangement Scheme.

Please note paragraphs in Annexe B are numbered as they appear in the Scottish Executive’s memorandum.
741. We are aware that the proposed reform of bank arrestment arrangements will place new administrative arrangements on third parties including banks and employers who are required by the courts to co-operate in the debt recovery process. The Executive has consulted with representatives of these sectors to ensure that any impact is minimised and can be implemented in a planned way. Changes will be of a one off nature and be applicable to well established and tested administrative and IT based systems.

742. It is assumed that banks will be able to recover costs from their customer charging structure. The Committee of Scottish Clearing Banks estimate that the current cost to them of an arrestment is £42.00. They have further indicated that the Bill proposal for a calculation of minimum balance could increase this figure to £50.00 based on staff costs and new administrative arrangements. Longer term, there is likely to be an administrative gain for such bodies in relation to bank and earnings arrestment, through the operation of information disclosure orders.

SUMMARY TABLE OF COSTS ON THE SCOTTISH ADMINISTRATION

<table>
<thead>
<tr>
<th>Proposal</th>
<th>Reference</th>
<th>2006/07</th>
<th>2007/08</th>
<th>2008/09 and subsequent years</th>
<th>Comment</th>
</tr>
</thead>
<tbody>
<tr>
<td>BANKRUPTCY Accountant in Bankruptcy</td>
<td>Para 692</td>
<td>1.44m*</td>
<td>536,000*</td>
<td>536,000</td>
<td></td>
</tr>
<tr>
<td>Student Award Agency</td>
<td>Para 697</td>
<td>-102,213</td>
<td>-102,213</td>
<td>-102,213</td>
<td>Based on assumptions using historic write off</td>
</tr>
<tr>
<td>Scottish Court Service</td>
<td>Para 698</td>
<td>-60,000</td>
<td>-60,000</td>
<td>-60,000</td>
<td>Saving on court costs</td>
</tr>
<tr>
<td>FLOATING CHARGES Registers of Scotland</td>
<td>Paras 705 to 709</td>
<td>375,000*</td>
<td>412,500*</td>
<td>75,000*</td>
<td></td>
</tr>
<tr>
<td>SCOTTISH CIVIL ENFORCEMENT COMMISSION</td>
<td>Para 716</td>
<td>27,000*</td>
<td>868,000*</td>
<td>632,000*</td>
<td></td>
</tr>
<tr>
<td>Scottish Court Service</td>
<td>Para 721</td>
<td>-15,000</td>
<td>-15,000</td>
<td>-15,000</td>
<td>15,000 savings to SCS</td>
</tr>
<tr>
<td>Messengers of the court</td>
<td>Para 721</td>
<td>-17,000</td>
<td>-17,000</td>
<td>-17,000</td>
<td>17,000 income from fees</td>
</tr>
</tbody>
</table>

Please note paragraphs in Annexe B are numbered as they appear in the Scottish Executive’s memorandum.
**DILIGENCE**  
Scottish Court Service  
Para 730  
Para 731  
Para 734  

| Information Disclosure Orders | 0 | 141,725* | 566,900* | Based on quarter year 2007/08  
| Reprogramming IT system  
| Based on middle range of applications  
| 10,000 | 967,500 |

| Implementation by the Scottish Executive | 0 | 253,251* | 253,251* | Staff costs Programme costs  
| 110,000* | 110,000* |

* Denotes resources secured

**SUMMARY TABLE OF COSTS ON LOCAL AUTHORITIES, OTHER BODIES, INDIVIDUALS AND BUSINESSES** *

* Based on illustrative figures only with some untested assumptions of usage and take up of diligence measures.

<table>
<thead>
<tr>
<th>Proposal</th>
<th>Reference</th>
<th>Local authority</th>
<th>Other Bodies</th>
<th>Individuals &amp; Business</th>
</tr>
</thead>
</table>
| BANKRUPTCY  
Creditor to issue debt advice and information pack | Para 701 | | | Creditors to pay postage for pack – can be incorporated into existing arrangements offset against increased chance of recovery |
| FLOATING CHARGES  
Registration fee payable | Para 714 | | | £30 per registration offset by enhanced security of information |
| SCOTTISH CIVIL ENFORCEMENT | | | | |

*Please note paragraphs in Annexe B are numbered as they appear in the Scottish Executive’s memorandum.*
<table>
<thead>
<tr>
<th><strong>COMMISSION</strong></th>
<th>Para 721</th>
<th>Increase in revenue from compulsory membership, fee level of £450</th>
<th>£100 per officer offset against reduced fee to the professional body</th>
</tr>
</thead>
<tbody>
<tr>
<td>Messengers of the court to pay fee to SCEC</td>
<td>Professional body income increase</td>
<td>Para 726</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th><strong>DILIGENCE</strong></th>
<th>Para 737</th>
<th>Creditors to pay postage for pack – can be incorporated into existing arrangements offset against increased chance of recovery</th>
<th>Creditors to pay postage for pack – can be incorporated into existing arrangements offset against increased chance of recovery</th>
</tr>
</thead>
<tbody>
<tr>
<td>Creditors and local authorities to issue debt advice and information pack</td>
<td>Impact on banking sector</td>
<td>Para 742</td>
<td>£8 increase in admin costs per bank arrestment offset by a reduced number of cases given the availability of information disclosure. Creditor pays £100 per application which is recoverable and offset against increase chance of recovery.</td>
</tr>
<tr>
<td>Cost of application Information Disclosure Orders</td>
<td></td>
<td>Para 733</td>
<td></td>
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