Forgiving our Debtors: a Scottish Perspective on a Fresh Start for Debtors*

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Abstract

Against a background of rising debt levels, this article examines the range of solutions available to a debtor in financial difficulty in Scots law and the recent proposals for reform of bankruptcy law in Scotland brought forward by the Scottish Executive as part of its new approach to debt management and enforcement in Scotland and considers the extent to which they may accord an over-burdened debtor the opportunity for a fresh start. It concludes that while the emphasis on providing appropriate solutions for over-burdened debtors with a view to enabling them to make a fresh start evidenced by these proposals is to be welcomed, they may not yet have struck quite the right balance in this respect. Copyright © 2004 John Wiley & Sons, Ltd.

I. Introduction

As the Scottish Executive stated simply in its consultation paper *Personal Bankruptcy Reform in Scotland: A Modern Approach*, published in November 2003 ("the First Consultation Paper"), "[d]ebt is a common feature of modern life".[1] There has, however, been growing concern recently about rising debt levels and over-indebtedness, particularly among consumer debtors.[2] Recent research indicates that household debt in the UK and within Scotland is at record levels both in absolute terms and relative to income.[3] Debt is not, of course, the same as over-indebtedness and is only a problem where people cannot meet their repayments[4] and the First Consultation Paper noted that most people incur debt through their everyday

*This article is based on a paper delivered at the INSOL Academics' Group Meeting in Cape Town, 2–4 April 2004. The author is grateful to the British Academy for a contribution towards the travelling costs of attending that Meeting to give the paper.

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1. First Consultation Paper, para 2.1.

2. See, for example, *Report of the Task Force on Tackling Over-indebtedness* (July 2001); *Over-indebtedness in Britain: A report to the Department of Trade and Industry* (September 2002); *Second Report of the Task Force on Tackling Over-indebtedness* (January 2003); *Scottish Economic Report* (February 2003), Ch. 4; Citizens Advice Scotland, *On the Cards: The debt crisis facing Scottish CAB clients* (January 2004).

3. Scottish Economic Report, Ch. 4. See also *On the Cards: The debt crisis facing Scottish CAB clients* paras 3 (overall level of debt) and 53–55 (debt to income ratios).

4. Scottish Economic Report, Ch. 4.

Int. Insolv. Rev., Vol. 14: 1–26 (2005)
Published online 29 November 2004 in Wiley InterScience (www.interscience.wiley.com). DOI: 10.1002/iir.122

living and the majority of debts are well managed and paid in full over time.[5] This would appear to be borne out by recent research,[6] which also indicated low credit use in Scotland compared to the UK as a whole[7] and much lower levels of arrears among those in financial difficulty in Scotland (and Wales) than in any of the English regions,[8] while other research has indicated that Scotland also has a lower level of household indebtedness than the UK as a whole.[9] However, the First Consultation Paper acknowledged that people may at some point in their lives face a situation of over-indebtedness if they have financial commitments that they cannot meet[10] and it has been concluded that a far greater number of people than at present would potentially be at risk of serious financial difficulties in an economic downturn or a period of sustained interest rate increases.[11] It has also been concluded that current debt levels are unsustainable and could be damaging to the Scottish economy.[12]

The First Consultation Paper noted that the Scottish Executive supports a "can pay should pay" approach to debt management but recognises the importance of having fair solutions for individuals suffering from severe debt problems[13] and the Ministerial Foreword to the First Consultation Paper specifically stated that it is important that people are reassured that if they suffer from unexpected hardship and severe debt problems, there are humane solutions to help them move forward with their lives. The Scottish Executive had already embarked on a number of policy initiatives designed to introduce a new approach to debt management and enforcement in Scotland, including the introduction of a statutory debt arrangement scheme (DAS) designed to allow individuals with multiple debts to repay these in a managed way while protected from enforcement action by creditors which is due to come into force by November 2004.[14] The First Consultation Paper noted that debt management in Scotland can provide solutions for debtors in a number of ways,[15] namely voluntary arrangements with creditors, the new statutory DAS, trust deeds for creditors and sequestration, and it stressed the importance of there being a comprehensive, integrated debt management framework with appropriate solutions for all those with debt problems.[16]

5. First Consultation Paper, para 2.1.

6. *Over-indebtedness in Britain: A report to the Department of Trade and Industry*, p. 52.

7. *Ibid*, p. 10.

8. *Ibid*, p. 23.

9. *Scottish Economic Report*, Ch. 4.

10. First Consultation Paper, para 2.3.

11. *Over-indebtedness in Britain: A report to the Department of Trade and Industry*, p. 52. See also *Scottish Economic Report*, Ch. 4.

12. *Scottish Economic Report*, Ch. 4.

13. First Consultation Paper, para 2.2.

14. Other initiatives include reform of the law of diligence (enforcement). This was partly achieved by the Abolition of Poinding and Warrant Sales Act 2000 and the Debt Arrangement and Attachment (Scotland) Act 2002, which together reformed the law of diligence as it relates to moveable property in the hands of the debtor. The Scottish Executive also consulted on other possible reforms to the law of diligence in a consultation paper entitled *Enforcement of Civil Obligations in Scotland* published in April 2002 and further proposed reforms to the law of diligence have now been brought forward alongside proposed reforms to bankruptcy law: see further below.

15. First Consultation Paper, para 2.4.

16. *Ibid*, paras 6.1 and 6.24–6.26. It should be noted that the law in Scotland in relation to these matters differs from the law in England and Wales in a number of important respects; in particular, although corporate insolvency law is in many respects the same or similar in both jurisdictions and is in most respects reserved to the UK Parliament, bankruptcy law in Scotland remains distinct from bankruptcy law in England and Wales with distinctive features unique to Scotland and is in most respects devolved to the Scottish Parliament.

Against that background, the First Consultation Paper sought views on a number of possible reforms to bankruptcy law. It explained that reform of bankruptcy law was an important step in building a modern and prosperous Scotland[17] and that the proposals were intended "to reduce the stigma of bankruptcy and encourage responsible risk taking while providing a robust and effective regime to protect the public and business community from the small minority of bankrupts who have acted in a fraudulent or culpable manner".[18] It went on to say that the proposals were not designed to rewrite the whole content and structure of Scottish bankruptcy law, but rather aimed "to develop and refine the existing bankruptcy laws taking into account the needs of Scotland's debtors, creditors and small businesses and policy developments in other areas."[19] The First Consultation Paper has now been followed by a further consultation and draft bill published in July 2004, *Modernising bankruptcy and diligence in Scotland: Draft Bill and Consultation* ("the Second Consultation Paper") which sets out firm proposals on which it is intended to legislate and proposals for further consultation in both of these areas.

This paper examines the range of solutions available to a debtor in financial difficulty under Scots law and the proposals for reform set out in the First and Second Consultation Papers and considers the extent to which they may accord an overburdened debtor the opportunity for a fresh start.

II. Solutions Available to Debtors in Financial Difficulty in Scots Law

As noted above, the range of solutions available to debtors in financial difficulty comprises voluntary arrangements with creditors, the new statutory DAS, trust deeds for creditors and sequestration. Each of these solutions may be appropriate in different circumstances and varies in the extent to which it can offer the debtor a fresh start.

A. Voluntary arrangements with creditors

It is always open to a debtor to enter into a voluntary arrangement or arrangements with some or all of his creditors. Such arrangements may be made either before or after steps have been taken to recover the debt and in some cases the taking of such steps by creditors can act as a catalyst for the debtor to instigate negotiations to that end. Debtors may attempt to negotiate such arrangements themselves or may seek assistance in doing so, increasingly from organisations offering specialist money advice such as Citizens Advice Bureaux.[20] Voluntary arrangements may take a variety of forms, but generally anticipate the debtor making full repayment over time, although creditors may waive accruing interest and/or charges in the

17. *Ibid*, para 1.6.
18. *Ibid*, para 1.7.
19. *Ibid*, para 1.8.
20. Consumer debt is currently the biggest single issue brought to Citizens Advice Bureaux in Scotland: see *On the Cards: The debt crisis facing Scottish CAB clients*, Executive Summary. The provision of appropriate money advice is another important part of the Scottish Executive's strategy for debt management.

light of an agreement. To the extent that they do require full repayment, such arrangements may be regarded as not offering the debtor a fresh start as such, although they may allow the debtor to avoid formal insolvency and to manage his debt(s) to the mutual benefit of both debtor and creditor(s). Sometimes, however, creditors may agree to accept less than full payment of the debt and if some or all creditors are willing to accept less than full payment at the outset, a debtor may conclude a formal composition contract with those creditors. This would typically provide for the participating creditors, who must be treated rateably, to accept a proportion of their outstanding debts, often in instalments, in return for the debtor receiving a discharge. Such a composition offers the debtor a fresh start following fulfilment of its terms. The difficulty with all types of voluntary arrangements, however, is that they require creditor agreement and even if the majority of creditors are willing to reach an arrangement with the debtor, dissenting creditors cannot be forced to do so.

