Scottish Parliament – Economy and Fair Work Committee

Bankruptcy and Diligence (Scotland) Bill

Call for Views

Response (July 2023)

This response is provided by Professor Donna McKenzie Skene and Dr Alisdair MacPherson, who are both members of the Centre for Scots Law at the University of Aberdeen

Q1. Do you agree that the Scottish Government should take forward legislation in these areas?

Yes, we agree that the Scottish Government should take forward legislation in the areas of bankruptcy and diligence, subject to the points that we make below. A number of the legislative provisions will address problems with the existing legislation or will correct errors or clarify points in such legislation. Of course, this Bill is part of a wider project of reviewing and reforming the law of statutory debt solutions and diligence. There are various other issues in these areas that require attention. Some of these can be dealt with easily and quickly by secondary legislation or through AiB guidance. However, others are likely to be more difficult or contentious, and so it would be most appropriate to await the broader Stage 3 review for such matters.

Q2. What are the key issues that the Scottish Government should consider when developing a mental health moratorium?

As the Bill stands, there is significant uncertainty regarding the mental health moratorium. The content of the moratorium will depend on secondary legislation (regulations). It can be contended that the title of the section (section 1) is too broad and misleading, as it suggests that the moratorium will apply to debtors with mental illnesses generally. In reality, it appears that the intention is for the mental health moratorium to be limited to those suffering mental health crises, similar to the position under the equivalent moratorium in England and Wales (see Debt Respite Scheme (Breathing Space Moratorium and Mental Health Crisis Moratorium) (England and Wales) Regulations 2020 (SI 2020/1311)). We agree that the scope of the moratorium should be restricted to those suffering crisis treatment, which means that relevant individuals do not have the ability to address their debt issues. The appropriate forms of treatment should comprise of those provided under the Criminal Procedure (Scotland) Act 1995, section 57A and Parts 6 and 7 of the Mental Health (Care and Treatment) (Scotland) Act 2003. Individuals receiving such treatment are vulnerable and not in a position to deal with debt matters and so the law should protect them from e.g. enforcement by creditors at such a time.

The perceived legitimacy and reputation of the new mental health moratorium will depend upon defining its boundaries clearly and making sure it is difficult for it to be abused, while giving respite to those who are truly in need of it on an urgent basis. Related to this, we consider it necessary for there to be third-party confirmation (or verification) of a mental health crisis, ideally from a mental health professional.

Of course, the standard moratorium can be used by debtors who have mental illnesses, as well as those who do not. An alternative model would have been to use the existing moratorium flexibly to take account of periods of mental health crisis and extend the moratorium period accordingly. However, we accept that there is sufficient demand in favour of a separate mental health moratorium and this, of course, is the approach that has been adopted in England and Wales. It should be remembered though that the moratorium does not write off debts owed by debtors and creditors will still be entitled to payment at a later date. As such, it is sometimes beneficial for a debtor to address debt issues as soon as possible, as such issues may be the cause of anxiety, stress and other problems. The standard moratorium should therefore be a mechanism by which debtors can seek and obtain a suitable mechanism for dealing with debt. We consider that the effects of the mental health moratorium should be as similar as possible to the effects of the standard moratorium.

Another point of uncertainty regarding the moratorium is its duration. Presumably, it is to be for the duration of the relevant period of crisis treatment plus some extra recovery time (see e.g. Regulation 32 of SI 2020/1311 in England and Wales). This could then be followed by a fixed period moratorium to enable the debtor to deal with their debt issues. The latter could simply be the standard moratorium or an equivalent to this in terms of duration etc. Of course, the current length of the standard moratorium is 6 months, which is a considerable period of time. The period was increased from 6 weeks to 6 months in the wake of the Covid-19 pandemic and this longer period was made permanent to support individuals in the context of the recovery from the pandemic and wider economic circumstances. It was accepted then that the period would be monitored and reviewed going forward and as economic circumstances improved. The current period is therefore lengthy compared to the previous period and also in comparison to England and Wales (60 days). As always in debt and insolvency, there is a need to balance the interests of different parties. One person's creditor is another person's debtor. If it becomes more difficult or expensive for a creditor to obtain payment from their debtors, this may impact their ability to repay their own creditors, which could lead to further debt problems and insolvencies. In addition, creditors come in all varieties and sizes and some may be more susceptible to debt problems than others.

