

## Bankruptcy and Diligence (Scotland) Act 2007

In January 2007 The Scottish Parliament passed The Bankruptcy and Diligence (Scotland) Act 2007.

The largest piece of legislation embarked upon by the Parliament to date the policy objective for the reforms are to modernise the laws of Scotland's personal bankruptcy and diligence (judgement enforcement). By so doing the intention is to strike a better balance between the rights of creditors and debtors as well as supporting business risk. Whilst the Act has received Royal assent dates for its full implementation will only be publicised after this May's Scottish Parliamentary elections.

### Bankruptcy Reform

Keeping Scotland in line with The Enterprise Act 2002 has meant reducing the period of Bankruptcy from three to one year. The laudable aim for this is based on the principle of encouraging business restart after bankruptcy. However it is probably true to say this has been based on a false premise. Whilst we are all aware of situations when a business proprietor has been made bankrupt as a result of inadvertence, possibly justifying a reduced period of bankruptcy, the reality is that the vast majority of bankruptcies are generated by consumer debtors who have become hopelessly insolvent. It is largely this type of debtor who will be able to take advantage of the relaxed bankruptcy regime in the same fashion as 'the business' bankrupt. The success of the Act's operation will depend largely upon the Accountant in Bankruptcy's (a civil servant) ability to 'police' it.

Following the theme of 'insuring bankrupts pay' the Act introduces Income Payment Arrangements and Income Payment Orders which will last a maximum period of three years and hence survive after the bankrupt's discharge. The Income Payment Arrangement will take the form of a voluntary agreement between the debtor and the trustee in bankruptcy whereby the debtor voluntarily agrees to make contributions towards the bankrupt estate. In a situation where a voluntary agreement cannot be made the trustee is able to apply to the court for an Income Payment Order.

In an effort to ensure the public will be protected from 'culpable' debtors two new forms of restriction are introduced, being a Bankruptcy Restriction Order and Bankruptcy Restriction Undertaking lasting between two to fifteen years. In common with the Income Payment Undertaking/Order in surviving the bankrupt's discharge, the new regime is intended to provide a method of dealing with those debtors who represent a risk to public or commercial interests. They will cover a wide variety of conduct for both trade and consumer debtors. The 'undertaking' will be a voluntary arrangement between the debtor and trustee failing which application can be made to the court for an appropriate 'order'. In making the order the court shall, in particular, take into account a whole host of bad practice including a failure to keep records which account for a loss of property, failure to co-operate with the trustee in bankruptcy, creating an unfair preference as well as making an excessive pension contribution. The carrying on of gambling, speculation or extravagance, which could have materially contributed to the bankrupt's debt, will also be subject to the court's scrutiny.





Whilst the period of bankruptcy has been reduced to one year, the financial limit for bankruptcy has been raised from £1,500 to £3,000. This is to bring it in line with the brand new Land Attachment, which will be incompetent for debts of less than £3,000. The reasoning behind this is to encourage the less draconian Land Attachment rather than bankruptcy. If the bankruptcy limit were to be less than the Land Attachment equivalent the Parliament were concerned creditors would be tempted to bankrupt the debtor rather than attempt land attachment. Whilst the reasoning is sound there will be many raised eyebrows that this puts us out of step with England - although one would argue that this is what devolution is all about - the right of the Scots to be different!

### Protected Trust Deeds

Scotland's approximate equivalent to England's individual voluntary arrangements are protected trust deeds. They have been subjected to much criticism largely because the amount of return to creditors has been seen to be particularly low. In an effort to make trust deeds more palatable the Scottish Executive initially proposed trust deeds would only be competent if the anticipated dividend creditors would receive would be 25%. However this was vehemently opposed by the insolvency practitioner lobby who were able to persuade The Scottish Executive that, in many circumstances, the protected trust deeds gave creditors a better monetary return than bankruptcy. The insolvency practitioners also argued that trust deeds played a vitally important role in providing debt relief. Their argument was that in many instances debtors would be unable to comply with the strict criteria for them to be made bankrupt (known as "notour bankruptcy"), from which an individual ultimately has their debts 'written off'. The argument put forward was if it was incompetent for these many unfortunates to be made bankrupt, and if they would then be unable to enter a trust deed because of the high dividend threshold, then many thousands of Scottish debtors would be unable to take advantage of the debt relief which the protected trust deed offered.