There are certain circumstances in which an arrangement may be imposed on an individual creditor. Firstly, where court action has been raised, the debtor may in most cases apply for a time to pay direction under the Debtors (Scotland) Act 1987.[21] Such an application must be made prior to decree being granted and the debtor may offer to pay in weekly, fortnightly or monthly instalments or in a lump sum at the end of a period.[22] If the creditor accepts the offer, decree will be granted in terms thereof but if he rejects it, a hearing will take place at which the court will decide whether or not to grant the debtor's application. In such a case, therefore, an arrangement may be imposed on the creditor against his wishes. While a time to pay direction is in force, and is being complied with by the debtor, the creditor is prohibited from using most types of diligence against the debtor in respect of that debt[23] although if the debtor defaults, the creditor's rights to use diligence to recover the remaining balance of the debt will, with some exceptions, revive.[24] A time to pay direction may be varied by the court on the application of either the creditor or the debtor if there is a change of circumstances.[25] Secondly, where certain diligence has been commenced against a debtor following on from a decree or other document (e.g. an agreement registered for execution), the debtor may in most cases apply to the court for a time to pay order under the Debtors (Scotland) Act 1987.[26] If the creditor accepts the debtor's offer, a time to pay order will be granted in terms thereof but if the creditor rejects it, a hearing will take place at which the court will decide whether or not to grant the order. Again, therefore, an arrangement may be imposed on the creditor against his wishes. While a time to pay order is in force and is being complied with by the debtor, the creditor is

21. Time to pay directions are not competent in certain cases, including cases where the debt (exclusive of interest and expenses) exceeds £10,000 and cases involving certain types of debt: Debtors (Scotland) Act 1987, s 1(5). "Debt" is defined as excluding fines, maintenance and certain other sums: Debtors (Scotland) Act 1987, s 15(3).
22. Debtors (Scotland) Act 1987, s 1.
23. *Ibid*, s 2.
24. *Ibid*, s 2.
25. *Ibid*, s 3.
26. Time to pay orders are not competent in certain cases, including cases where there has already been a time to pay direction or earlier time to pay order: Debtors (Scotland) Act 1987, s 5.

prohibited from completing the diligence which he has started or from commencing other diligence in respect of the debt,[27] although if the debtor defaults, the creditor's rights to use diligence to recover the remaining balance of the debt will revive.[28] Thirdly, where a debtor is a party to a regulated consumer credit or consumer hire agreement under the Consumer Credit Act 1974, he may in certain circumstances apply for a time order under that Act. Such an order may provide for the payment of any sum due under the relevant agreement by instalments or allow the debtor time to remedy any non-monetary breach of the agreement[29] and may be granted even where it is opposed by the creditor. While a time order is in place, the creditor is prevented from taking certain types of action against the debtor.[30]

While these measures may assist a debtor in particular circumstances, however, they may be regarded as being of limited general use. A time to pay direction or order does not offer the debtor a fresh start as such, as he must still pay the full amount of the debt plus interest and expenses, although it may help him to avoid formal insolvency and to manage his debt(s). A time order, on the other hand, may affect the amount the debtor has to pay, since the court has the power, when making such an order, to amend the terms of the agreement to which it relates,[31] for example by altering the rate of interest to be paid. Research has indicated, however, that the use of time to pay directions has been low and the use of time to pay orders lower still,[32] and although there is no comparable research in relation to time orders, it would appear that applications for such orders are extremely uncommon.[33] The research relating to time to pay directions and orders indicates a number of possible reasons for the low uptake of these measures,[34] including the fact that they may be seen as inappropriate in situations of multiple debt.[35] This is logical. In cases of multiple debt, which now appear to be the norm,[36] the debtor will still have to deal with his other debts and in fact using a time to pay direction or order or a time order may make it more difficult to do so if the debtor thereby leaves himself with little or no surplus income to service these other debts. The Scottish Executive has recognised that while these provisions remain valuable, this is mainly so in relation to single debts and while it has therefore proposed a number of reforms designed to improve time to pay directions and orders,[37] it has also provided an alternative solution intended to be more appropriate for cases of multiple debt in the form of the new statutory DAS.

27. *Ibid*, s 9.
28. *Ibid*, s 9.
29. Consumer Credit Act 1974, s 129.
30. *Ibid*, s 130.
31. *Ibid*, s 136.
32. For a summary of the research, see *Enforcement of Civil Obligations in Scotland*, paras 4.17–4.33.
33. *Ibid*, para 4.36.
34. *Ibid*, paras 4.20–4.23 (time to pay directions) and para 4.33. (time to pay orders).
35. *Ibid*, para 4.22.
36. See, for example, *On the Cards: The debt crisis facing Scottish CAB clients*, para 49.
37. See *Enforcement of Civil Obligations in Scotland*, paras 4.41–4.57 and the Second Consultation Paper, paras 10.100–10.103. Reforms to time orders were also seen as desirable, but the subject matter of the Consumer Credit Act 1974 is reserved to the UK Parliament. However, a review of time orders is currently being undertaken as part of the government's strategy for tackling over-indebtedness: see White Paper *Fair, Clear and Competitive* published in December 2003 (Cm 6040), paras 5.73–5.76.

B. The Debt Arrangement Scheme ("DAS")

The DAS was introduced by the Debt Arrangement and Attachment (Scotland) Act 2002 ("the 2002 Act") and is intended to provide a simple mechanism for dealing with "the social problem of multiple debt".[38] The 2002 Act sets out the basic framework of the DAS leaving the details to be provided for in regulations. Draft Debt Arrangement Scheme (Scotland) Regulations ("the regulations") were laid before the Scottish Parliament on 19 February 2004 and approved by the Scottish Parliament on 31 March 2004 but are not yet in force. It is anticipated that the scheme will be in operation by November 2004.

The DAS is designed to allow individual debtors with multiple debts to enter a debt payment programme ("DPP") for repayment of their debts while protected from enforcement action. It was proposed initially that the DAS would be restricted to consumer and small trade debtors only[39] and the 2002 Act provides that regulations may make further provision as to the class of debtor who may apply for a DPP[40] but the regulations contain no such restriction. It was also proposed initially that the DAS should be subject to a maximum time limit, extendible within certain limits,[41] and an upper monetary limit of total debts,[42] and the 2002 Act provides that regulations may make further provision as to these matters, but again no such restrictions are contained in the regulations. This means that the DAS will be open to all individuals irrespective of their debt situation.

The basic structure of the scheme provides for an application for approval of a DPP to be made by a debtor,[43] although the regulations provide that an application may not be made in certain defined circumstances including where there is already a protected trust deed for creditors or the debtor has been sequestrated.[44] The debtor must have an approved money adviser when applying for and during a DPP. The DPP will provide for the debtor to make a single periodic payment based on his surplus income after deduction of necessary outgoings including ongoing payments to creditors.[45] This payment will be made to an approved payments distributor for distribution among the creditors included in the DPP in accordance with its terms.[46] The debts which may be included in a DPP are widely defined[47] and include arrears of secured debts (although a secured creditor will not be prevented from enforcing his security[48]) and creditors will be paid rateably.[49] The payments may be made in a number of ways, including deduction at source from the debtor's earnings.[50] The consent of creditors is required and where all

38. Policy Memorandum on the Debt Arrangement and Attachment (Scotland) Bill, SP Bill 52-PM, paras 12, 15.
39. *Enforcement of Civil Obligations in Scotland*, para 4.153.
40. 2002 Act, s 7(2).
41. *Enforcement of Civil Obligations in Scotland*, paras 4.152, 4.153.
42. *Ibid*, para 4.153.
43. See the 2002 Act, s 2 and reg 20(1). An application cannot be made by a creditor or creditors.
44. Reg 21(2). Trust deeds and sequestration are discussed further below.
45. 2002 Act, s 2.
46. *Ibid*.
47. Reg 3.
48. See further below.
49. This was the original intention when the DAS was proposed (see *Enforcement of Civil Obligations in Scotland*, para 4.156) and although s 7(2) of the 2002 Act provides that further provision may be made in regulations for the priority in which debts are to be paid, no such provisions are in fact made in the regulations.
50. Reg 32.

creditors have consented to the DPP, approval is automatic.[51] Where all creditors have not consented (or been deemed to consent), however, there is provision for the DAS administrator[52] to dispense with the consent of a creditor or creditors within certain limits[53] and where either the DAS administrator may not dispense with consent, creditors object on certain specified grounds or the DAS administrator considers it appropriate in all the circumstances, the application will be referred to the court for a decision.[54] Approval of a DPP stops most enforcement action during the currency of the DPP other than enforcement of a security[55] while the debtor is restricted from taking on new credit during the DPP.[56] The DPP can be varied on the application of the debtor or a creditor or creditors[57] and can be revoked in certain circumstances.[58] There will be a public register of DPPs.[59]

The DAS will be important in the context of providing a fresh start for a debtor because it provides a mechanism for binding dissenting creditors where the majority are prepared to enter into an arrangement with the debtor for repayment of his debts. However, concern has been expressed that the DAS will be inaccessible to low income debtors who are unlikely to have sufficient surplus income to make repayments in the way envisaged by the DAS.[60] Furthermore, the DAS does not provide for the composition of debts unless individual creditors agree,[61] and to the extent that they do not, the DAS may be regarded as offering the debtor a limited fresh start, although the debtor will still benefit from being allowed to pay back the debts in a more managed way and free from enforcement action including formal insolvency.

