

Sewel Memorandum

Insolvency Bill

Background

1. The Insolvency Bill was introduced in the House of Lords on 3 February 2000 and had its second reading on 4 April. It is about to enter Lord Committee. The Bill has still to go through its Commons stages. The purpose of the Bill is described in Annex A. It has GB effect and largely deals with matters reserved to the United Kingdom Parliament under Section C2 of Schedule 5 to the Scotland Act 1998 (insolvency).

The model law

2. There is one area of the Bill which may have an impact on devolved matters. This is the intention in clause 13 (see Annex B) to provide a regulation making power to implement the model law on cross-border insolvency which was adopted by the United Nations Commission on International Trade Law (UNCITRAL) of which the UK is a member; and for the amendment of section 426 of the Insolvency Act 1986 (co-operation between courts exercising insolvency jurisdiction).

Implications for devolution

3. Any regulations to implement the model law are likely to contain a mixture of reserved and devolved provisions. In particular, they may affect private international law, which is a devolved matter. They may also affect personal bankruptcy, which is devolved, and the process of winding up insolvent bodies corporate, which is an exception to the reservation under Section C2.

4. At present, however, the intended scope of any regulations is not known, and the balance of devolved and reserved matters covered in such regulations is not clear. There is no particular timescale for making the regulations which are not essential to the proper operation of the Insolvency Bill. Essentially clause 13 is an enabling power which may be used or not used at the discretion of the Ministers to whom the power is given.

Proposed amendment of clause 13

5. Clause 13 is at present drafted in terms which give the Secretary of State power to make regulations with the agreement of the Lord Chancellor. The UK Government recognises that such regulations could contain devolved provisions and therefore proposes to amend the Bill to provide that such regulations shall also require the consent of the Scottish Ministers.

6. The Executive has considered whether this goes far enough. There are two factors which must be balanced. In the first place, there is the integrity of the devolution settlement, which allows matters of Scots private law to be developed coherently by the Scottish Parliament. In the second place, however, there is the need for GB law to be simple to understand and to operate especially where it may have to be used in a cross border context. If the Scottish Ministers were to be given a separate power to make regulations under clause 13 this could lead to a requirement for users of the regulations, including foreign users, to refer to two separate sets of regulations. One set would cover reserved matters at GB level and other matters purely for England and Wales. The other set would cover only Scottish

devolved matters. This does not seem desirable for ease of understanding and use by creditors and debtors both in the UK and abroad.

7. The approach suggested by the UK Government therefore seems on balance preferable. This would result in only one set of regulations, made by UK Ministers, but with the consent of the Scottish Ministers. The result would be that the Scottish Executive would be fully involved in the drafting of the regulations and would have a veto.

Consent of Scottish Parliament

8. Since the provisions of Clause 13 will result in the UK Parliament legislating on devolved matters, the consent of the Scottish Parliament is sought.

The Scottish Executive
May 2000

PROVISIONS OF INSOLVENCY BILL

(Taken from Explanatory Notes published on introduction)

SUMMARY

1. The Bill provides for:

- small companies¹ in financial difficulty to make voluntary arrangements with their creditors by providing the option of a moratorium² to give the firm's management time to put a rescue plan to creditors and for minor modifications to be made to the provisions relating to the existing company³ and individual⁴ voluntary arrangement schemes;
- changes to the procedure for disqualifying persons who are unfit to be company directors by allowing the Secretary of State to accept undertakings which would have the same legal effects as disqualification orders⁵ made by a court and for various technical amendments to be made to existing legislation in relation to disqualification;
- the procedure for reporting delinquent officers and members of a company with a view to prosecution to be changed;
- amendment of section 219 of the Insolvency Act 1986 to ensure that it is compatible with the European Convention on Human Rights (ECHR);
- the property of a person who dies insolvent to be treated in the same way as that of a live insolvent (England and Wales only);
- a power to make rules or regulations concerning the investment of funds held in the Insolvency Services Account on behalf of bankruptcy estates, and the payment of interest on such funds; and
- a power to make regulations to give effect with or without modifications to the model law on cross-border insolvency which was adopted by the United Nations Commission on International Trade Law (UNCITRAL) of which the UK is a member state; and for the amendment of section 426 of the Insolvency Act 1986 (co-operation between courts exercising insolvency jurisdiction)

1. Section 247(3) Companies Act 1985 defines a small company as one which satisfies two or more of the following criteria:

- Turnover - not more than £2.8 million.
- Balance sheet total - not more than 1.4 million.
- Number of employees - not more than 50.

2. Moratorium is a temporary stay, or in Scotland a sist, on certain legal acts and processes from being performed or continued.

3. Company Voluntary Arrangements were introduced by the Insolvency Act 1986 Part I and provide a means for financially troubled companies to reach a legally binding agreement with their creditors in satisfaction of their debts or a scheme of arrangement of their affairs. A proposal for a voluntary arrangement will determine who the nominee is to be. The nominee is the person chosen by the directors to put their voluntary arrangement to the creditors and the company and to act as supervisor of the voluntary arrangement if it is implemented. A liquidator or an administrator of the company may also propose a voluntary arrangement.

4. Individual Voluntary Arrangements were introduced by the Insolvency Act 1986 Part VIII and similarly provide a means for financially troubled individuals to reach a legally binding agreement with their creditors in satisfaction of their debts or a scheme of arrangement of their affairs (England and Wales only).

5. A person can be disqualified by the courts, by way of a disqualification order, from being an insolvency practitioner or director or from being involved in the promotion, formation and management of a company, for a maximum of fifteen years, if his conduct in an insolvent company (or partnership in England and Wales) makes him unfit and if other specified conditions are satisfied.

