The Enterprise Act 2002
Personal Insolvency Provisions

SGH Keynotes

Revised: March 2004

Sprecher Grier Halberstam LLP
30 Farringdon Street
London EC4A 4HJ

DX 53333 Clerkenwell

Tel: 020 7544 5555
Fax: 020 7544 5565

TABLE OF CONTENTS

Tab No.	Description	Page Nos.
1.	Biography	3-4
2.	Introduction	5-6
3.	Summary of personal insolvency provisions flow chart	7
4.	Duration of bankruptcy	8-10
5.	Bankruptcy restriction orders and undertakings	11-13
6.	The bankrupt’s home	14-18
7.	Individual Voluntary Arrangements	19-21
8.	Income payment orders & Agreements	22-23
9.	Miscellaneous	24-27

1. Biography

DANIEL SEJAS was admitted in 1996, and joined the firm's Insolvency Department in 1997, having acquired substantial experience of insolvency law and commercial litigation with a well-known London firm. He became the firm's youngest ever partner in 1999.

He specialises in insolvency, concentrating primarily on contentious insolvency. Daniel acts almost exclusively for insolvency practitioners, although he also advises debtors, creditors secured lenders etc. Daniel has considerable experience of both corporate and individual insolvency, covering the whole scope of insolvency matters including: petitioning for administration orders, 'out of Court' administrations under the Enterprise Act 2002, assisting administrators in the conduct of their administration, advising administrative receivers as to the validity of appointment, acting for liquidators in pursuing former directors, advising insolvency practitioners and debtors/companies in relation to voluntary arrangements, and extensive experience on advising insolvency practitioners on all aspects of personal insolvency, acting for creditors and advising company directors faced with disqualification proceedings.

Daniel's clients appreciate the quality of legal advice that he renders, his prompt proactive service, his strong commercial sense, and consider him a highly assertive litigator. His global knowledge of insolvency allows him to give clients the most proactive and realistic advice.

He lectures widely on insolvency law, and is a regular speaker at R3 conferences.

Daniel speaks fluent Spanish and French, and has a Masters in French Law (University of Bordeaux – France).

IAN GRIER is a leading insolvency specialist. He was admitted in 1972 and initially practised commercial litigation in a medium sized London firm. From 1977, he focused on insolvency law and rapidly became a well-known expert. He co-founded the firm with David Sprecher in 1984.

He is a licensed insolvency practitioner and Fellow of the Association of Business Recovery Professionals (R3)

His well established reputation stems not only from the popularity of several textbooks he has co-written on insolvency law, but also and essentially from many years of handling the complete range of insolvency matters.

Ian heads the Insolvency Department and deals with all aspects of corporate and individual insolvency. Whether providing the broadest assistance to insolvency practitioners (with liquidations, receiverships, bankruptcies and voluntary arrangements), devoting his expertise to the rescue, restructuring and/or disposal of businesses in difficulty, or advising directors facing legal responsibilities, his approach remains equally solution oriented. His expertise also covers Court appointed receiverships and LPA receiverships.

Ian's other areas of practice include corporate and contractual litigation, banking litigation and the defence of accountants in disciplinary matters. This, combined with his past experience as a local councillor, has allowed him a global as well as precise insight into the whole range of issues facing businesses.

His impressive experience, expert legal knowledge and in depth understanding of the specific commercial reality of insolvency situations enable Ian to give other insolvency practitioners as well as company directors the most proactive and accurate support.

Ian lectures widely to the R3, firms of Chartered Accountants and other professional bodies in relation to the law and practice of insolvency.

2. Introduction

The last two years have seen a period of fundamental change in insolvency law within the jurisdiction, through the introduction of significant regulations and legislation. Although no new insolvency procedures have been created per se, the Government has taken the opportunity of passing Acts of Parliament that make substantial amendments to current insolvency procedures. The personal insolvency provisions of the Enterprise Act 2002, the vast majority of which are due to come into effect on **1 April 2004**[1]**,** are the last provisions affecting insolvency law that have recently been introduced by the Government.

The Government and the European Union have introduced the following significant legislation, which affects personal insolvency, over the course of the last two years:

Date in force	Legislation/Regulation	Reference
31/05/02	European Insolvency Regulation	Council Regulation (EC) No. 1346 of 2000
01/01/03	Balance of Insolvency Act 2000, including schedule III (incorporating amendments to IVA procedure)	SI2002 No. 2711
15/09/03	Enterprise Act 2002 provisions concerning abolition of Crown preference and amendment of Trustee's powers under Schedule 5 Insolvency Act 1986	SI2003 No. 2093
01/04/04	Balance of personal insolvency provisions contained in Enterprise Act 2002	SI2003 No. 2093

Objectives of Personal Insolvency Reform

The personal insolvency provisions encapsulated in the Enterprise Act 2002 represent the Government's attempt to update the current bankruptcy regime, so as to bring the same in line with economic reality. Over recent years the level of consumer debt in British society has escalated dramatically, largely as a result of historically low interest rates, and an ever-increasing property market. It would not be unfair to suggest that the current high level of consumer credit has been encouraged as a means of keeping afloat the UK economy.

The existing bankruptcy regime was brought into force at a time when consumer credit was not as widely available as it is now. The Government is naturally concerned by the high level of consumer debt in today's society, and equally concerned by the potential effects (i.e. the potential drastic increase in the number of bankruptcies), were for example there to be another 'crash' in the housing market, or a significant increase in the base rate.

Traditionally there has been stigma attached to bankruptcy by the public. The objectives of the bankruptcy regime have been historically to divest a bankrupt of his assets, and to effect an ordered and expeditious distribution of the same amongst a debtor's creditors (in

[1] *Save for the relevant provisions concerning abolition of Crown preference and the amendments to Part 1 Schedule 5 Insolvency Act 1986 (Trustee's powers), namely the requirement to obtain sanction prior to issuing proceedings pursuant to s339, s340 and/or s423 Insolvency Act 1986, all of which came into effect on* ***15 September 2003***

accordance with the statutory rank of priority). The existing regime does not distinguish, or take into account, the culpability of a debtor for the events that resulted in bankruptcy.