C. Trust deeds for creditors

A trust deed for creditors is a voluntary deed by the debtor conveying specified assets to a named trustee to be administered for the benefit of his creditors and the payment of his debts. It may also provide for the debtor to make contributions from income. A trust deed generally operates in much the same way as a sequestration but without its formalities and as it avoids some of the more serious consequences of sequestration, it may be seen as an attractive option by a debtor.

Trust deeds are creatures of the common law, although the Bankruptcy (Scotland) Act 1985 ("the 1985 Act") contains a number of provisions relating to trust deeds as defined for the purposes of that Act, that is, trust deeds which convey to the trustee under the trust deed the same assets of the debtor as would vest in a trustee in sequestration under the 1985 Act.

51. A creditor who does not respond to a request to consent within the specified time period is deemed to consent: see reg 22(3).
52. Who will be the Accountant in Bankruptcy.
53. Reg 22(4).
54. Reg 27.
55. 2002 Act, s 4 and reg 35.
56. Reg 35.
57. See regs 37–40.
58. See regs 41–45.
59. 2002 Act, s 7.
60. *On the Cards: The debt crisis facing Scottish* CAB clients, Executive Summary and para 124.
61. Reg 24 makes provision for individual creditors to agree to waive interest or compound debts and for any such agreement to be subject to conditions.

The difficulty with trust deeds is that at common law, creditors who do not accede to a trust deed are not bound by it. In order to get round this difficulty, the 1985 Act introduced the concept of the protected trust deed. Originally, it provided for a trust deed to become protected if a defined majority of creditors acceded to it and certain other provisions were satisfied. Few trust deeds became protected, however, and the procedure was therefore amended by the Bankruptcy (Scotland) Act 1993. The procedure as so amended is contained in Sch 5 of the 1985 Act and provides for a trust deed which satisfies certain conditions to become protected if the trustee follows certain procedural steps and a defined percentage of the creditors do not object within a specified time limit: in order for the trust deed not to become protected, a majority in number, or at least a third in value, of the creditors must object. Creditors who do not object are effectively deemed to have acceded to the trust deed. Once the trust deed has become protected, all creditors (including those who objected to it) are bound by it and only limited rights of challenge to the deed are available.

A trust deed does not automatically provide the debtor with a discharge of his debts and thus a fresh start, but it may, and in practice usually will, include provision for the debtor's discharge. The normal provision would be for discharge after three years (the same period as would normally apply in a sequestration),[62] even if little or nothing has been paid to creditors under the trust deed. The utility of the trust deed as a means of providing a debtor with a fresh start may, however, be affected as a result of the proposals for reform which are discussed further below.

D. Sequestration

Sequestration is the formal judicial procedure whereby a debtor's assets are placed in the hands of a trustee for realisation and distribution among his creditors. It is initiated by a petition to the appropriate court which may be made, *inter alia*, by the debtor himself or by a qualified creditor or creditors.[63] Where the court awards sequestration, it appoints at the same time an interim trustee who administers the sequestration process until a permanent trustee ("the trustee") is elected by the creditors or, absent such election, appointed by the court. All the debtor's assets, with limited exceptions, vest in the trustee and the debtor may also be required to make a contribution from income in appropriate cases. The trustee sells or otherwise realises the debtor's assets and distributes the proceeds, together with any contribution from income, amongst the creditors according to their respective rights. There is provision for the election of up to five commissioners (creditors elected by the creditors themselves) who play an important role in advising the trustee and sanctioning certain of his actions; where no commissioners are elected, these functions are carried out by the Accountant in Bankruptcy and/or the court. In certain cases, principally those where there are few or no assets, modified procedures

62. Discharge in sequestration is discussed further below.

63. Qualified creditors are discussed further below.

apply for the purpose of saving time and cost. Unless it is deferred by the court on cause shown following an application by the trustee or a creditor, the debtor will receive an automatic discharge three years after the commencement of sequestration which relieves him of liability for his pre-sequestration debts (with limited exceptions) and also releases him in most cases from the disqualifications, restrictions etc which flow from the sequestration (hereafter referred to for the sake of simplicity as "bankruptcy restrictions").[64] There is also provision for discharge on composition by the debtor at any time after the commencement of the sequestration.[65] The administration of the sequestration itself, however, may continue beyond the debtor's discharge, in which event the debtor has a continuing obligation to cooperate in the sequestration process; on completion of the sequestration process, the trustee also obtains a discharge and the sequestration process is effectively brought to an end.

Sequestration provides the debtor with a fresh start through the mechanism of the automatic discharge even where little or nothing has been paid to creditors. As the First Consultation Paper notes, however, it carries serious legal consequences and restrictions for the debtor[66] as well as the stigma which the proposals for reform are seeking to reduce.[67] It is also viewed primarily as a remedy for creditors, and the debtor's ability to access the sequestration process himself is currently limited, although the proposals include some which may make it easier for debtors to access the sequestration process: these are discussed further below.

III. Proposals for Reform

As noted above, the reform of bankruptcy law is seen as an important step in building a modern and prosperous Scotland.[68] The Second Consultation Paper states, in relation to the proposed reforms to bankruptcy law, that:

> [t]he reform proposals seek to strike a balance between encouraging people to get on with their lives and start again after bankruptcy with the need to protect public and business communities from reckless spending behaviour. Their overall thrust is to encourage personal and business restart whilst upholding a "can pay, should pay" principle.[69]

64. The precise terms of the relevant provision will, however, have to be checked in each case as these vary and release from a particular restriction may not necessarily occur, or occur automatically, on discharge.

65. This is generally known as judicial composition to distinguish it from a composition at common law outwith sequestration as described above.

66. First Consultation Paper, para 2.9.

67. See above.

68. First Consultation Paper, para 1.6. See also the Ministerial Foreword to the Second Consultation Paper, which states that Scotland has proud traditions of fairness and enterprise and expresses the Scottish Executive's intention to build on these so that Scotland will always be "a modern and efficient place to live and to do business in."

69. Second Consultation Paper, para 3.1. Cf the First Consultation Paper which, as noted above, described the proposals as intended to "reduce the stigma of bankruptcy and encourage responsible risk taking while providing a robust and effective regime to protect the public and business community from the small minority of bankrupts who have acted in a fraudulent or culpable manner": First Consultation Paper, para 1.7.

The First Consultation Paper identified two drivers for change in the law of bankruptcy in Scotland which lie behind the current proposals. The first is the importance of having an integrated debt management framework in Scotland within which the debt management tools available work together to form a comprehensive package of solutions.[70] The second is referred to simply as developments, namely the introduction of the DAS and the consequent need to consider its fit with sequestration;[71] the need to consider whether action is still required in relation to issues raised in earlier consultations on apparent insolvency and protected trust deeds;[72] and the significant changes to the law of personal bankruptcy in England and Wales, in particular the reduction of the period of bankruptcy to one year, contained in the Enterprise Act 2002.[73]

The First Consultation Paper sought views on a wide range of possible reforms, including:

- the introduction of a one-year bankruptcy period for all debtors similar to that introduced in England and Wales by the Enterprise Act 2002, but with certain limited exceptions
- changes to the level of debt required as a pre-requisite for sequestration
- changes to the current provisions on contributions from income by the debtor to allow these to continue beyond discharge in a way similar to that provided for in England and Wales by the Enterprise Act 2002 if a one-year bankruptcy period were introduced
- changes to the provisions on apparent insolvency designed to make access to sequestration by the debtor easier
- the integration of bankruptcy and the DAS
- changes to the range of debt management tools available
- the introduction of time limits for dealing with the bankrupt's home and for claiming certain other assets of the bankrupt
- improved monitoring and transparency of protected trust deeds
- the introduction of a bankruptcy restriction order regime similar to that introduced in England and Wales by the Enterprise Act 2002 if a one-year bankruptcy period were introduced
- review of current bankruptcy restrictions
- changes to streamline procedures

These will now be considered in more detail.