A fairly rigorous debate developed with many confusing statistics being introduced by different parties. As the issue was not finally resolved, and because the whole issue was perhaps more complex than the Executive had initially thought, the result is the Act does not specifically legislate on how trust deeds will be addressed. Instead, the Act introduces a section entitled "modification of provisions relating to trust deeds" which basically states that the Parliament may, by Regulations, make provision to the various conditions which require to be fulfilled in order for a trust deed to be granted, including the remuneration payable to trustees as well as the rights of any creditor who does not accede to a trust deed which is granted protected status.

### Low Income Low Asset Debtors

In a situation where a debtor has a low level of income and a minimum amount of assets the Act gives the Parliament power to make Regulations setting out how such individuals will be able to achieve debt relief via the bankruptcy route. What the Parliament is desperate to avoid is the situation whereby significant numbers of consumer debtors are ineligible for the debt relief which bankruptcy, the protected trust deed, or The Debt Arrangement Scheme could provide. As yet these Regulations have not been formalised but it is fair to say, from a creditor's perspective, the chances of them making any financial recovery against this group of debtors will be remote in the extreme.

## Sheriff Officer Reform

The office of Sheriff Officer and Messenger at Arms are to be abolished and replaced by a single tier 'Judicial Officer'. In addition the Act provides for the creation of a new statutory body to be known as 'The Scottish Civil Enforcement Commission'. The Commission will take over the functions of The Court of Session in respect of the regulation of Sheriff Officers as well as their training and procedures to be adopted by them, including their appointment and the investigation of any alleged misconduct.



## Land Attachment

Following upon the concept of "universal attachability" (meaning no Scottish property should be immune from enforcement) there will be introduced into Scotland the new diligence of 'Land Attachment'. Land attachment will apply to specific property, including a dwelling house, for a period of 5 years. Incompetent for debts less than £3,000, it certainly will be the nearest equivalent to England's 'Charging Order'. For the avoidance of doubt, inhibition, which affects all of the debtor's heritable (freehold) property, but does not give the creditor the power of sale, will remain with some minor amendments.

Land attachment will only be available post judgement with the creditor requiring to register a 'Notice of Land Attachment' in the property and personal registers. The Land Attachment itself will be created 28 days after the notice has been registered. Its effect will be that of an inchoate security over the property and will rank after any fixed securities created before it. It will only be competent to make an application for the sale of attached property 6 months after the notice has been registered. At a full hearing on an application for the sale of a property the court will be entitled to appoint a surveyor to report on the property's open market value with the court also requiring any prior security holders to disclose amounts outstanding. The purpose of this is to establish whether there will be any financial benefit to the creditor if a sale were to take place. What the Parliament does not intend is for applications of sale to be made where there will be no potential financial return to creditors. Accordingly the court will not grant the sale order unless, if the sale were to take place, the net free proceeds will accumulate to the aggregate of all expenses plus the lesser of 10% of the debt or £1,000. In addition, the Act provides for other debtor protections preventing the property sale. Accordingly whilst it still will be competent for the creditor to register a Notice of Land Attachment, it will be incompetent to proceed for the land's sale if there is an extant Time to Pay Direction or Order in force or whether the debtor has the benefit of a Consumer Credit Act 'Time Order'. In addition the Court can refuse a sale order if it considers that to do so will be unduly harsh.

Whilst Land Attachment will be competent for all types of commercial property there was considerable debate whether it would be competent for an application of sale to relate to the debtor's principal dwelling house. Finally, whilst the Parliament agreed to this, the quid pro quo was that debtor protections would need to be 'bolstered'. This is why it was provided that even Notice of Land Attachment would be incompetent for debts of less than £3,000. Accordingly the Court will have power to order or limit the sale of a principal dwelling house, and in so doing take account of whether the house is occupied by the debtor, the debtor's spouse, a co-habiting partner, a civil partner, a same-sex partner, or another parent looking after a child of the debtor. In addition the Court has power to order or refuse to grant a warrant to sell the dwelling house if it is reasonable in all of the circumstances to do so having regard to the nature of the debt and the reasons for its being incurred; the debtor's ability to pay the debt within an extended period; any action taken by the creditor to assist the debtor to fulfil those obligations and the ability of those occupying the dwelling house as their sole or principal residence to obtain reasonable alternative accommodation and the personal circumstances of any such occupiers.

### Residual Attachment

Following the principle of universal attachability the diligence of Residual Attachment will function as a residual diligence to attach every other kind of property which is not attachable by any other enforcement measure. The type of property which potentially can be caught by the remedy will include various types of intellectual property types along with other assets, such as a time share. It being exclusively a post judgement remedy, application for residual attachment will require to be made to the court, and if granted, a schedule of attachment served on the debtor. If payment has not been made the creditor can thereafter apply to the court for a 'satisfaction order' which will be refused if the debtor has applied for a Time to Pay Direction or Order.