A further point that needs to be considered is what is to happen if an individual suffers a mental health crisis but they have not previously sought the assistance of a debt adviser. If the expectation is that a debt adviser is to submit an application for a mental health moratorium on behalf of a debtor, consideration needs to be given as to how they will become aware of a debtor's mental health crisis. Even if a debtor has previously consulted with a debt adviser and the adviser becomes aware of a debtor's mental health crisis, attention needs to be given to the basis on which the adviser is applying on behalf of the debtor. As the debtor may not have sufficient mental capacity to agree to the application and there may not be a formal power of attorney, it may be advisable to include a clear statutory statement that the debt adviser can still make the application in spite of this fact.

In addition, consideration should be given as to whether and how the coming into force of a mental health moratorium could be challenged and whether there should be the possibility of a challenge to any other aspects, such as in relation to its duration (e.g. if evidence came to light that the debtor exited crisis treatment at an earlier date but this was not disclosed). We are aware that there has been a recent case in England, *Kaye v Lees* [2023] EWHC 758 (KB), dealing with such issues. On the basis of this case, we wonder whether it would be worthwhile to consider if there should be express statutory provision to deal with these matters. It may be appropriate to consider whether section 1(2) of the Bill should also include specific mention of this.

Q3. What are the practical implications of the proposed amendments to bankruptcy legislation?

The proposed amendments to the bankruptcy legislation correct errors, clarify matters, and should make the legislation easier to operate and provide more certainty regarding the meaning of its provisions.

Q4. Are there any other aspects of the Bankruptcy (Scotland) Act 2016 that you think could benefit from reform?

There are various other technical changes that could usefully be made to the legislation. Many of these are outlined in D McKenzie Skene, *Bankruptcy* (2018). We have listed some of these, and others, below but we acknowledge that some of them would most appropriately be addressed as part of the future review of statutory debt solutions and diligence and it may be too controversial or complicated to include them in the current Bill.

- A statutory clarification of the position with respect to statutory interest payable on recall of sequestration. A ground for recall of sequestration is that the debtor has paid their debts in full (see Bankruptcy (Scotland) Act 2016, ss 30-31). It has been determined that these debts do not include statutory interest, which accumulates between the commencement of sequestration and the recall being sought (*Advocate General for Scotland v Accountant in Bankruptcy* [2020] SAC (Civ) 5 on appeal from 2019 SLT (Sh Ct) 235). However, the correctness of this interpretation is open to question and at first instance Sheriff Holligan stated (obiter) (at para 26):

  > "I can foresee that there may be circumstances in which recall of the sequestration without some payment of interest might be inequitable quoad the interests of a creditor. For example, a petition for recall may come a long time after commencement of the process which may have particular adverse effects upon a creditor. I reserve my opinion as to whether it would be open to the court, in the exercise of its discretion, to refuse to recall the sequestration in order to avoid such an inequitable outcome."

  This leaves the law in a somewhat uncertain position. Rather than including or excluding statutory interest in all circumstances involving recall of sequestration, a more acceptable approach might be to identify a period after which statutory interest requires to be paid in order to obtain a recall on the basis that debts have been paid in full. This would be fairer to a creditor, who may otherwise be disadvantaged by significant delays in obtaining payment and not having statutory interest added to ameliorate this. It would also help meet the policy objective of supporting debtors extracting themselves from an insolvency procedure timeously. Furthermore, it gives concrete form to a reasonable (but not the only) interpretation of the current law. A relevant time period after which statutory interest would require to be paid might be 6 months.

  An argument could, however, be made that such a change should await the review of the statutory rate of interest at Stage 3.

- The remedies for challengeable transactions following the decision in *MacDonald v Carnbroe Estates Ltd* [2019] UKSC 57 – this case and its implications are discussed at length in ADJ MacPherson and D McKenzie Skene, "Gratuitous Alienations and the Implications of *MacDonald v Carnbroe Estates Ltd* 2022 *Juridical Review* 59.

- The provision of a suitable definition of non-vested contingent interests.

- A clarification of the relationship between sequestration and debt arrangement schemes.

- A general review of discharge and the reopening of cases – this is of relevance for sequestration and protected trust deeds (for the latter, see e.g. ADJ MacPherson and D McKenzie Skene, "Insolvency Set-off, Discharged Debts and Protected Trust Deeds: *Royal Bank of Scotland Plc v Donnelly*" (2020) 24 *Edinburgh Law Review* 262).

- The extent of the vesting of damages for personal injury.

- The rules on pensions in light of recent changes to the debtor's ability to draw down pensions.
- Clarification of how council tax claims are to be dealt with in personal insolvencies given varying approaches across different local authorities in practice.
- The disqualifications flowing from sequestration – a review of these was provided for after the 2007 Act but has never been carried out.
- A review of composition generally across the debt procedures.