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70. First Consultation Paper, para 3.1.

71. *Ibid*, para 3.3. This could equally well be seen as an aspect of the first driver change.

72. *Ibid*, para 3.4. Apparent insolvency is a concept which was introduced by the 1985 Act, s 7 of which sets out various ways in which a debtor may become apparently insolvent: for further detail, see McKenzie Skene, *Insolvency Law in Scotland*, T & T Clark, Edinburgh (1999). A consultation paper entitled *Apparent Insolvency, A Consultation Paper on Amending the Bankruptcy (Scotland) Act 1985* was issued by the Scottish Office in July 1997 and followed by a further consultation paper entitled *The Bankruptcy (Scotland) Act 1985, a Consultation Follow-Up: Protected Trust Deeds and Other Issues* published by the Scottish Office in July 1998, but no legislation resulted.

73. First Consultation Paper, para 3.5. These changes came into force on 1 April 2004.

A. Introduction of a one-year bankruptcy period for all debtors

As indicated above, the current bankruptcy period in Scotland is normally three years, after which the debtor receives an automatic discharge. In the light of the reduction in the normal bankruptcy period from three years to a maximum of one year in England and Wales as a result of the Enterprise Act 2002, however, the First Consultation Paper sought views on a similar reduction in the bankruptcy period to one year in Scotland. It stated that the current three-year regime could be harsh for small business bankrupts and the Scottish Executive wished to encourage those who had failed in business honestly to try again,[74] stimulation of enterprise being important in the context of the Scottish Executive's primary commitment to growth in the Scottish economy.[75] This is essentially the same rationale as that behind the introduction of the reforms in England and Wales.[76] There was, however, an additional consideration in Scotland arising from the changes in England and Wales: the First Consultation Paper took the view that retaining a three-year bankruptcy period in Scotland could potentially disadvantage those running small businesses in Scotland as compared with those in England and Wales and that there was a need, so far as possible, to ensure a level playing field for business throughout the UK, part of which is providing for the adoption of consistent bankruptcy periods.[77]

The reasons for the introduction of a reduced bankruptcy period were thus essentially business-related, but the First Consultation Paper made it clear that it was not intended to restrict the changes to business-related bankruptcies. The reasons given for this were essentially two-fold: firstly, the difficulty of identifying "business-related" bankruptcies and secondly, the creation of a two-tier system which, it was thought, would provide minimal benefits, would complicate other policy areas such as the bankrupt's home, would limit a non-business person's ability to begin again and would not be commensurate with the idea of reducing stigma.[78] This echoed the approach taken in England and Wales, where it had proved very controversial on the basis that consumer debtors raise very different policy issues.[79] The responses to the First Consultation Paper did not disclose the same level of controversy on this particular aspect of the proposals, however, although the proposal for the introduction of a one-year bankruptcy period itself was the proposal on which the views of consultees were most evenly divided.[80]

74. *Ibid*, para 4.3.
75. *Ibid*, para 4.4.
76. See, in particular, *Bankruptcy—A Fresh Start* published by the Insolvency Service in March 2000 ("the English First Consultation Paper") and the White Paper *Productivity and Enterprise—Insolvency: A Second Chance*, Cm 5234 published on July 31, 2001 ("the White Paper"). See also McKenzie Skene, Morally Bankrupt? Apportioning Blame in Bankruptcy, 2004 JBL 171.
77. First Consultation Paper, para 4.4.
78. *Ibid*, para 4.5.
79. Many respondents to the White Paper expressed serious reservations about extending the reduced bankruptcy period to consumer debtors and repeated, although ultimately unsuccessful, attempts were made to amend the provisions of the Enterprise Act 2002 during its passage through Parliament to distinguish between business and consumer debtors in this respect. For a more detailed discussion on this point, see McKenzie Skene, Morally Bankrupt? Apportioning Blame in Bankruptcy, cite note 76.
80. Second Consultation Paper, para 5.4.

The First Consultation Paper acknowledged that it was important to strike the right balance between encouraging people to get on with their lives and start again and the need to protect the public and businesses from "reckless and culpable spending behaviour"[81] and that there were implications for the protection of others in reducing the bankruptcy period which would require appropriate safeguards to be put in place.[82] The Scottish Executive has decided to implement this reform despite the divided views of consultees, believing that the safeguards to be put in place, discussed further below, will meet any concerns[83] and that this will strike the correct balance between reducing the stigma of bankruptcy and encouraging responsible risk taking while providing an effective means of protecting the public and businesses from culpable debtors.[84]

The question of whether the proposals do in fact strike the right balance and provide adequate safeguards is explored further below, but it is notable in this context that the Scottish Executive believes that there are categories of bankrupt who should not automatically qualify for a one-year bankruptcy period. The First Consultation Paper identified two such categories and also sought views on any other categories of debtor for whom the proposed new reduced period of bankruptcy would be inappropriate. The first category identified in the First Consultation Paper was bankrupts who do not cooperate with their trustee, in respect of whom it was proposed that it should remain possible to defer discharge in the same way as discharge may be deferred under the current system.[85] The responses to the consultation showed that there was widespread support for a longer period of bankruptcy for bankrupts who had failed to cooperate with their trustee or were otherwise culpable in various ways,[86] but the Second Consultation Paper now seems to indicate that these categories of bankrupt will be dealt with by way of deferral or a bankruptcy restriction order.[87] This may be compared with the position in England and Wales, where there is provision for suspension of a debtor's discharge where he has failed or is failing to comply with any of his statutory obligations[88] but where failing to cooperate with the official receiver or trustee is also relevant in the context of the bankruptcy restriction order regime introduced by the Enterprise Act 2002, in terms of which it is one of the factors which the court may in particular take into account in deciding whether or not to make a bankruptcy restriction order.[89] The second category identified in the First Consultation Paper was repeat bankrupts, where it was proposed to have an automatic five-year bankruptcy period for individuals who were *either* bankrupt for a third or subsequent time *or* bankrupt for a second time having had a bankruptcy restrictions order made against them in the earlier bankruptcy.[90] The responses to the consultation showed that there was widespread support for a longer period of bankruptcy

81. First Consultation Paper, para 4.4.
82. *Ibid*, paras 4.4, 4.6.
83. Second Consultation Paper, para 5.8, 5.10.
84. *Ibid*, para 5.8.
85. First Consultation Paper, para 4.8. Discharge may currently be deferred on any good grounds, not only for failure to cooperate with the trustee.
86. Second Consultation Paper, paras 5.16, 5.20.
87. *Ibid*, para 5.22, although it is not entirely clear.
88. Insolvency Act 1986, s 279(3).
89. The bankruptcy restriction regime is discussed further below.
90. First Consultation Paper, para 4.9.

for repeat bankrupts,[91] and the Second Consultation Paper now indicates that a five-year bankruptcy period for repeat bankrupts will be provided for in the Bill at introduction.[92] Again, this may be compared with the position in England and Wales, where repeat bankrupts now fall to be dealt with as part of the bankruptcy restriction order regime, in terms of which the court is specifically directed to consider whether the bankrupt was an undischarged bankrupt in the six years preceding the current bankruptcy when deciding whether or not to make a bankruptcy restriction order. It is suggested that although it has superficial attractions, the Scottish Executive's approach to repeat bankrupts lacks logic if the intention is to distinguish between culpable and non-culpable bankrupts since it implies that recurring bankruptcy in itself involves a degree of culpability on the part of the debtor deserving of a longer period of bankruptcy. There may, however, be no such culpability in fact, in which case the automatic imposition of a longer period of bankruptcy would be unfair. If the intention is that a debtor who is a *culpable* repeat bankrupt should be subject to a longer period of bankruptcy, then the logical approach would be for it to remain possible to defer the discharge of such bankrupts as is apparently proposed for uncooperative or other culpable bankrupts. Alternatively, unless the issue of the debtor's discharge from debts, as opposed to his release from bankruptcy restrictions, is seen as critical,[93] repeat bankrupts could be dealt with through the bankruptcy restriction order regime in the same way as in England and Wales. In that way, either a longer period of bankruptcy or bankruptcy restrictions would then be imposed only where this was actually justified by the facts.