### Inhibitions in Execution

An Inhibition affects lands and buildings of the debtor. It is different from other diligences because it is personal to the debtor and affects future voluntary deeds dealing with land, to the prejudice of the creditor. It does not attach any particular land or buildings. It is a preventative or 'freezing' diligence.

As with Attachment, broadly speaking, it will be unlawful for a debtor to intromit with articles which have been attached by an interim attachment such as moving the article from the place at which it was attached or from it being sold or gifted by the debtor, as well as being damaged or destroyed. An interim attachment will last for 6 months after decree has been granted. Thereafter if the creditor wishes to vindicate his remedy he must proceed with the post-judgement attachment under the 2002 Act. The creditor will be entitled to the expenses of an interim attachment unless acting unreasonably.





The Act codifies and, in some instances, amends much of the common law's principles and, in so doing, clarifies the legalities in what can often be a fraught set of circumstances. Of benefit to most creditors will be that Sheriff Courts will be able to grant Warrant for Inhibition. Previously this had been the exclusive preserve of the Court of Session, making the application process more expensive than necessary. Whilst an Inhibition secures an obligation to convey land, complex legal argument arose as to the date when a debtor would be deemed to have acquired the land. Would it be the date of delivery of a deed or conveyance or would it be the date when such an instrument had been registered in the appropriate property register? The Act now confirms that an Inhibition will secure a Deed once that Deed has been delivered to the debtor, as opposed to its registration. The Act further provides that Inhibitions registered within 21 days of registration of the Notice of Inhibition will be effective from the date of its service on the debtor. If the Inhibition is registered after 21 days of the Notice of the Inhibition's registration, then the Inhibition will be effective from its date of registration. Various other reforms have been introduced to confirm that an Inhibition will no longer provide the creditor with any preference on the debtor's insolvency. Creditors will be pleased to note that the expenses of the Inhibition will be chargeable against the debtor as opposed to the creditor being liable for these.

### Diligence on the Dependence

The two forms of diligence on the dependence are arrestment and inhibition. The effect of the arrestment on the dependence is to 'freeze', usually money, held on the hands of a third party and owed to the debtor, thus preventing these monies being made over to the debtor. Currently all monies due by the third party to the Debtor are frozen irrespective of the sum claimed by the Pursuer. An Inhibition on the Dependence affects the Debtor's heritable (freehold) property such as a house or factory. The Inhibition prevents the debtor from dealing with the property in a way which could prejudice the Pursuer's claim such as selling it, gifting it, or granting security over it to a third party.

An inhibition on the dependence affects all of the debtor's heritable property and not restricted, for example, to a property arising out of the court action, and regardless of the amount of the Pursuer's claim.

There has been much written and, indeed, litigated upon these Scottish pre-judgment remedies. Largely the issue has been whether these protective measures can be seen to be Human Rights Act compliant. The Scottish Judiciary has gone a long way to preserving these remedies, almost intact, despite the expectation they would be lost forever. In so doing they have ensured Scotland is one of the few jurisdictions in the western world which can 'boast' the availability of such remedies which can be granted with relative ease.

Following upon a number of celebrated court decisions, certain conditions must be satisfied before diligence on the dependence is compatible with Article 1 of Protocol 1 of ECHR, being:

- The creditor must have a prima-facie case, that is the allegations in the claim document will, if proven true, lead to success in the action.
- The creditor must show a specific need for diligence on the dependence such as the debtor is insolvent or verging on insolvency or is likely to remove assets from the court's jurisdiction and frustrate the claim.
- There must be a hearing before a judge

Basically the new Act has now embodied into statute what the court's had decided in previous decisions. This, of course, is welcome as it removes uncertainty.

However the statute has gone beyond that by detailing the circumstances where the diligences can be granted prior to a formal court hearing where the debtor will be present. Accordingly, the Act provides that at all stages the onus will be upon the creditor to prove the reasonableness for having the pre-judgement remedy. A hearing will be required in all circumstances except where there is an urgent need for it before the claim is intimated to the debtor. Thereafter there will be a hearing once the writ has been served on the debtor.

There will be provision to allow the debtor to move for the diligence on the dependence to be recalled. Whilst there will be a presumption for the recall to be granted the Court will not do so if the Pursuer is able to persuade the court that it is necessary if reasonable in all of the circumstances. In reaching its decision the Court will have regard to the debtor's insolvency, or the fact that the debtor is verging on insolvency, or the likelihood that the debtor will remove assets which could defeat or prejudice the enforcement of any decree.