Q5. How will the diligence reform proposals in the Bill impact on creditors and people in debt?

We broadly support the diligence reform proposals in the Bill and we think their impact will generally be positive. We do, however, have some comments in relation to particular proposals.

Arrestment – Duty of Disclosure

With reference to the arrestee's duty of disclosure, we agree that an arrestee (or purported arrestee) should be required to notify a creditor seeking to arrest where no property is arrested. This will further move the law in this area in the direction of transparency and an information-driven approach to debt enforcement. There will likely be some costs involved for an arrestee in responding to an arrestment that has not captured any property but such a party has to check for property to be arrested anyway, so increased costs will be limited to the administrative costs of responding. We note that for larger entities such as banks, on whom many arrestments are served, the overall costs of the proposed reform may be fairly substantial in aggregate. While for smaller parties, the numbers of arrestments will be much smaller but the relative work required could be more onerous and there may be uncertainty as to what precisely must be done and when. There is consequently a danger that banks and other creditors seek to pass the costs on to consumers and other counterparties, either directly or indirectly.

To minimise costs for arrestees, and others, the requirements for disclosure of the non-arrestment of property should not be onerous and the necessary information should be clearly stipulated. The latter will require that an amended response form is served on arrestees and that disclosure requirements for arrestees are straightforward (e.g. in a simple prescribed form or to provide certain prescribed information via post or email etc). The current forms are located at Schedules 7 and 8 of the Diligence (Scotland) Regulations 2009 (SSI 2009/68). We support electronic service of forms and the ability of arrestees to respond electronically.

It should be made clear in the explanatory notes that the expanded duty of disclosure for non-arrestment applies not only to funds but also to other moveable property (whether corporeal or incorporeal). While "funds" are likely to be the most common type of property which a creditor seeks to arrest, the failure to arrest any type of property (which could conceivably be arrested) should require the purported arrestee to disclose this. Arrestment applies to moveable property that a third party holds for the common debtor or owes to them, whether that is funds, other rights, or goods. The examples that are to be included in section 73G(4)(c) of the Debtors (Scotland) Act 1987 (by virtue of section 6(2)(b) of the Bill) are limited to funds and the explanatory notes do not fully clarify the position. While it may be "clunky" and cumbersome to add further examples into the legislation itself, the explanatory notes could easily resolve the issue.

We note that the amount payable by an arrestee upon the failure to disclose relevant information is to be reduced to the lesser of £500 or the sum due to the creditor by the debtor. Specifically, the first-noted figure of £500 is to replace £1,000. It would be helpful if further justification of this were provided.

Diligence Against Earnings – Duty of Disclosure

Most of the above comments also apply to the provisions about the employer's duty to provide information in relation to diligence against earnings.

Diligence on the Dependence – Provision of Debt Advice and Information Package

There is currently insufficient clarity regarding the date before which a debt advice and information package requires to be served where a warrant for diligence on the dependence is granted prior to a hearing. Given the need to avoid alerting the debtor regarding diligence on the dependence in these circumstances, it should be clearly stipulated in the legislation that a DAIP requires to be served prior to the date of the hearing (instead of e.g. before the date when the diligence is executed). The legislation and the explanatory notes do seem to indicate that this is the intended position, but the matter is not undeniably clear and could be easily rectified via a provision in section 8 of the Bill, which amends Part 1A of the Debtors (Scotland) Act 1987. Regarding the penalty for failure to serve the DAIP on time, we wonder whether the court should have discretion to determine whether or not the diligence should be recalled (perhaps with a presumption in favour of this), rather than it being automatically recalled.

We also consider that it would be useful for consistency to introduce equivalent provisions in the Bill for interim attachment, which would require amendments to Part 1A of the Debt Arrangement and Attachment (Scotland) Act 2002. Interim attachment is the attachment version of inhibition on the dependence and arrestment on the dependence (albeit with certain differences), and so it would be sensible to have as coherent an approach as possible across these interim forms of diligence.

Exceptional Attachment

The planned increase of the redemption period for exceptional attachment (from 7 to 14 days), where the property is not removed from the premises, seems sensible to us and aligns the position with attachment more generally. We agree that the period of redemption for property removed from the dwellinghouse should remain at 7 days for exceptional attachment.

Money Attachment

The new provision for money attachment is fair and will assist creditors in recovering their debts against certain types of business.