B. Changes to qualifying level of debt for sequestration

At present, a creditor (or a number of creditors combining their debts) seeking to present a petition for a debtor's sequestration must, *inter alia*, be due at least £1,500. Similarly, a debtor seeking to petition for his own sequestration must *either* have the concurrence of a creditor or creditors with debts of not less than that amount *or* satisfy a number of other conditions including a requirement that the total amount of his debts is not less than £1,500.[94]

The First Consultation Paper sought views on whether this level should be changed for creditors or debtors or both.[95] Most consultees favoured the limit remaining unchanged and the Scottish Executive agrees, with the result the limit will remain unchanged for the present.[96] The qualifying level of debt is important, however, because it affects access to the sequestration process, although it raises different issues in relation to creditors and debtors in that respect: in relation to creditors, the issue is at what level of debt a creditor should have the right to force a debtor into bankruptcy, with all the consequences which that entails for the debtor—as

91. Second Consultation Paper, para 5.16.
92. *Ibid*, para 5.17.
93. The issue of discharge from debts and its separation from the issue of release from bankruptcy restrictions is discussed further below.
94. These requirements are discussed in more detail below.
95. First Consultation Paper, paras 5.8–5.13.
96. Second Consultation Paper, para 5.67.

the First Consultation Paper recognised, there is a need to strike a balance between protecting debtors from being subjected to bankruptcy for small sums of money and the needs of creditors in debt enforcement[97]—while in relation to debtors the issue is rather at what level a debtor should be able to access the sequestration process and the fresh start it offers for himself, particularly if an earlier discharge from debts is available. The qualifying level of debt must therefore be seen as part of the wider issue of the development of an integrated debt management framework: the qualifying level of debt must be set at the right level to ensure that its effect on access to the sequestration process is consistent with the place which the sequestration process is meant to occupy within that framework.

C. Changes to current provisions on contributions from income by the debtor

At present, income (other than income arising from the estate vesting in the trustee) which the debtor receives between the date of sequestration and discharge, e.g. income from employment, vests in the debtor.[98] The trustee can, however, apply to the court for an order requiring the debtor to make a contribution to the estate from any excess income,[99] although in practice any such contribution is often agreed between the debtor and the trustee without the necessity of going to court. Any contributions, voluntary or otherwise, only continue until the debtor's discharge, however, which means that if the bankruptcy period is reduced, the period within which contributions fall to be paid will also be reduced, with a corresponding loss to creditors, unless provision is made for contributions to continue after discharge.[100]

In England and Wales, the Enterprise Act 2002 made provision for contributions from income to be made by a debtor for a period of up to three years from the date of the income payments agreement or order under which the contributions fall to be paid notwithstanding the debtor's earlier discharge, and the First Consultation Paper sought views on whether voluntary contribution agreements and contribution orders should be extended beyond discharge in Scotland also.[101] It also sought views on whether, if this were provided for, the period of contributions should be fixed or variable and the length (or maximum length in the case of variable contributions) of the period which would be appropriate in either case.[102] The majority of consultees were in favour of extending the period within which income contributions should be exigible beyond discharge,[103] although there was no consensus on whether that period should be fixed or variable.[104] It is now therefore intended that the period during which contributions will be exigible will extend beyond the debtor's discharge, but that such payments will be made for a maximum period of three years.[105]

97. First Consultation Paper, para 5.9.
98. 1985 Act, s 32(1).
99. 1985 Act, s 32(2). "Excess income" is income over and above the sum which the court considers suitable for the debtor's own aliment and any "relevant obligations" he may have; "relevant obligations" are aliment, periodical allowance and child support under the Child Support Act 1991.
100. See First Consultation Paper, para 5.16.
101. *Ibid*, para 5.16.
102. *Ibid*, Discussion points 4b–4d.
103. Second Consultation Paper, para 5.23.
104. *Ibid*, para 5.27.
105. *Ibid*, paras 5.24, 5.28.

Extending the period of contribution beyond discharge will, of course, impact on the debtor's fresh start, and it may be asked what a debtor will gain in practice in terms of a fresh start by a reduced bankruptcy period if he still has to make income contributions for three years which is the normal bankruptcy period at present (although part of the answer to this may be found in the position with respect to after-acquired property, as opposed to income, which is discussed further below). Nonetheless, it is suggested that an extension beyond the one-year bankruptcy period is justified in terms of providing a fair balance between the interests of debtors and creditors and the proposals seem to strike a reasonable balance in this respect.

These proposals also impact on the relative attractiveness of sequestration and the other alternatives open to debtors, and it is suggested that this must be considered as part of the wider issue of the development of an integrated debt management framework in order to ensure that their effect on the relative attractiveness of the options available fits with the place which sequestration is meant to occupy within that framework. The First Consultation Paper took this on board to an extent by recognising the need to consider the interface between bankruptcy and the DAS, noting that it would seem odd to require contributions in sequestration for a shorter period of time than would have been required if the debtor had entered a DAS,[106] although it might be argued that one is not comparing like with like in that in sequestration, the debtor will have had to give up his non-exempt assets (if any), whereas in a DAS, he would not normally have had to do so.[107] Restricting the contribution period in sequestration to a maximum of three years, however, may have exactly this result, since there is no maximum time limit on payments under the DAS. The integration of the various debt management tools is discussed further below.

Although the proposals address the effect of a reduced bankruptcy period on income contributions by the debtor, neither the First nor the Second Consultation Paper address the issue of its effect on after-acquired property. At present, subject to certain provisos, property acquired by the debtor between the date of sequestration and his discharge falls into the sequestration, so if the bankruptcy period is reduced, the period within which after-acquired property falls into the sequestration will also be reduced, with a potential corresponding loss to creditors, unless provision is made for after-acquired property to continue to be acquired after discharge. No such proposals are made in relation to after-acquired property in either the First or Second Consultation Papers, however, and this mirrors the position in England and Wales, where the Enterprise Act 2002 made no provision for after-acquired property equivalent to that made for contributions to income. This has a potentially significant effect on both the creditors and the extent of the debtor's fresh start.

106. First Consultation Paper, para 5.17.

107. The DAS does contain provision for the debtor to realise non-exempt assets to contribute to the payments under the scheme in appropriate cases, but in general terms it is intended to be a tool for those who have no other assets which could be used to pay the debts but can pay back their debts from income over time or who do have assets but wish to avoid losing them and to pay back their debts from income over time instead.

D. Changes to the provisions on apparent insolvency

As noted above, at present sequestration is viewed primarily as a remedy for creditors, and the debtor's ability to access the sequestration process himself is limited. At present, an individual debtor may only petition for his own sequestration *either* with the concurrence of a qualified creditor[108] *or* where certain other conditions are satisfied, namely that the total amount of his debts (including interest) is not less than £1,500; there has been no previous award of sequestration against him in the preceding five years; and *either* he is apparently insolvent *or* he has granted a trust deed which has failed to become protected.[109] It is the last of these conditions which has proved to be problematic for debtors seeking to access the sequestration process without the concurrence of a qualified creditor. Most debtors wishing to petition for their own sequestration in those circumstances would be seeking to rely on their apparent insolvency as a means of fulfilling that condition. The First Consultation Paper noted, however, that in the past, establishing apparent insolvency for this purpose had been problematic for some debtors.[110] Some changes to the provisions on apparent insolvency making it easier to establish in some cases have recently been made[111] but the First Consultation Paper sought views on whether establishing apparent insolvency remained problematic and on further proposed changes to the provisions on apparent insolvency to make it easier to establish in other cases,[112] which would then make it easier for a debtor to access the sequestration process himself. A large majority of consultees were in favour of further changes, and it is therefore intended to introduce some further changes, although the Second Consultation Paper is seeking further views on certain aspects of these.[113] In addition, a working group is being set up to consider, *inter alia*, apparent insolvency, including the issue of whether it should remain a pre-requisite for sequestration at all in any or all of those cases where it is presently required.[114] This issue also requires to be considered as part of the wider issue of the development of an integrated debt management framework in order to ensure that the effect of any changes to the provisions on apparent insolvency on ease of access to the sequestration process fits with the place which sequestration is meant to occupy within that framework.