As to the amount secured by the remedy this will require to be proportionate to the sum sued for and be restricted to the principal sum sued for, plus 20% of that amount, along with interest on the principal sum claimed for one year. The expenses of the diligence will be granted to the Pursuer unless he has acted unreasonably.

### **Interim Attachment**

This is a new diligence introduced by the Act and may be used on the dependence (prior to judgment) of the court action. The property which could be subject to an interim attachment will be corporal movables kept outwith a dwelling house. The onus will be on the creditor to satisfy the court the remedy is needed. In reaching its decision the court will consider whether the debtor is insolvent or verging on insolvency, along with the likelihood of assets being removed which could ultimately affect the success of the Pursuer's claim. Interim attachment will not be competent against any article exempt from attachment under section 11 of The Debt Arrangement and Attachment (Scotland) Act 2002, including tools of the trade up to the value of £1,000, DIY tools kept outside a dwelling house, mobile homes and a vehicle up to the value of £1,000.



## Money Attachment

A new diligence of money attachment is introduced which will enable a creditor, holding a decree or other enforceable document, to attach money, including foreign currency, held on business premises in the same manner as diligence against corporal moveable property. Money attachment will not be available on the dependence of a court action.

It will also be incompetent for it to be carried out in a dwelling house. Personal searches against the individual will be prohibited. Money attachment will be incompetent if carried out before 8am and after 8pm, unless a special application is made by the judicial officer to the court. In executing the attachment the Judicial Officer can assume the cash is the debtor's unless he has reason to believe otherwise. Judicial Officers have already expressed some concern how practically the procedure will be carried out.

Obviously creditors think the process will be defeated because when the officer attends the business premises the debtor will make a dive for the cash register and quickly disappear with the takings! How practically effective this new diligence will be will have to be seen. Once attached, the Judicial Officer submits an interim report to the Sheriff within 14 days. Thereafter the creditor will apply for a Payment Order allowing for the attached money to be, in effect, credited against the sums due by the debtor to the creditor. It will be open to a debtor to make an application for release of the money attachment if the court can be persuaded the remedy is unduly harsh, although no more than £1,000 can be withheld for this purpose.

## Time to Pay Arrangements

A Time to Pay Direction may be applied for by the debtor in the time between receiving a summons for payment but before the court has pronounced decree. A Time to Pay Order, alternatively, is only available after decree has been granted and diligence commenced. There is concern about the low 'take up' by debtors of these 'diligence stoppers'. To encourage their adoption the Act provides the automatic receipt by the creditor of any Time to Pay Direction application with their forms containing more details about the debtor's financial circumstances. In addition a charge for payment (the first stage of an enforcement post decree) will be accompanied by an explanation of the debtor's entitlement to apply for a Time to Pay Order. An application form for the Order will be enclosed with the charge.

Creditors should carefully note that to some degree the goal posts have changed. When considering an application for either a Time to Pay Direction or Order the Sheriff 'shall' grant the application 'if satisfied it is reasonable to do so in all of the circumstances'.



## Earnings Arrestment

An Earnings Arrestment is designed to attach future sums due to the debtor from his employers. One problem with their operation is the uncertainty which surrounds the amounts due by the debtor to the creditor during the course of the arrestment, and whether all of the parties involved are aware of the debt's status throughout its duration. Another difficulty is if the debtor leaves their employment there is no onus or obligation upon anyone to advise the creditor of this. What usually transpires is a fairly bland letter from an employer saying the arrestment will be no longer operable because the debtor has left their employment and that no further payment will be forthcoming.

Following mounting criticism about how earnings arrestments operate it has been decided they could function more effectively if the parties involved with them were obliged to inform others in the triangular relationship of creditor, debtor and employer of certain salient facts.

Accordingly the law has been reformed to increase the flow of information amongst the parties. The Act now provides that an employer will be obliged to advise the creditor specifying the debtor's net earnings and the calculation of the deduction from these earnings to be made. When deducting and transmitting payments to the creditor employers will briefly specify the debtor's earnings and the calculation of the deduction made. This will also be made available to the employee. Employers will also be required to pass on information known to them about an employee's change of employment.

Employers will be under a duty each 6 months to send updated information to the employee with creditors being obliged to advise employers and debtors of the status of the employee's debt at 6 monthly intervals.

There will be a duty on employers to advise creditors when a debtor's employment is terminated and to provide, where known, details of the new employment. If the employer fails to do this the creditor may make an application to the court requiring the employer to pay to the creditor an amount not exceeding twice the amount recoverable by that creditor from the debtor.