In its consultation paper, *bankruptcy – a fresh start*[2] the Government set out an intention to distinguish between culpable and non-culpable bankrupts. On considering this paper it is apparent that the Government's view is that consumer debts incurred by bankrupts should not be viewed as a matter resulting in culpability.

For the non-culpable bankrupt the new regime is supposed to emphasise that bankruptcy is meant to be a 'clean start', and is intended to provide (in light of the increased number of bankruptcies anticipated as a result of consumer debt) a quick and streamlined bankruptcy procedure, with a view to ultimately eradicating the stigma attached to bankruptcy.

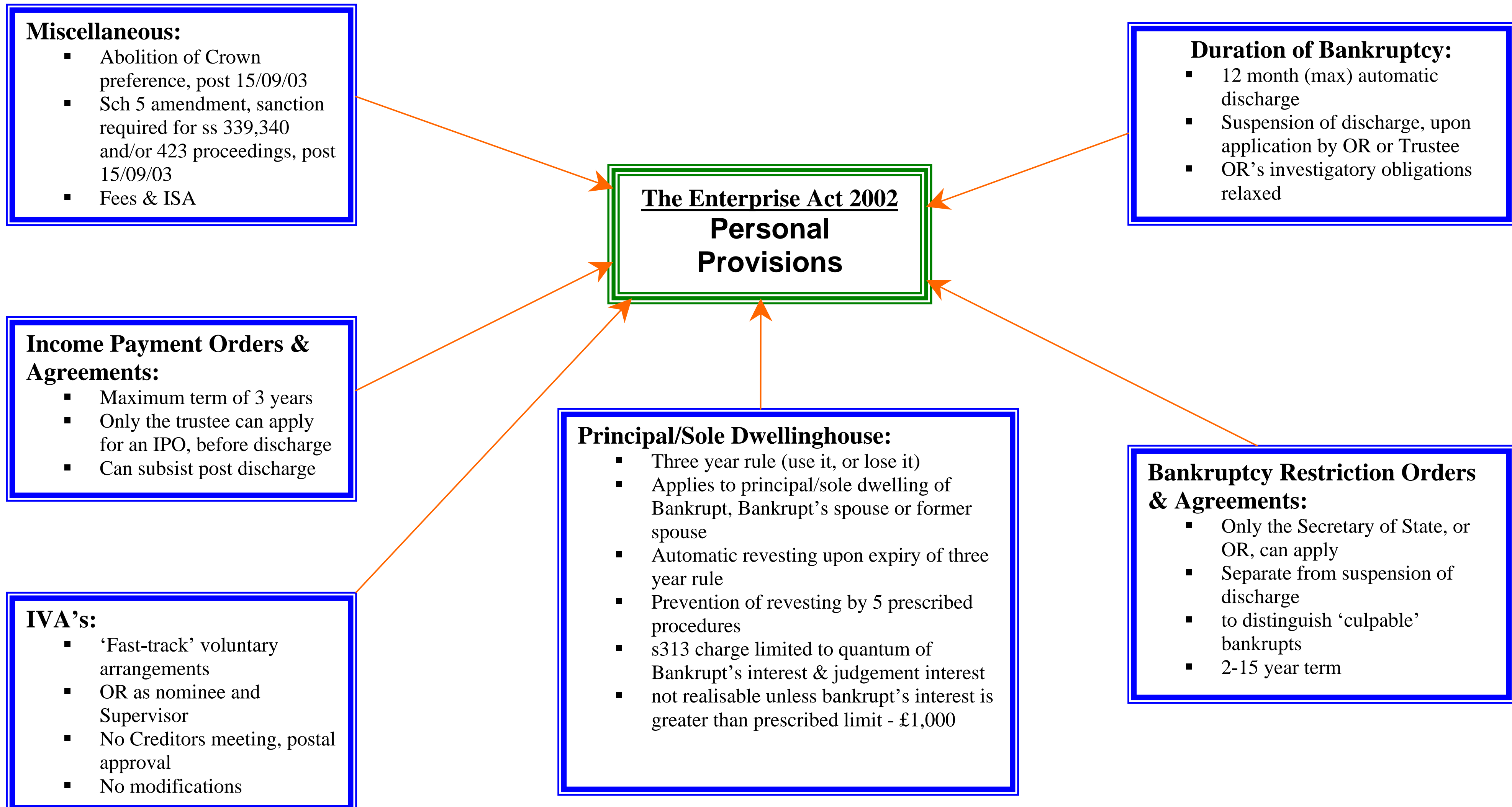
The Government's reforms were modelled largely on the American bankruptcy regime. It is perhaps somewhat ironic that the US is commencing to retract from its current liberal bankruptcy regime.

Nevertheless the changes to be brought into effect by the Enterprise Act 2002, and indeed those in the Insolvency Act 2000, have largely come into existence as a result of the Governments appraisal of the merits of American insolvency procedures. Insofar as concerns the corporate insolvency reforms introduced in September, it is the writers' view that the Government has 'missed the boat' by failing to make provisions for DIP (debtor in possession) financing, and the creation of priority charges for monies advanced to entities subject to insolvency procedures.

The purpose of these notes is to provide an overview of the relevant Enterprise Act 2002 reforms insofar as concerns solely its effects on personal insolvency.

[2] *March 2000*

Summary of Enterprise Act 2002
Personal Insolvency Provisions



4. Duration of Bankruptcy

The existing regime provides for the same period of discharge for all bankrupts, whereby they are automatically discharged from bankruptcy three years after the making of the Bankruptcy Order. There are of course exceptions to this, where for example the Court has suspended the period of automatic discharge, or an order for summary administration has been made, or where the debtor has been an undischarged bankrupt within the previous 15 years. In general however the duration of bankruptcy is the same for bankrupts regardless of culpability, or the level of their assets/liabilities.

Earlier discharge

With a view to promoting 'rescue culture', the Government has considered it appropriate to reduce the period of this charge through bankruptcy. Section 256 of the Enterprise Act 2002 substitutes s279 Insolvency Act 1986, so as to reduce the period of automatic discharge from bankruptcy to a ***maximum one year*** from the date of commencement.

The 12-month automatic discharge period is the maximum period prior to receipt of automatic discharge. Indeed under the consultation paper it was anticipated that the vast majority of bankrupts would receive their discharge in less than six months.