BACKGROUND

Moratorium in company voluntary arrangements

2. Company rescues can be made more difficult or can be thwarted because of the absence of provision in the Insolvency Act 1986 for obtaining a short moratorium in the company voluntary arrangement procedure whilst a proposal for a voluntary arrangement is being drawn up and considered.

3. The absence of a moratorium means that, until the arrangement is formally approved, any creditor can take legal action against the assets of the company and so jeopardise the prospects of the voluntary arrangement succeeding. The addition of an optional moratorium to this procedure will offer the management of a small company a short time within which to put a rescue plan to creditors.

4. In the last three years an average of 500 company voluntary arrangements have been agreed annually.

Disqualification Undertakings

5. The present director disqualification regime was introduced by the Company Directors Disqualification Act 1986. In particular, this allows the court to make a disqualification order against a director of an insolvent company whose conduct as a director of that company either on its own or when taken with his conduct of other companies is such as to make him in the view of the court unfit to be involved in the management of a company. The application is made by the Secretary of State or the official receiver. Over the past two years, about 2800 disqualification orders have been made under Section 6.

6. At present disqualification can only be achieved by means of court proceedings and there are delays in getting cases through the courts. The power to accept undertakings which is to be conferred on the Secretary of State will mean that, where there is agreement, disqualification can be achieved administratively by the director giving an undertaking to the Secretary of State. This will result in earlier disqualification for those who give an undertaking. It will also save time.

Reports by liquidators of criminal misconduct by company officers or members

7. In certain circumstances, Section 218 Insolvency Act 1986 requires a liquidator¹ to report suspicions of criminal misconduct by company officers or members to the Director of Public Prosecutions, who may then refer such reports to the Secretary of State for investigation. The Bill requires liquidators to make such reports directly to the Secretary of State rather than to the Director of Public Prosecutions. In Scotland reports will continue to be made to the Lord Advocate who will no longer be able to require the Secretary of State to investigate the alleged offences.

¹ A liquidator is the insolvency practitioner appointed to realise the assets of a company and distribute the proceeds to creditors in a liquidation.

Restriction on use of answers obtained under compulsion

8. Section 219 of the Insolvency Act 1986 allows answers obtained under powers of compulsion, derived from the Companies Act 1985, to be used as evidence against that person. This is not compatible with the judgment of the European Court of Human Rights in the case of *Saunders v. UK*. The Court decided that for the prosecution to use answers given pursuant to a power of compulsion in subsequent criminal proceedings infringed Mr Saunders' rights under Article 6 of the European Convention on Human Rights. The Bill therefore amends section 219 to make it compatible with the Convention.

Property of deceased insolvents

9. The order-making power contained in Section 421 of the Insolvency Act 1986 is not sufficient to ensure that all property, the ownership of which was vested in a deceased debtor immediately prior to his death (including his share in property held on a joint tenancy), is available to his creditors in insolvency proceedings where the insolvency order was made after the debtor's death¹. That means that in some instances, what may appear to be the main, if not the only asset, namely the debtor's interest in the matrimonial home, will be beyond the reach of his creditors. The Bill therefore amends Section 421 by providing that the deceased's interest in property which he held on a joint tenancy on the day he died becomes part of his estate and may be dealt with accordingly.

¹ This was established by the decision of the Court of Appeal in the case of *In re Palmer Deceased (A Debtor)* [1994] Ch. 316.

Bankruptcy: Interest on sums held in Insolvency Services Account

10. For many years it has been possible for funds held in the Insolvency Services Account for a company in liquidation to be invested in Treasury Bills or other government securities for the benefit of the estate. There was also a facility for funds in excess of £2,000 to be placed on an interest bearing account and since 1994, interest of 3.5% per annum has been paid automatically on such funds. Similar provisions have never applied to bankruptcy estate funds. The Bill, therefore, gives the Secretary of State the power to make rules or regulations which will remove that anomaly.

Model law on cross-border insolvency

11. The UNCITRAL model law seeks to facilitate the process of obtaining recognition of foreign insolvency proceedings; to introduce a greater degree of certainty as to the assistance the courts can give a foreign officeholder and the stage of the proceedings at which the assistance is given; and to require courts with insolvency jurisdiction to co-operate with each other. The power taken in the Bill will enable the Secretary of State with the agreement of the Lord Chancellor to give effect in our law to the model law, with or without modifications.

Full Text of Section 13

Model law on cross-border insolvency.

13.

(1) The Secretary of State may by regulations made with the agreement of the Lord Chancellor make any provision which he considers necessary or expedient for the purpose of giving effect, with or without modifications, to the model law on cross-border insolvency.

(2) In particular, the regulations may

(a) apply any provision of insolvency law in relation to foreign proceedings (whether begun before or after the regulations come into force),

(b) modify the application of insolvency law (whether in relation to foreign proceedings or otherwise),

(c) amend any provision of section 426 of the Insolvency Act 1986 (co-operation between courts),

and may apply or, as the case may be, modify the application of insolvency law in relation to the Crown.

(3) The regulations may make different provision for different purposes and may make

(a) any supplementary, incidental or consequential provision,

or (b) any transitory, transitional or saving provision, which the Secretary of State considers necessary or expedient.

(4) In this section

"foreign proceedings" has the same meaning as in the model law on cross-border insolvency,

"insolvency law" has the same meaning as in section 426(10)(a) and (b) of the Insolvency Act 1986,

"the model law on cross-border insolvency" means the model law contained in Annex I of the report of the 30th session of UNCITRAL.

(5) Regulations under this section are to be made by statutory instrument and may only be made if a draft has been laid before and approved by resolution of each House of Parliament.