E. Integration of bankruptcy and the DAS

This was mentioned above in the context of contributions from income, but was also addressed separately by the First Consultation Paper, which expressed the view that while bankruptcy would continue to be the most appropriate solution

108. 1985 Act, s 5(2).
109. 1985 Act, s 5(2), (2B).
110. First Consultation Paper, para 6.3.
111. *Ibid*, para 6.4.
112. *Ibid*, Discussion points 6a–6d. The proposals included providing for apparent insolvency to be constituted on the failure of a DPP in order to provide for articulation between sequestration and the DAS in this respect; in fact, the DAS regulations already make provision for apparent insolvency to be constituted where a DPP is revoked: see reg 46.
113. Second Consultation Paper, paras 7.1–7.7.
114. *Ibid*, paras 7.3, 7.10.

for some debtors, it would be better for those who were suitable to enter the DAS to do so.[115] This was because a debtor with surplus income would have to make contributions from such income in sequestration anyway and would in addition have to experience the other consequences of sequestration which would be avoided by the DAS.[116] The First Consultation Paper accordingly sought views on whether it would be useful to divert debtors in the early stages of bankruptcy to the DAS if they met the criteria for the DAS,[117] irrespective of who had initiated the petition for sequestration.[118] It also considered how that could be achieved, and in particular sought views on how far the system should go to steer debtor behaviour beyond the provision of advice.[119] Consultees generally supported the idea of encouraging suitable debtors to enter a DAS, but there was less consensus on an appropriate mechanism[120] and the Second Consultation Paper therefore indicates that it is not proposed to impose any further conditions on a debtor in this respect.[121] The problem of leaving the matter purely to debtor choice, however, is that the reforms to sequestration might be seen as making it more attractive than the other options while at the same time making it more accessible to debtors with the result that debtors will always choose sequestration where possible. The working group referred to above will also therefore consider whether debtor choice in respect of debt relief or management measures should be further restricted and, if so, how and this further consideration of this critical issue is to be welcomed.

F. Changes to the range of debt management tools available

As noted above, the First Consultation Paper emphasised the need to provide a comprehensive debt management framework with debt solutions for all[122] and accordingly sought views on whether there were people for whom the existing and planned solutions do not work or are not accessible.[123]

On the face of it, the range of available solutions would seem to cater for most situations: all debtors may attempt voluntary arrangements with their creditors; for debtors who have assets, irrespective of their income position, a trust deed may be suitable; for debtors who have an income, irrespective of their assets position, the DAS may be suitable; and there is the formal process of sequestration. However, it was noted above that concern has been expressed that the DAS will be inaccessible to low income debtors who are unlikely to have sufficient surplus income to make repayments in the way envisaged by the DAS[124] and the Second Consultation

115. First Consultation Paper, para 6.10.
116. *Ibid*, para 6.15.
117. *Ibid*, para 6.15.
118. See *Ibid*, paras 6.16–6.20.
119. *Ibid*, paras 6.16–6.20.
120. Second Consultation Paper, para 5.69. One possibility would have been to divert debtors away from sequestration to a more appropriate solution by making it a condition of a debtor petition for sequestration that an alternative solution had previously been attempted but failed through no fault of the debtor's *or* that there was no suitable alternative in the circumstances.
121. *Ibid*.
122. See, in particular, First Consultation Paper, para 6.24.
123. *Ibid*, para 6.26. The other side of the coin is whether all of these solutions are in fact necessary and the working group referred to above is to consider, *inter alia*, whether the range of measures should be simplified, for example because of overlap between the DAS and protected trust deeds.
124. *On the Cards: The debt crisis facing Scottish CAB clients*, Executive Summary and para 124.

Paper acknowledges that there are a number of debtors on low incomes for whom none of the existing solutions may be accessible or appropriate.[125] The Second Consultation Paper states that the Scottish Executive is not attracted to the idea of a separate scheme for debtors with little or no assets or income but acknowledges that the matter requires further consideration and the working group referred to above is therefore to consider this issue.[126]

It is suggested that there is another gap in the current provision: there is no rescue-oriented procedure for trading debtors, and while some of the existing solutions can be utilised to effect the rescue of a business, none are specifically designed to do so. This is not mentioned in either the First or the Second Consultation Paper, but given that so much emphasis is being placed on encouraging entrepreneurship, it might be appropriate to consider whether a rescue-type procedure for trading debtors would be appropriate.[127]

G. Introduction of time limits for dealing with the bankrupt's home and for claiming certain other assets of the bankrupt

At present, although the Accountant in Bankruptcy's Guidance Notes for Trustees encourage the trustee to deal with the debtor's home as quickly as possible, there is no legal time limit for doing so and the First Consultation Paper therefore sought views on the possible introduction of a three-year time limit for dealing with the debtor's home[128] which could be extended in appropriate circumstances.[129] Although the First Consultation Paper did not refer to it, a similar provision was included in the Enterprise Act 2002 for England and Wales and the majority of consultees were in favour of this proposal.[130] The First Consultation Paper did not indicate what would happen to the home if it was not dealt with within the three-year period or any extension thereof, but the Second Consultation Paper makes it clear that the intention is that the debtor's interest in the home will revert to him if the trustee has not commenced dealing with it within three years of the date of the bankruptcy or the date of discovery of its existence.[131] This may assist the debtor in his fresh start but of course also has implications for the creditors, who will then lose any potential return from this asset.

The First Consultation Paper also noted that it is also the case at present that where the debtor is named as a beneficiary in a will or trust before or during

125. Second Consultation Paper, para 7.8. In its report *On the Cards: The debt crisis facing Scottish CAB clients*, Citizens Advice Scotland took the view that some clients would never be in a position to repay their debts due to the sheer scale of the debt and factors such as their age and little prospect of change in their financial circumstances: see in particular paras 118, 133.

126. Second Consultation Paper, para 7.10.

127. The problem is probably most acute in the case of partnerships, to which the DAS will not apply, while this paper is concerned with individual debtors; however, it is suggested that individual business debtors do raise different issues from consumer debtors in a number of respects e.g. the need to keep employees and secure supplies in order to keep a business running, and there might therefore be benefit in considering a rescue-oriented procedure which would include sole traders as well.

128. First Consultation Paper, para 7.3.

129. *Ibid*, para 7.4.

130. Second Consultation Paper, para 5.30.

131. *Ibid*, para 5.31.

sequestration, his rights vest in the trustee and remain vested in the trustee notwithstanding his discharge and that the effect of this on the debtor can be harsh where these rights materialise perhaps many years after discharge.[132] The First Consultation Paper therefore sought views on the possible introduction of a time limit for the trustee being able to "claim" these rights[133] and on the appropriate length of any such time limit.[134] The majority of consultees were in favour of the introduction of such a time limit and it is therefore intended to introduce one, which the Scottish Executive has decided will be linked to the debtor's discharge.[135] As with the debtor's home, the First Consultation Paper did not indicate what would happen to the relevant rights at the end of the period, but the Second Consultation Paper makes it clear that the intention is that the relevant rights will revert to the debtor if they have not been realised by the time of his discharge.[136] The relevant rights will include legitim and rights arising under a revocable deed such as the will of a person who is alive, but will not include rights arising under an irrevocable deed such as an established trust.[137] Again, this may assist the debtor in his fresh start but has implications for the creditors, who will then lose their potential return from these assets. The First Consultation Paper noted that the question was one of balance,[138] but whether the balance has been struck in the right place may be a matter of debate: the Second Consultation Paper took the view that the time limit in this case need not be the same as the time limit for the debtor's home,[139] but leaving issues of consistency apart, a three-year time limit might arguably be seen as more nearly striking the appropriate balance than the limit now proposed.

H. Improved monitoring and transparency of protected trust deeds

As noted above, trust deeds for creditors generally operate in much the same way as sequestration but without some of its formalities, and as they avoid some of the more serious consequences of sequestration, may be seen as an attractive option by a debtor. The First Consultation Paper noted that the number of protected trust deeds has grown significantly and in 2002/3 considerably exceeded the number of sequestrations.[140] The use of trust deeds is likely to be affected by the introduction of the DAS, but precisely how is obviously not yet known.[141] Against that background, the Scottish Executive believed that this was an opportune time to consider improvements in the transparency and monitoring of protected trust deeds.[142] The proposed reforms in this respect are not considered in detail here with the exception of one which has a particular bearing on the issue of a fresh start for the debtor. The First Consultation Paper identified amongst other concerns previously

132. First Consultation Paper, para 7.5.
133. *Ibid*, para 7.8. It is suggested that the use of the term "claim" was misleading, since the rights are vested in the trustee; the use of the term "retain" might have reflected the proposed position more accurately.
134. *Ibid*, paras 7.9–7.10.
135. Second Consultation Paper, paras 5.32, 5.33.
136. *Ibid*, para 5.33.
137. *Ibid*, para 5.35.
138. First Consultation Paper, para 7.8.
139. Second Consultation Paper, paras 5.34.
140. First Consultation Paper, para 8.2.
141. *Ibid*, para 8.2.
142. *Ibid*, para 8.2.

expressed about protected trust deeds the concern that not all protected trust deeds are for the benefit of creditors and a number of them appear to be designed simply to save the debtor from the more serious consequences of sequestration.[143] In consequence, the First Consultation Paper included amongst its proposed reforms to protected trust deeds a proposal which would effectively result in protection being refused to a trust deed where, *inter alia*, the prospect of a reasonable dividend for the creditors cannot be demonstrated.[144] The proposed reforms, including this one, were widely supported by consultees and are to be implemented accordingly.[145] Such a provision will clearly limit the use of this mechanism as a means of providing a debtor with a fresh start to those cases where there are sufficient assets and/or income to allow a reasonable dividend for creditors (however that might be defined) to be paid.