The period of automatic discharge will be less than one year if, during the first year following commencement of bankruptcy, the Official Receiver files at Court a notice stating that his investigation of the conduct and affairs of the bankrupt (under s289 Insolvency Act 1986) is unnecessary or concluded. Should the Official Receiver, file such notice within the first year of bankruptcy, the debtor will receive his discharge as at the date that the said notice is filed.

As aforesaid, the period of bankruptcy will only therefore be reduced below the one-year new automatic discharge period if the Official Receiver is of the view that there is no 'culpability' to be attached to the bankrupt's actions.

Pursuant to Insolvency Rule 6.214A, the creditors are also given a right to object to the bankrupt receiving his automatic discharge prior to one year following commencement. This proposed insolvency rule provides that the Official Receiver must (prior to filing a notice that his investigation of the conduct and affairs of the bankrupt is unnecessary/concluded) give written notice of his intention to do so to all of the creditors of whom he is aware. The Official Receiver is obliged to provide 28 days notice, before filing the appropriate notice at Court pursuant to s279(2). During this 28-day period the creditors have a right to object.[3] Upon receipt of objection, the Official Receiver is obliged to consider the same. If the objection is rejected, the Official Receiver shall serve written notice of the rejection (providing full particulars) upon the complainant, and thereafter the complainant has the right to elect whether or not to issue an appeal to Court.[4]

Transitional provisions

The provisions for automatic discharge stipulated above do not apply to a person adjudged bankrupt prior to the coming into force of the Enterprise Act 2002[5], and who remains an

---

[3] *through filing Form 6.82, and serving the same on both the Court and the Official Receiver.*
[4] *Under Insolvency Rule 7.50(2)*
[5] *1 April 2004*

undischarged bankrupt as at 1 April 2004. Such bankruptcies are defined as 'pre-commencement bankruptcies.'[6] A pre-commencement bankrupt shall be discharged as at whichever is the earlier of:

1. the end of the period of one year from the period of commencement of the Enterprise Act 2002 (i.e. on 1 April 2005); or

2. the end of the relevant period applicable to the bankrupt under the 'old' s279(1)(b) Insolvency Act 1986.

The position is however different for those individuals who have been undischarged bankrupts more than once in the previous 15 years, and who are still undischarged as at 1 April 2004. In such instances the bankrupt will be discharged five years from the date of commencement of the Enterprise Act 2002 (1 April 2009), or earlier if an order is made under s280(2) Insolvency Act 1986]

Suspension of Discharge

Notwithstanding the shorter period of automatic discharge to be introduced by the Enterprise Act 2002, there is still scope within the legislation for an application to be made to suspend the period of automatic discharge. This is distinct to the effects of a Bankruptcy Restriction Order/Agreement[7].

Under the existing bankruptcy regime it is only the Official Receiver who can apply to suspend the period of automatic discharge, usually following a report/request by the Trustee. Section 256 Enterprise Act 2002[8] expressly provides that both the Official Receiver or the ***Trustee*** are ***empowered to apply to Court to suspend the period of automatic discharge*** until :-

1. the end of a specified period; or

2. the fulfilment of a specified condition.

The Court shall only make an order suspending discharge if it is satisfied that the bankrupt has failed, or is failing, to comply with one of his/her obligations. The relevant supporting legislation is contained in Insolvency Rules 6.215 – 6.216.

The effects of suspension of the automatic discharge ought to be remembered, particularly when contrasting the relevant provisions to those in respect of Bankruptcy Restriction Orders/Agreements, namely in particular the bankrupt not obtaining his release from bankruptcy debts, and still being subject to the restrictions imposed by the insolvency legislation[9].

---

[6] *Paragraph 3, Schedule 19, Enterprise Act 2002*
[7] *see section 5 below*
[8] *through substitution of s279 Insolvency Act 1986*
[9] *as reduced by the Enterprise Act 2002*

Investigatory Duties of Official Receiver

Currently under s289 Insolvency Act 1986 the Official Receiver is under a duty to investigate the conduct and affairs of every bankrupt, except in summary cases[10]. Under the existing regime, it is perceived that there is little incentive to investigate summary cases, since in such instances there are small assets and unsecured liabilities[11]. In essence, where there are small unsecured liabilities it is deemed not to be commercial/required to use the Official Receiver's resources for a full investigation.

In view of this, and bearing in mind the emphasis on rescue culture, s258 Enterprise Act 2002[12], removes the automatic obligation on the Official Receiver to investigate every case. The ***Official Receiver is only obliged to investigate the conduct and affairs of a bankrupt where he/she considers it necessary*** to do so.

[10] *where the Official Receiver will only investigate if he/she deems it necessary to do so*
[11] *less than £20,000*
[12] *through substitution of s289 Insolvency Act 1986*

5. Bankruptcy Restriction Orders & Undertakings

One of the key objectives of the Enterprise Act 2002 is to encourage business enterprise through removal of the stigma of bankruptcy. This requires a distinction between the dishonest and culpable bankrupt, and those 'ordinary' bankrupts where their bankruptcy has ensued through no fault of their own.

At present the only punishments available in respect of rogue bankrupts are the criminal sanctions under the existing legislation. These require criminal standards of proof – beyond all reasonable doubt – before they can be brought into effect. In practice they are used exceptionally rarely. Therefore, under the existing legislation, there are no procedures that can be used against culpable bankrupts whose standard, whilst culpable, falls short of the level required to make use of the criminal sanctions.

In order to allow greater protection of the public, the Enterprise Act 2002 introduces Bankruptcy Restriction Orders (BRO) and Bankruptcy Restriction Undertakings (BRU), which are subject to a civil standard of proof – on the balance of probability. The entirety of the new regime is encompassed in s246 Enterprise Act 2002.[13]. The main body of the relevant provisions are included in Schedule 20 and Schedule 21 Enterprise Act 2002.

In brief, if following the requisite investigation by the Official Receiver, if it is deemed that a bankrupt has acted 'improperly', or is otherwise culpable for his bankruptcy, then an application can be made for a BRO, or the bankrupt can be asked to agree to a BRU so as to avoid the need for Court proceedings[14].