Q6. Are there other proposals for diligence reform that should be taken forward in this Bill?

There are many other ways in which the law of diligence could be reformed. However, it may be difficult to do so in the context of the current Bill (due to difficulty and/or likely controversy) and certain changes could be made by secondary legislation.

It is necessary to deal with replacing adjudication for debt with land attachment and residual attachment (or equivalents) as soon as possible. This reform was originally supposed to take place through provisions in the Bankruptcy and Diligence etc (Scotland) Act 2007; however, those provisions have never been brought into force. This was because of controversy surrounding the possibility that the diligence could be executed over people's homes. These issues have still not been resolved but they have also held up the reforms in relation to commercial property too. It is understood that diligence and the debtor's home, and a replacement for adjudication for debt more broadly, will be considered at Stage 3 of the Review of this area of law. However, this is likely to mean much further delay to needed reform in this area. We would recommend the uncoupling of the debtor's home from the wider reform of this area for the moment and to proceed with the reform of the diligence excluding the debtor's home (or excluding residential property more broadly) as soon as possible. The debtor's home or residential property can be revisited in the Stage 3 Review.

Adjudication for debt is a diligence with certain archaic features but would have to be used by a creditor to obtain a judicial security interest in land (including buildings) and for other property for which there is no alternative form of diligence available, such as intellectual property and certain digital assets (including cryptocurrencies in some instances). This is all commercially undesirable and creates difficulties for creditors in recovering debts using diligences. It also further justifies reform in this area. For more details, see ADJ MacPherson, "Scottish Statutory Debt Solutions and Diligence: A Response in a Time of Crisis" (2023) 27 *Edinburgh Law Review* 64 at 73-74. We appreciate that making such amendments in the current Bill may not be appealing, but if it is no longer desirable to bring the 2007 Act provisions into force (minus the debtor's home), then a suitable alternative should be identified and enacted without awaiting the conclusion of the Stage 3 Review.

Another mechanism in the 2007 Act (s 220) that has not been introduced is the information disclosure order (IDO). This would be of considerable benefit to creditors in recovering debts and ensuring that this is done efficiently and without wasting resources. Introducing IDOs would align well with an intention to increase the availability of information in this area, to support decision making, and to provide creditors with a reasonable tool for recovery of debts that are payable. Making it easier for creditors to obtain sums due to them will help them avoid their own debt problems. IDOs can be introduced by regulations but it would be desirable if their introduction could take place at the same time of the entry into force of the Bill following its passing, or at least close to that time.

Furthermore, it would be desirable if the asset limits which give an exemption from attachment in s 11 of the Debt Arrangement and Attachment (Scotland) Act 2002 were reviewed and increased. These limits are: (a) up to £1,000 in value for implements, tools of trade, books or other equipment reasonably required for the use of the debtor in the practice of the debtor's profession, trade or business; and (b) up to £3,000 for any vehicle, the use of which is so reasonably required by the debtor. These changes can be made by regulations. However, again, it would be useful if such changes were to be brought into force at the same time as the other amendments. At Stage 3 of the Review, it may be worthwhile to further consider whether these value limits are sufficient here, or whether further clarification is required, including with respect to what the test should be for exempting a vehicle from attachment and what happens if a party has a vehicle or equipment etc over the relevant limit (e.g. whether they are able to obtain funds in return for the property being attached to enable them to acquire exempt property up to the limit).

Also, property exempted from diligence (particularly exceptional attachment), and sequestration, should include disability/mobility scooters and all other disability aids reasonably required by a debtor. While it can be contended that such items fall within the meaning of "medical aids or medical equipment reasonably required for the use of the debtor or any member of the debtor's household", which are also excluded from attachment (under s 45 and Sch 2 of the Debt Arrangement and Attachment (Scotland) Act 2002), it may be desirable to put the matter beyond doubt via statutory provision. Changes to property exempted from attachment can be dealt with by way of secondary legislation.

For further discussion of some of these matters, see ADJ MacPherson, "Scottish Statutory Debt Solutions and Diligence: A Response in a Time of Crisis" (2023) 27 *Edinburgh Law Review* 64.

Q7. Do you have any other comments on the Bill or this area of policy?

Alongside the Bill, there are various other desirable changes in this area of law (as noted above). The passing of this Bill must not be the end of reform in this area of law for the foreseeable future. Secondary legislation should be enacted and more substantial changes are needed following the Stage 3 Review, which should proceed as soon as possible. While incremental and targeted changes as provided by this Bill are valuable, a holistic approach to this complex area of law is greatly appealing.