I. Introduction of a bankruptcy restriction order regime

It was noted above that the First Consultation Paper acknowledged the importance of striking the right balance between encouraging people to get on with their lives and start again and the need to protect the public and businesses from reckless spending behaviour[146] and that there are implications for the protection of others in reducing the bankruptcy period which require appropriate safeguards to be put in place.[147] This is echoed in the Second Consultation Paper.[148] The First Consultation Paper went on to consider what protection mechanisms were required and in particular how to continue controls on bankrupts who had acted in a potentially fraudulent or culpable manner[149] and in that context sought views on the possible introduction of a bankruptcy restriction order regime for such bankrupts.[150] Such a regime was introduced by the Enterprise Act 2002 in England and Wales as a counterpart to the reduced bankruptcy period introduced there.[151]

The First Consultation Paper did not contain any detailed proposals as to how such a regime would operate in Scotland, but it was clear that it was intended in principle to achieve the same effects as the regime in England and Wales although such details as were contained in the First Consultation Paper suggested that the mechanisms might be slightly different. In particular, while an application for a bankruptcy restriction order in England and Wales is made by the Secretary of State, the First Consultation Paper contemplated the application for a bankruptcy restriction order in Scotland being made by the trustee, albeit with a requirement to obtain the approval of the Accountant in Bankruptcy as to the proposed length of the order before proceeding to court with a view to maintaining consistency in

143. See *Ibid*, para 8.5 referring to the concerns regarding protected trust deeds identified in a previous First Consultation Paper entitled *The Bankruptcy (Scotland) Act 1985, a Consultation Follow-Up: Protected Trust Deeds and Other Issues* published by the Scottish Office in July 1998.
144. First Consultation Paper, para 8.7.
145. Second Consultation Paper, paras 6.3, 6.4.
146. First Consultation Paper, para 4.4.
147. *Ibid*, paras 4.4, 4.6.
148. Second Consultation Paper, paras 3.1, 5.8.
149. *Ibid*, para 9.5.
150. First Consultation Paper, para 9.6.
151. The broad outline of the regime in England and Wales is described in the First Consultation Paper at paras 9.1–9.4.

the length of orders.[152] The Second Consultation Paper, however, provides for the application to be made by the Accountant in Bankruptcy, although it states that the decision to apply will be made by the trustee,[153] which is more appropriate for two reasons: firstly, for the sake of consistency and secondly, because since the application is essentially one in the public interest rather than directly for the benefit of creditors, it does not seem appropriate that the cost of such an application should be borne by the creditors rather than the public purse.

The First Consultation Paper proposed not to introduce bankruptcy restriction undertakings, which are part of the regime in England and Wales, unless consultees specifically recommended this be considered.[154] No reason was given for this approach, but it did not seem sensible to eschew the use of undertakings which could substantially reduce the time and costs involved in obtaining the protection to be provided by the regime, and the Second Consultation Paper indicates that it is now intended to introduce bankruptcy restriction undertakings alongside bankruptcy restriction orders.[155]

A bankruptcy restriction order regime effectively separates the issue of discharge from liability for debts from that of release from bankruptcy restrictions. At present, as was seen above, a bankrupt's discharge both relieves him of liability for his pre-sequestration debts (with limited exceptions) and also releases him in most cases from bankruptcy restrictions. Under a bankruptcy restriction order regime, however, while a bankrupt who has no bankruptcy restriction order made against him will continue to be both relieved of liability for his pre-sequestration debts and released from bankruptcy restrictions by his discharge, a bankrupt who has a bankruptcy restriction order made against him will be relieved of liability for his pre-sequestration debts by his discharge but will not be released from the bankruptcy restrictions which flow from the bankruptcy restriction order. Two important related issues arise from this: the first is whether this is an appropriate way of dealing with what are hereafter described as "blameless" and "blameworthy" bankrupts; the second is the appropriate criteria for distinguishing between them.

With regard to the first issue, the concept of a bankruptcy restriction order regime seems to have been accepted in principle without much demur in England and Wales, although concerns were raised there about various aspects of its operation,[156] and the same is true in Scotland.[157] There does not seem to have been a great deal of discussion, however, about the resultant separation of the issue of discharge from liability for debts from that of release from bankruptcy restrictions. It is interesting to note in this context, however, that, as discussed above, the Scottish Executive has proposed that repeat bankrupts should be subject to a longer period of bankruptcy (not a bankruptcy restriction order), although it is not entirely clear whether the fact that the debtor would thereby remain not discharged from his

152. *Ibid*, para 9.7. The First Consultation Paper also sought views on the appropriate minimum and maximum length of orders, with one possibility being the 2–15 years adopted in England and Wales: see para 9.7.
153. Second Consultation Paper, para 5.4.
154. First Consultation Paper, para 9.6.
155. Second Consultation Paper, para 5.37.
156. For a more detailed discussion on this point, see McKenzie Skene, Morally Bankrupt? Apportioning Blame in Bankruptcy, cite note 76.
157. Second Consultation Paper, para 5.37.

debts (as well as not released from bankruptcy restrictions) was part of the rationale for adopting that approach nor why, if it was, this category of bankrupt in particular should merit differential treatment in this respect. It is suggested, therefore, that this issue would merit further analysis. With regard to the second issue, in England and Wales, it is provided that the court shall grant an application for a bankruptcy restriction order "if it thinks it appropriate having regard to the conduct of the bankrupt (whether before or after the making of the bankruptcy order)" and there is a non-exhaustive list of types of conduct by a bankrupt which the court is directed in particular to take into account in reaching its decision and which includes types of conduct relevant to both business and consumer debtors.[158] The First Consultation Paper gave no indication as to what form the Scottish provisions for the making of a bankruptcy restriction order might take nor, apart from describing as typical examples of the situations in which a bankruptcy restriction order might be made in England and Wales some of the types of conduct included in the non-exhaustive list referred to above,[159] did it really give any indication of the types of conduct which might lead to a bankruptcy restriction order in Scotland beyond some rather vague references to conduct such as "reckless and culpable spending behaviour"[160] and bankrupts who have acted in a "potentially fraudulent or culpable manner."[161] Yet the definition of the types of conduct which might lead to a bankruptcy restriction order is critical, given that the making of a bankruptcy restriction order would (intentionally) have a considerable impact on a bankrupt's ability to make a fresh start following bankruptcy. It may be observed that such language as was employed in this context in the First Consultation Paper suggested that the kind of conduct which was likely to be seen as meriting a bankruptcy restriction order was *morally culpable* conduct. That would have raised difficult issues: in the past, when engaged in the similar exercise of determining whether a debtor should receive a discharge or not, the Scottish courts have taken into account a wide variety of conduct not all of which could be described as morally culpable.[162] The Second Consultation Paper now makes clear, however, that the bankruptcy restriction order regime is intended to cover a wide variety of conduct of both trading and consumer debtors[163] and the provisions of the draft bill in fact mirror the provisions introduced in England and Wales which are not restricted to what might be described as morally culpable conduct. There is, however, undoubtedly still room for debate about what should and should not be considered conduct meriting a bankruptcy restriction order, perhaps particularly in relation to consumer debtors, and it will ultimately be for the courts to decide this, resulting perhaps in initial uncertainty.

158. Insolvency Act 1986, Sch 4A as added by the Enterprise Act 2002, Sch 20.

159. First Consultation Paper, para 9.4. The types of conduct there mentioned are: failure to maintain business accounting records; failure to account satisfactorily for any loss or deficiency of assets; culpable neglect of business; and incurring any bankruptcy debt without reasonable expectation of being able to pay it.

160. First Consultation Paper, para 4.4.

161. *Ibid*, para 9.5.

162. For a more detailed discussion of this issue, see McKenzie Skene, Morally Bankrupt? Apportioning Blame in Bankruptcy, cite note 76.