The BRO regime is intended to mirror the existing regime under the Company Directors Disqualification Act 1986, and consequently a BRO of ***between 2 – 15 years*** can be made. It is highly likely that the Court will adopt the same guidelines as in disqualification cases, and in particular those established in *Re Sevenoaks Stationers,* namely:

a) a BRO of 2 – 15 years where the bankruptcy has resulted due to the bankrupt's negligence;

b) a BRO of 6 – 10 years where the bankruptcy has arisen as a result of a combination of negligence and self-serving conduct; and

c) a BRO of 11 – 15 years where the bankruptcy has arisen as a result of conduct bordering on fraud or criminal activity.

Following investigation, the procedure to obtain BRO is through the issue of an application to Court. Such an ***application can only be made by the Secretary of State or the Official Receiver*** (acting upon the direction of the Secretary of State). An application cannot be made by a Trustee in Bankruptcy. The application ***must be made within one year*** of the date upon which the bankruptcy commences, i.e. before the reduced period of automatic discharge[15].

In view of the shortened period of automatic discharge, the Enterprise Act 2002 also introduces the concept of an interim BRO. Therefore if the 12 month automatic discharge

[13] *through insertion of a new s281a into the Insolvency Act 1986.*
[14] *In effect BRU is a BRO, entered into by consent, without formal Court involvement.*
[15] *Paragraph 3(1)(a), Schedule 4a, Insolvency Act 1986 (as amended by the Enterprise Act 2002)*

period is due to come into effect prior to the hearing of a BRO application by the Court, the Court can order that an interim BRO be made pending the outcome of the full application.

As in disqualification proceedings, a bankrupt can offer a BRU, so as to avoid the need for a Court application for a BRO to be made. This is analogous to a defendant agreeing to dispose of company director disqualification proceedings by way of undertaking prior to issue.

On deciding whether or not to make a BRO, the Court is obliged to consider the conduct of the bankrupt (whether before or after the making of the bankruptcy order). The relevant matters to be considered by the Court, which may result in a BRO being made, are similar to those matters that may result in a disqualification order being made, as set out in Schedule 1 Company Director Disqualification Act 1986. They include[16]:-

1. failure to co-operate;

2. fraud/fraudulent breach of trust;

3. failure to account satisfactorily, to the Court/Official Receiver/Trustee, for any loss of property;

4. gambling, unreasonable extravagance, that may have materially contributed to an increase of the extent of the bankruptcy;

5. incurring a debt, prior to commencement of bankruptcy, which the bankrupt had no reasonable expectation of being able to pay;

6. trading, prior to commencement of bankruptcy, when the bankrupt knows himself to be unable to pay debts;

7. failure to supply goods/services that have been wholly or partly paid for;

8. excessive pension contributions;

9. antecedent transactions (preferences, transactions at an undervalue etc);

10. failure to maintain records, and/or to produce the same upon demand;

11. neglect of business affairs, which may have particularly contributed or increased the extent of the bankruptcy;

12. whether the bankrupt has been an undischarged bankrupt at some time during the period of six years ending with the date of the bankruptcy upon which the application for a BRO relates.

Effects of BROs & BRUs

A comprehensive list of prohibited activities that apply, following the making of a BRO/BRU, is not set out in the Enterprise Act 2002. Instead Schedule 21 Enterprise Act 2002 provides for a number of new sections to be incorporated into the Insolvency Act 1986.

[16] *Schedule 20 Enterprise Act 2002*

In essence the effect of a BRO/BRU is to extend the bankruptcy offences to which an undischarged bankrupt is subject, throughout the period of a BRO/BRU, notwithstanding when the bankrupt may receive his discharge from bankruptcy. Therefore the bankrupt will be committing an offence if he/she:-

a) acts as a receiver or manager of a company's property on behalf of a debenture-holder;

b) either alone, or jointly with any other person, obtains credit above the prescribed limit without disclosing that he is subject to a BRO, an interim BRO or a BRU;

c) trades under a name, other than that under which he was made bankrupt, without disclosing to all persons with whom he enters into any business transaction the name under which he was made bankrupt;

d) acts as an insolvency practitioner;

e) acts as a director of a company or limited liability partnership, or directly or indirectly takes part in or is concerned in the promotion/formation/ management of a company or limited liability partnership without leave of Court;

f) acts as a member of the House of Commons, sits/votes in the House of Lords, and sits/votes on a Committee of the House of Lords or a joint committee of both Houses;

g) acts as a member of a local authority.

As with disqualification proceedings, the Secretary of State is obliged to maintain a publicly available register of people subject to BROs or BRUs. Breach of a BRO/BRU is a criminal offence.

6. The Bankrupt's Matrimonial Home

Under the current legislation all of the bankrupt's estate permanently vests in his Trustee in Bankruptcy[17]. This includes any interest that the bankrupt may have in the matrimonial home, or a former matrimonial home. It is not unheard of for cases to be referred, by the Protracted Realisations Unit, to insolvency practitioners 8 – 10 years after a bankruptcy order has been made. In view of recent trends in the property market, where previously there was little/no equity in a property, when the matter has been referred to an insolvency practitioner, it is not unusual (8 – 10 years later) to find that the bankrupt's property has a significant level of positive equity. During the intervening period the bankrupt, or his/her family, would have been making payments towards the mortgage, although this does not serve so as to reduce any interest that the Trustee in Bankruptcy may have in the matrimonial home[18].

Such situations prompted a number of complaints to members of Parliament. The Government's original proposals for reform of the bankruptcy regime did not include any reforms concerning realisation of the matrimonial home. An appropriate clause was only tabled during the committee stages in the House of Commons, largely as a result of representations made by the Insolvency Practice Council, the Bankruptcy Advisory Service, and the Association of Business Recovery Professionals.

The Three Year Rule – 'Use it or lose it'

By way of introduction of s283A Insolvency Act 1986 provision is made effectively compelling a Trustee in Bankruptcy to deal with the matrimonial home within a period of ***three years*** beginning on the date on which a bankruptcy order is made.

The three-year rule ***applies to*** a bankrupt's ***interest in*** a ***dwelling house***, which as at the commencement of bankruptcy, was a ***sole or principal residence of*** :

a) the ***bankrupt***;

b) the bankrupt's ***spouse***; or

c) a ***former spouse*** of the bankrupt.