## Arrestments in Execution

An Arrestment in Execution is a post-judgement diligence which enables the creditor to attach the debtor's goods or funds held in the hands of a third party. The third party is often a bank. This arrestment attaches the whole of the common debtor's property in the third party's possession regardless of the size of the debt due. To that extent it is seen by many to be inequitable. The arrestment creates a 'nexus' over the property arrested, prohibiting the third party from releasing it to the debtor.

Usually, as a matter of common practice, property release is achieved by the debtor signing a mandate addressed to the third party authorising the property arrested to be made over to the creditor. However if such an agreement cannot be reached, the arrestment, being an incomplete diligence, requires to be followed up with an action of furthcoming. This adds time and expense which many regard as unnecessary. If successful, the furthcoming decree orders the third party to pay over to the creditor the sums arrested, or to deliver the goods, to the creditor.



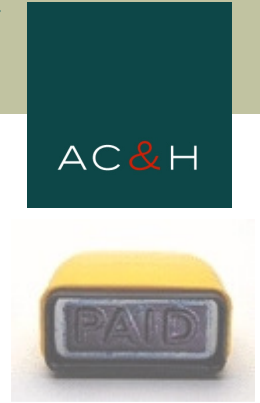
The Act modifies the law by putting in place the provision for the automatic release of the arrested funds within an approximate 3 month time frame. In addition, the sums arrested will require to be appropriate to the amount of the outstanding debt along with interest and expenses.

Accordingly once an arrestment has been served the debtor or arrestee (quite often a bank) will have a period of 4 weeks from the arrestment to intimate an objection to it. A bank will be required to disclose if anything has been arrested within 3 weeks of their being asked without their being concerned about a possible breach of confidentiality between them and their customer. If there is an objection to the property being released then the court will have a maximum period of 8 weeks to consider the objection. If the objection is upheld then an action of furthcoming will be needed. However, it is anticipated that few actions of furthcoming will be required, in which case if the objection is not upheld the court will order the release of the arrested property. For the avoidance of doubt the debtor can still authorise the earlier release of the arrested property.

### The Debt Arrangement Scheme

The Debt Arrangement Scheme was introduced by The Debt Arrangement and Attachment (Scotland) Act 2002. The scheme's purpose is to allow those having multiple debt and surplus income to repay their debts in an organised fashion, free from the threat of enforcement, thus putting debt management before debt enforcement. This is achieved by an individual making an application for a debt payment programme which requires to be completed on the applicant's behalf by a certified money adviser. The Regulations which set out the detail of the scheme are very formulaic. There has been a far lower 'take up' of the payment programmes than was anticipated or, indeed, deemed to be desirable by the Scottish Parliament. One reason for this low take up is there is little advantage for a debtor in taking part in one. This is particularly acute because there is no obligation upon creditors to be required to freeze interest or for them to agree to write off some of the principal amount of the debt. In an effort to make the schemes more attractive the Parliament have considered there should be amending legislation put in place to allow for debt composition, the freezing of interest as well as the requirement for a certified money adviser to prepare the application on behalf of the debtor to be removed.

Accordingly the new Act amends the 2002 Act to the extent that, inter alia, debt relief will be imposed on creditors as well as their being a variation to the creditor's right to charge interest. In addition the debtor will no longer be required to sign the application for a programme or its variation, with the money adviser's duties to be carried out by an approved intermediary as opposed to a certified money adviser.



## Conclusion

The policy objective behind the Act is to improve the enterprise economy by encouraging those who have inadvertently become bankrupt a quicker route back into business. Whilst a laudable aim, at best, with the vast majority of bankruptcies arising from consumer debt, this objective is misconceived. There is a real possibility bankruptcy will be seen as an easy alternative to repaying properly constituted debt, with the unintended result that the number of Scottish bankruptcies could soar. What will prevent this is the extent to which the Accountant in Bankruptcy will initiate Payment Undertakings and Orders as well as the bankruptcy restriction regime. Only time will tell how effective this will be, but one racing certainty will be that more financial resources will have to be made available to the AIB to “fight the good fight”.

The introduction of new judgment enforcement measures, particularly, Land Attachment are welcomed. Creditors are already expressing an interest in their use. However the Parliament have already said once in place they will be carrying out an impact assessment to be certain the operation of the sale process does not increase homelessness. Despite the multitude of debtor protections in place, if the Land Attachment has this effect then we can expect future amending legislation, possibly to exclude the main dwellinghouse from the attachment process.

In all, the Act has to be seen as a major effort to modernise the law of Scottish Judgement Enforcement which now must be the most ‘modern’ in the western hemisphere. However ‘modern’ does not necessarily mean better, and whether an equitable balance has been struck between creditor and