163. Second Consultation Paper, paras 5.36, 5.39.

J. Review of current bankruptcy restrictions

The First Consultation Paper noted that at present, there are a significant number of disqualifications which apply to a bankrupt irrespective of the cause of his sequestration; these disqualifications do not distinguish on the basis of culpability and many of them are historical and unrelated to financial matters.[164] It went on to indicate that the Scottish Executive was minded to develop a more focused approach and remove outdated disqualifications which confer stigma without offering public protection while retaining provision to apply disqualifications when appropriate[165] and sought views on whether such an approach would be supported generally. It also noted that it would be necessary to consider what disqualifications should flow from a bankruptcy restriction order if a bankruptcy restriction order regime were introduced in Scotland.[166]

The First Consultation Paper also sought immediate views on two of the current disqualifications which automatically flow from bankruptcy, namely serving as a Justice of the Peace (where the automatic restriction has been removed in England and Wales) and serving as a member of a local authority (where the automatic restriction has been removed in England and Wales and replaced by a restriction on so acting if subject to a bankruptcy restriction order) and asked for views on other automatic disqualifications which should be removed from or applied to bankrupts or those subject to a bankruptcy restriction order.[167]

From the point of view of offering a debtor a fresh start, it certainly makes sense to review the current bankruptcy restrictions with a view to determining which remain valid and which can be either wholly dispensed with or replaced with a reference to the making of a bankruptcy restriction order. It is, however, important to be clear about what constitutes a valid reason for imposing a restriction, whether that flows from the mere fact of bankruptcy or from the making of a bankruptcy restriction order: one reason might be financial, another might relate to public expectations of those holding public office. In the latter case at least, any restriction might more appropriately flow from the making of a bankruptcy restriction order rather than the mere fact of bankruptcy, although this might depend on the way in which conduct meriting a bankruptcy restriction order is ultimately defined. The Second Consultation Paper does not really address this issue, although it certainly adopts a radical approach to the existing disqualifications. In particular, it intends that the only disqualifications flowing automatically from bankruptcy itself will be disqualification from acting as a company director and disqualification from acting as an insolvency practitioner[168] and any other disqualifications which are considered appropriate will be linked to the bankruptcy restriction order regime.[169]

164. First Consultation Paper, para 9.10.
165. *Ibid*, para 9.11.
166. *Ibid*, para 9.11.
167. *Ibid*, para 9.12.
168. Second Consultation Paper, para 5.46.
169. *Ibid*, paras 5.45–5.52. Some specific disqualifications which it is intended should be linked to the bankruptcy restriction order regime are identified in the Second Consultation Paper itself and provision is made for further changes in this area to be made by secondary legislation to allow review of the whole area as appropriate: Second Consultation Paper, para 5.50.

One important restriction which a bankrupt is currently subject to is the requirement to disclose his status as a bankrupt before obtaining credit over a certain level, currently £250.[170] The First Consultation Paper noted that this limit was set to be increased to £500 in England and Wales[171] and sought views on whether there should also be an upward adjustment of the current limit in Scotland.[172] The majority of consultees were in favour of the credit limit being increased to £500 and it is therefore intended to implement this.[173] The First Consultation Paper also sought views on whether there should be a total credit limit applied to bankrupts in Scotland, since the present system does not prohibit obtaining credit from multiple sources.[174] Again, the majority of consultees were in favour of this and it is therefore intended to introduce a total credit limit which would require an undischarged bankrupt to inform a lender of his status irrespective of the amount of credit sought in the particular case if that limit had been reached or would be exceeded by the borrowing;[175] a total credit limit of £1,000 has been provisionally suggested, but further views on the appropriate level are sought.[176] Raising the current credit limit could be seen as facilitating a fresh start for a debtor, while imposing a total credit limit could be seen as restricting it; it is not intended, however, to prohibit debtors from taking out further credit in excess of a specified amount, only to provide for the appropriate disclosure,[177] although there might be something to be said for the former approach. On a practical level, however, it is suggested that this provision will be difficult to police.

K. Changes to streamline procedures

Finally, the First Consultation Paper made a number of proposals for streamlining procedures which were supported by the majority of consultees and which the Second Consultation Paper states will be introduced accordingly. These include consolidating all bankruptcy proceedings in the sheriff court but providing for debtor petitions for sequestration to be processed by the Accountant in Bankruptcy rather than the court; combining the roles of interim and permanent trustee in sequestration; and streamlining the procedure for judicial composition to minimise court time and expense. They are not considered in detail here since, with the possible exception of the proposed improvements to the judicial composition procedure, they do not directly impact on the question of the debtor's fresh start, but to the extent that the bankruptcy process is streamlined, this would seem generally to be to the benefit of all involved.

170. First Consultation Paper, para 9.13.
171. In fact, this has now been achieved by the Insolvency Proceedings (Monetary Limits) (Amendment) Order 2004, SI 2004/547 which came into force on 1 April 2004.
172. First Consultation Paper, para 9.14.
173. Second Consultation Paper, para 5.53.
174. First Consultation Paper, para 9.15.
175. Second Consultation Paper, paras 7.13, 7.14.
176. *Ibid*, para 7.15. It should be noted that it is intended that credit incurred in respect of what is described as essential utilities such as gas, electricity, water and council tax should be excluded from the calculation of both the single-lender credit limit and the total credit limit: see para 5.54.
177. *Ibid*, para 7.14.

IV. Conclusions

Debt is a feature of modern life and it is now generally recognised that there is a need to provide solutions for over-burdened debtors to allow them in appropriate circumstances to make a fresh start.

Scots law provides a number of possible solutions for over-burdened debtors ranging from voluntary arrangements with creditors through the new DAS and trust deeds for creditors to sequestration. In the light of the need to develop an integrated framework for debt management within which the available solutions will work together and provide a comprehensive set of solutions for debtors and of other developments, in particular the changes to the law of personal bankruptcy in England and Wales brought about by the Enterprise Act 2002, the Scottish Executive has brought forward proposals for reform of the law of personal bankruptcy in Scotland.

The main elements of the proposed reforms are similar to the main elements of the reforms to the law of personal bankruptcy in England and Wales contained in the Enterprise Act 2002: a reduction in the period of bankruptcy, the introduction of a bankruptcy restriction order regime for blameworthy bankrupts and a review of bankruptcy restrictions. As in England and Wales, the intention is to encourage enterprise by making it easier for those who have failed in business honestly to try again while protecting the public from blameworthy bankrupts. A number of points arise, however. Firstly, the proposed reforms are not confined to business debtors, although it is arguable that consumer debtors raise different policy issues. Secondly, there is room for debate on the issue of what type of conduct will merit a bankruptcy restriction order and it will ultimately be for the courts to decide this, resulting perhaps in initial uncertainty. Thirdly, there may be room for debate about whether the correct balance has been struck between the interests of debtors and the interests of creditors in relation to contributions from income, after-acquired property and the treatment of debtor's home and certain other assets in the sequestration. Fourthly, the question of whether the right approach been taken, and the correct balance struck, in relation to protection of the public may bear further analysis. Finally, although the argument for having a level playing field across the UK is a strong one, it could equally be argued that it might have been preferable to wait and see how the reforms worked in practice in England and Wales before following the same road in Scotland.

So far as the development of an integrated debt management framework is concerned, a number of issues arise here also. Firstly, the proposals concentrate on the interface between sequestration and the DAS, and in particular the need to divert debtors away from sequestration to the DAS where possible. Without some means of compelling this, however, it may be difficult to achieve in practice, particularly since the proposed reforms to sequestration may make it seem a more attractive option for debtors, and the proposals which would make debtor access to sequestration easier would open this option up to more debtors. Furthermore, little attention has been given to the other alternatives to sequestration and how they might fit into an integrated framework although, for example, a trust deed might be an appropriate alternative to sequestration in cases where the DAS would not and a debtor could equally well be diverted away from sequestration to a trust deed. Secondly, although on the face of it the range of solutions available to debtors seems to cater for most situations, there are questions about accessibility which it has been acknowledged require to be explored further and it is suggested that a rescue-oriented procedure for trading debtors might also be considered. It is therefore welcome that further consideration is to be given to the issue of whether to restrict debtor choice and also the issues of accessibility and the range of available measures, although this does not appear to extend to the possibility of a rescue-oriented procedure for trading debtors.

On the whole, therefore, while the emphasis on providing appropriate solutions for over-burdened debtors with a view to enabling them to make a fresh start evidenced by the Scottish Executive's proposals is to be welcomed, it is suggested that they may not yet have struck quite the right balance in this respect.