If the Trustee forms the view that a property is subject to the provisions of s283A Insolvency Act 1986, he is ***obliged to issue an appropriate notice*** to all interested parties notifying them of his decision pursuant to Insolvency Rule 6.237. Such notice must be issued no less than 14 days prior to expiry of the three-year period.

If within the aforementioned three-year period, a Trustee in Bankruptcy fails to deal with such an asset, the proprietary interest in question (i.e. the bankrupt's interest in the property) ***automatically re-vests in the bankrupt***[19]. Upon such re-vesting, and within seven days thereof, the Trustee is obliged to notify HM Land Registry that the interest has re-vested in the

---

[17] *s306 Insolvency Act 1986.*

[18] *Since payments to the mortgage are offset against the occupational rent that the Trustee would otherwise be able to charge for allowing the bankrupt and his family to remain in occupation following bankruptcy (re Gorman)*

[19] *s283A(ii)(b) Insolvency Act 1986*

bankrupt (or to provide an appropriate certificate as to re-vesting on Form 6.84 in the case of unregistered land)[20].

As aforesaid the three-year rule only applies to properties at which the bankrupt, the bankrupt's spouse, or the bankrupt's former spouse ***reside*** (as their sole or principal residence) ***as the date of the bankruptcy order***. The three year use it or lose it rule will therefore not apply to investment property. It is however conceivable that the three year rule may apply to more than one property, where for example the bankrupt resides at one property, and the bankrupt's former spouse resides at another (but both properties are jointly owned).

If the bankrupt does not inform the Official Receiver or Trustee of his interest in a qualifying property within three months of the commencement of the bankruptcy, the three-year rule will commence to run from the date that the Official Receiver or Trustee becomes aware of such an interest[21].

In certain circumstances it is also now proposed that the 3 year rule can be reduced in view of the provisions that are due to be introduced by the draft Insolvency (Amendment) Rules 2004. The final version of these Rules has yet to be finalised. The new proposed Rules provide[22]that a new Insolvency Rule 6.237CA be inserted into the insolvency legislation. This newly proposed Rule provides that the 3 year period may be reduced where the Trustee in Bankruptcy sends an appropriate notice to the bankrupt confirming that the Trustee considers that:

1. the continued vesting of a qualified property in the bankrupt's estate is of no benefit to the creditors; or

2. the re-vesting to the bankrupt, of a qualifying property, will facilitate a more efficient administration of the bankrupt's estate.

In the event that the Trustee issues such a notice, the qualifying property will re-vest automatically in the bankrupt after 1 month from the date of the said notice.

The writer's view is that this newly proposed Rule is to be inserted in view of the requirements of s332 Insolvency Act 1986. This section of the legislation provides that a Trustee is unable to summons a final meeting where there is comprised within the estate an interest in a dwellinghouse occupied by the bankrupt, the bankrupt's spouse or former spouse, and the Trustee has been unable to realise the said interest. In such circumstances the Trustee is not empowered to summons a final meeting pursuant to s331 Insolvency Act 1986 unless the Court has made a charging order pursuant to s313 Insolvency Act 1986, or has refused to make a charging order, or a Secretary of State Certificate has been obtained (stating it would be inappropriate or inexpedient for such an application to be made in the matter at hand)[23].

Conversely the provisions of the Enterprise Act 2002, through the introduction of s313A Insolvency Act 1986, provide that an order for sale or a charging order cannot be made where the value of net equity in the property fall below the prescribed limit. The introduction of Insolvency Rule 6.237CA is therefore intended to afford a Trustee in Bankruptcy an alternative exit route where there is minimal/no net equity in a property, and consequently an order for sale or charge cannot be obtained, so as to allow the Trustee to convene a final

[20] *Insolvency Rules 6.237(a) – 6.237(b)*
[21] *s283A(5) Insolvency Act 1986*
[22] section 47, the Insolvency (Amendment) Rules 2004 (draft)
[23] s332(2) Insolvency Act 1986

meeting without having to await automatic re-vesting after 3 years, or without having to obtain a Certificate from the Secretary of State[24].

Transitional provisions

The use it or lose it three year rule will not have retrospective effect. Notwithstanding this the relevant provisions will still apply to existing bankruptcies where a bankruptcy order has been made prior to 1 April 2004 (the day upon which the personal provisions of the Enterprise Act 2002 are due to come into force).

Insofar as concerns ***pre-commencement bankruptcies***, the bankrupt's interest in a qualifying property will ***re-vest in the bankrupt automatically after the expiry of a three year transitional provision, which commences to run on 1 April 2004*** (i.e. re-vesting will take place on 1 April 2007).

Personal liability

If a Trustee in Bankruptcy fails to take steps to realise the bankrupt's interest in a qualifying property, within the three-year rule, and consequently the proprietary interest re-vests automatically in the bankrupt, a Trustee may be faced with a claim against him by the creditors should the estate in bankruptcy have suffered a loss[25]

Preventing re-vesting of the proprietary interest in the bankrupt

During the three-year period, the Trustee may prevent a qualifying proprietary interest revesting in the bankrupt automatically, at the expiry of the relevant three-year period, by taking one of the following five prescribed steps:

1. realising the bankrupt's interest in the property (i.e. selling the same, or concluding a settlement);
2. applying for an order for sale pursuant to s335a Insolvency Act 1986[26];
3. applying for an order for possession of the dwelling house pursuant to s336 Insolvency Act 1986;
4. applying for a charge on the property, for the benefit of the bankrupt's estate, pursuant to s313 Insolvency Act 1986; and/or

---

[24] pursuant to s332(2)(c) Insolvency Act 1986

[25] *pursuant to ss303 and/or 304 Insolvency Act 1986*

[26] *it should be noted that there will be no reduction in the period of one year, beginning with the vesting of the bankrupt's estate in the Trustee, insofar as concerns the presumption or assumption that the interests of the creditors outweigh all other considerations upon an application for an order for sale.*

5. by the Trustee and the bankrupt agreeing that the bankrupt shall incur a specified liability to his estate (with/without interest from the date of agreement) in consideration of which the interest shall cease to form part of the estate[27].

Insofar as concerns the Court applications referred to above, the ***suspension of the three-year rule will take effect upon the date of issue (and not the date of the order)*** of the requisite application.

The legislation also provides that an application can be made by the Trustee, to Court, to defer/suspend the three-year rule. Such an application could conceivably be made, for example, where due to the late stage at which a Trustee has been appointed he has had insufficient time to investigate the bankrupt's affairs, and in particular the extent of the bankrupt's proprietary entitlement in a particular property.

Charge over bankrupt's interest

The Enterprise Act 2002 also seeks to limit the scope of s313 Insolvency Act 1986, so as to limit the value (as to quantum) of the charge obtainable by a Trustee.

The relevant amendments are intended to prevent the Trustee from recouping the benefit of any increase in the value of the property after the date that the s313 charge is made by the Court. Under the new provisions the value of the charge will be ***limited to the value of the bankrupt's interest*** in the property ***as at the date of the s313 order*** creating the charge, ***together with interest*** accruing thereafter at the prescribed rate under the Judgments Act 1838 (the judgment rate being fixed at that in force on the day that the charge is imposed)[28].

The draft Insolvency Rules[29] provide for the insertion of a new Insolvency Rule 6.237D(10). As aforesaid, when making a charging order, the Court will make a charge over the bankrupt's interest in a property limited as to quantum, as opposed to a percentage share of the net equity. The new Insolvency Rule 6.237D(10) provides that when determining the bankrupt's interest, there shall be excluded from the value of the property any amounts owing in respect of:

1. Any loan secured by a mortgage, or other charge against the property;
2. Any other third party interest; and
3. Reasonable costs of sale.

The writer's view is that this proposed Rule is to be inserted in order to clarify the relevant criteria to be taken into account by the Court when determining the bankrupt's interest. It is interesting to note that the Court will expressly take into account the costs of sale which will effectively reduce the bankrupt's interest. This appears to be unfair, since the costs of sale would ultimately be borne by the estate if the property has to be sold in the final analysis. In effect it may be that this proposed Insolvency Rule therefore deprives the estate, through 'double counting' costs of sale.

[27] *S283A Insolvency Act 1986, as amended by the Enterprise Act 2002*
[28] *Insolvency Rule 6.237(d)*
[29] the Insolvency (Amendment) Rules 2002

Minimum level of net equity

Through the insertion of a new s313A Insolvency Act 1986, an ***order for sale or a charge*** in respect of a property falling within the ambit of s283A Insolvency Act 1986 ***shall not be made if the value of the net equity in the property*** (as to the bankrupt's interest) ***is below the prescribed amount***.

This provision is intended to prevent the realisation of a bankrupt's interest in a property, where there is minimal value as to the bankrupt's share (and consequently where there is likely to be no benefit to creditors in realising the same). Under current case law, even if all the net equity available would only be used to pay the Trustee's costs, an order for sale can still be made[30].

The prescribed amount is defined in the Insolvency Proceedings (Monetary Limits) (Amendment) Order 2004[31], which is due to come into force on 1 April 2004. This expressly provides, in the schedule, that the minimum value of the bankrupt's interest in a dwellinghouse to allow the Trustee to obtain an order for sale, possession or a s313 charge, shall be **£1,000**.

[30] *Harrington v Bennett*
[31] Statutory Instrument 2004 No. 547

7. Individual Voluntary Arrangements

The Enterprise Act 2002 introduces further amendments to the Individual Voluntary Arrangement regime. These changes ought to be read in conjunction with the changes introduced by the Insolvency Act 2000. The changes introduced by the Insolvency Act 2000 do not form the subject matter of these notes, but can be summarised as follows:-

1. the introduction of a regime whereby bankrupts/debtors can put forward IVA proposals without having to apply for an interim order (thereby allowing debtors/bankrupts to effectively put forward more than one set of proposals in each 12 month period)[32].

2. An IVA, subject to approval, now binds every person who is entitled to vote at the meeting of creditors, whether or not he/she was present/represented thereat. It also binds any creditor who would have been entitled to vote had they received notice of the meeting.

3. Subject to the Individual Voluntary Arrangement having been commenced by way of application for an interim order, a landlord is prohibited from exercising forfeiture by way of peaceful re-entry, and/or levying distress.

4. In addition to insolvency practitioners, any member of a body recognised by the Secretary of State can act as a nominee and/or supervisor[33].

The Enterprise Act 2002 introduces further reforms to the voluntary arrangement regime, namely:-

a) Official Receiver as Nominee and Supervisor; and

b) Fast track voluntary arrangements.

<u>Official Receiver as Nominee and Supervisor</u>

Through the introduction of s389b Insolvency Act 1986, the Official Receiver is authorised to act as Nominee or Supervisor in respect of a voluntary arrangement in any case where the debtor is an undischarged bankrupt.

There is no provision per se authorising the Official Receiver to act as Nominee/Supervisor in respect of Case II IVAs. However there is specific provision[34] empowering the Secretary of State to bring into force a statutory instrument at some stage in the future repealing the proviso requiring the debtor to be an undischarged bankrupt if the Official Receiver is to act as Nominee/Supervisor. Such a statutory instrument could only be brought into force by

[32] *a moratorium is not created if IVA proposals are put forward outside of an interim order application*
[33] *To date no professional bodies have been recognised by the Secretary of State, although there is now provision for the* Official Receiver *to act as Nominee;/Supervisor in respect of Case I IVAs*
[34] *s389(b)(iii)(b)*

passing a resolution in one of the Houses of Parliament, but it is clearly envisaged that at some stage in the future the Official Receiver may be empowered to become Supervisor/Nominee in respect of both Case I and Case II IVAs.

Fast track voluntary arrangements

One of the intentions of the Enterprise Act 2002 is to promote the use of Case I IVAs (post-bankruptcy) with a view to enhancing rescue culture. The Government was also keen to promote voluntary arrangements in view of the general rule that returns to creditors are greater in arrangements than bankruptcy, and furthermore to protect against the unregulated activities of debt counsellors etc.

By allowing the ***Official Receiver to act as Nominee and Supervisor*** in respect of ***Case I IVAs***, the intention is to seek to reduce professional fees in instances where little assets are involved, so that a Case I IVA will be considered almost immediately after the onset of bankruptcy. Fast track voluntary arrangements are therefore likely to be of import in bankruptcies where small levels of assets are involved, and in instances where insolvency practitioners would not ordinarily be keen to be appointed Trustee, or to act as Nominee/Supervisor.

The new fast track voluntary arrangement regime is introduced through the insertion of s263A – s263G into the Insolvency Act 1986. The new fast track regime can only be used where:-

1. the debtor is an undischarged bankrupt;

2. the Official Receiver is specified in the proposal, as Nominee, in relation to the proposed voluntary arrangement; and

3. no interim order has been applied for under s253 Insolvency Act 1986[35]

The procedure is stipulated by the legislation as being commenced by the bankrupt submitting a proposal to the Official Receiver, together with a statement of affairs, and the prescribed fee. In practice invariably the debtor will require the assistance of the Official Receiver, or a licensed insolvency practitioner, to assist in the preparing of the requisite proposals and statement of affairs.

Following receipt the ***Official Receiver*** is to ***consider whether the proposal has a reasonable prospect of being approved***, and whether he is prepared to act as nominee[36]. The Official Receiver must also consider whether the proposed IVA should be solely in relation to bankruptcy debts, or alternatively whether the proposal should also attempt to bind creditors whose debts cannot be proved for in the bankruptcy.

If the Official Receiver forms the view that the proposal has a reasonable prospect of being approved, the Official Receiver will issue the proposals to the creditors and ask them to decide whether or not to accept it. There is ***no creditors meeting***. Furthermore the creditors ***cannot seek any modifications*** to the proposal. It is therefore anticipated that, in order to save costs, the new fast track voluntary arrangement procedure will take place ***entirely by way of correspondence***.

---

[35] *s263(a) Insolvency Act 1986, as amended by the Enterprise Act 2002*
[36] *s263(B)(ii) Insolvency Act 1986*

A fast track voluntary arrangement proposal is approved by the creditors if a majority of greater than 75% of the creditors in value vote for the approval of the proposal[37]. The legislation, as originally drafted, did not impose a requirement (to secure approval) for a requisite majority of non-associated creditors to also vote in favour of the arrangement. It now appears that this was a drafting error, which is to be corrected. The requisite associated creditor test is to be introduced by s27 of the draft Insolvency (Amendment) Rules 2004, through the insertion of Insolvency Rule 5.43(3). This newly to be inserted Insolvency Rule provides that a fast track IVA will not be approved if those voting against it include more than half in value of the creditors, counting only:

1. Those creditors who gave notice to the Official Receiver in accordance with Insolvency Rule 5.40;

2. Those claims to be excluded under the auspices of Insolvency Rule 5.43(2) (debts wholly/partially secured against a current bill of exchange or promissory note); and

3. Non-associated creditors of the debtor.

A newly to be inserted Insolvency Rule 5.43(4) expressly provides that it is solely for the Official Receiver to decide whether a particular creditor is an associate. Whilst a fast track IVA can still be challenged pursuant to s263F Insolvency Act 1986, the writer's view that Insolvency Rule 5.43(4) is intended to prevent a costs order being made against the Official Receiver in the event of material irregularity for admitting a creditor who was an associate[38] to vote as a non-associated creditor.

Subject to approval, the voluntary arrangement takes effect, and binds the debtor and creditors, upon the Official Receiver reporting the outcome to the Court[39]. Thereafter there follows a period of 28 days, following expiry of which the Official Receiver or the bankrupt can apply for annulment from bankruptcy as a direct result of the approval of a fast track voluntary arrangement[40].

During the said 28-day period an application can be made to Court to seek to revoke the voluntary arrangement on the grounds of either material irregularity or unfair prejudice[41]. Such an application can be made by any person entitled to participate in the fast track voluntary arrangement, the debtor, the Trustee in Bankruptcy, or the Official Receiver.

The Official Receiver will act as Nominee for a fixed fee of £300, and thereafter as Supervisor in return for fees equating to 15% of monies realised[42].

---

[37] *Insolvency Rule 5.43*
[38] within the meaning of s435 Insolvency Act 1986
[39] *s263(D)(i) Insolvency Act 1986*
[40] *Insolvency Rules 5.51 – 5.59*
[41] *s263 Insolvency Act 1986*
[42] Statutory Instrument No. 593 of 2004

8. Income Payment Orders & Agreements

Income Payment Orders

The existing Income Payment Orders (IPO) regime under the Insolvency Act 1986 is largely unaffected. In most cases, under the current regime, Income Payment Orders cease upon discharge. In view of the reduced period of automatic discharge to be introduced by the Enterprise Act 2002, this could create significant pitfalls. The legislation therefore provides that Income Payment Orders will now ***last for up to three years from the date of the IPO, irrespective of the date of discharge***[43].

Further the Enterprise Act 2002 also makes it clear that:-

a) an IPO ***can only be made upon the application by a Trustee*** in Bankruptcy; and

b) such an ***application must be made before the bankrupt receives his discharge*** from bankruptcy[44].

Insofar as concerns the latter, this creates an obvious pitfall, in view of the considerably shorter duration of bankruptcies following the introduction of the Enterprise Act 2002.

An IPO can be varied on the application of the Trustee or the bankrupt, whether before or after discharge.

Income Payment Agreements

In practice, under the current legislation, most applications for Income Payment Orders are uncontested. In order to remove the need for Court involvement in non-contentious cases, s260 Enterprise Act 2002 introduces the Income Payment Agreement (IPA) regime - by inserting a new 310A into the Insolvency Act 1986.

An IPA is in effect a ***written agreement*** made between a bankrupt and his Trustee, entered into by consent, pursuant to which a ***bankrupt voluntarily agrees to pay into his estate a specified proportion of his income for a specified period of time***. In effect it is an IPO, but without the need for formal Court involvement.

As with IPOs, an IPA ***must be entered into prior to receipt of discharge***. The IPA comes into effect on the date upon which the Official Receiver or the Trustee signs and dates the IPA[45].

Similarly, as with IPOs, an IPA ***cannot exceed three years*** in term, but can come to an end following receipt of discharge by the bankrupt.

---

[43] *s310(6) Insolvency Act 1986*
[44] *Enterprise Act 2002 s259(1), (2) and (3)*
[45] *Insolvency Rule 6.193B*

The bankrupt, the Trustee and/or the Official Receiver may seek to vary an IPA - but a Court application is required to do so[46].

[46] *Insolvency Rule 6.193*

9. Miscellaneous

The Enterprise Act 2002 also brings into force a number of other reforms, which are dealt with in this section of the notes.

Abolition of Crown Preference

With effect from 15 September 2003 the provisions of s251(1) Enterprise Act 2002 came into force. These provisions apply both to corporate and personal insolvency. This section simply provides that the relevant parts of Schedule 6 Insolvency Act 1986 will cease to have effect.

Insofar as concerns personal insolvency, the abolition of Crown preference provisions will apply where a bankruptcy petition has been presented, or a voluntary arrangement has effect, prior to 15 September 2003.

In such instances the remaining non-crown preferential debts are:-

1. contributions to occupational pension schemes (category 4);

2. remuneration of employees for the relevant period (category 5); and

3. levies on coal and steel production under the European Coal and Steel Community (ECSC) Treaty (category 6).

The subrogated rights of the Department of Trade and Industry, where the Crown has made payments from the National Insurance Fund, to cover all or part of any employee's preferential claims in respect of salary and wages under the Employment Rights Act 1996, will survive with (subrogated) preferential status.

Unlike corporate insolvency, in personal insolvency there are no 'top-slicing' provisions[47].

Trustee's powers

Schedule 5 Insolvency Act 1986 is amended, with effect from 15 September 2003, so as to require a Trustee to obtain sanction prior to issuing proceedings under ss339, 340 and/or 423 Insolvency Act 1986[48].

---

[47] *since there will be no floating charge*

[48] *Para 2A into Schedule 5 (Trustee's Powers)*

Disqualification from public office

Upon bankruptcy, a debtor shall no longer be automatically disqualified from acting as a Justice of the Peace, a member of the local authority, or a Member of Parliament[49].

However a bankrupt cannot be a member of the House of Commons, sit/vote in the House of Lords, and/or sit/vote in a Committee of both Houses if he/she is subject to a Bankruptcy Restriction Order.

Personal Insolvency Register

The existing separate registers of Bankruptcy Orders, and that of individual voluntary arrangements, are to be combined into a single individual insolvency register.

A separate Bankruptcy Restrictions Order Register is also to be established.

Money and fees

The Government has announced an intention to reform the current financial regime of the Insolvency Service established by the Insolvency Fees Order 1996.

Following introduction of a new s415A Insolvency Act 1986, the Secretary of State is empowered to charge fees to bodies recognised[50] as professional bodies for the purposes of Licensing Insolvency Practitioners.

Pursuant to s272(1) Enterprise Act 2002, the requirement[51] for excess income, from the IPA, to be paid into the Consolidated Fund, is removed.

Secretary of State/Official Receiver's fees

The Insolvency Proceedings (Fees) Order 2004[52] provides that in respect of all bankruptcies:

1. The Official Receiver shall be entitled to an administration fee of £1,625, for his general duties as Official Receiver upon the making of a bankruptcy order; and

2. The Secretary of State shall, in return for the performance of her general duties under the insolvency legislation in relation to the administration of the estate in bankruptcy, shall be entitled to a fee equivalent of **17%** of the total

[49] *ss265 and 267 Enterprise Act 2002*
[50] *under s391 Insolvency Act 1986*
[51] *under s405 Insolvency Act 1986*
[52] Statutory Instrument 593 of 2004

chargeable receipts relating to the bankruptcy. For the purposes of calculating the Secretary of State's fees there shall be excluded the first £2,000, and those part of the fees that exceed the bankruptcy ceiling. The Secretary of State's fees shall not exceed £100,000 in any event.

It is perhaps somewhat ironic that whilst the Government is attempting to emphasise rescue culture, and trying to promote IVAs to apparently increase dividends to creditors, the Secretary of State's administration fees appear to have the direct effect of adversely affecting the likely dividend to creditors in bankruptcy. It is also likely to impinge upon insolvency practitioners, when they consider whether or not to take a particular appointment. In effect only 83% of the realisations that could ordinarily be made would be available for payment of fees, and distributions etc. This provision is invariably to be introduced to make up for the loss of revenue on fees that are no longer paid into the ISA.

Trustee's remuneration

The draft Insolvency (Amendment) Rules 2004 provides for a newly inserted Insolvency Rule 6.138, together with the insertion of a new Schedule 6. The new provisions apply where the Official Receiver is not in office, and where the Creditors' Committee, or the creditors at a general meeting, have not passed a resolution in respect of the Trustee's remuneration (i.e. time costs basis, or as a percentage of realisations etc).

Previously in such circumstances the Trustee's costs used to be paid in accordance with the Official Receiver's scale. This is no longer the case. Insolvency Rule 6.138 provides that the Trustee's fees shall be calculated by:

1. Application of the Realisation Scale set out in Schedule 6; and

2. The sum arrived at through applying the distribution scale set out in Schedule 6.

In other words, Schedule 6 attempts to place the emphasis on rescue culture – through promoting greater fees greater fees remuneration where dividends are paid to creditors. The new fee regime in such circumstances is as follows:

Realisation Scale

Description	Percentage fees entitlement
On first £5,000, or fraction thereof	20%
Next £5,000, or fraction thereof	15%
Next £90,000, or fraction thereof	10%
All further sums realised	5%

Distribution Scale

Description	Percentage fees entitlement
First £5,000, or fraction thereof	10%

Next £5,000, or fraction thereof	7.5%
Next £90,000, or fraction thereof	5%
All further distributions	2.5%

It ought to be borne in mind that the Trustee in Bankruptcy will however still be entitled, to apply to Court for an appropriate declaration pursuant to Insolvency Rule 6.141.

© Daniel Sejas
SGH Sprecher Grier Halberstam LLP
30 Farringdon Street
London EC4A 4HJ

Tel: 0207 544 5555
Fax: 0207 544 5565
Email: daniels@sghlaw.com