Law Society of Scotland

Stage 3 Briefing

Bankruptcy & Diligence (Scotland) Bill

June 2024

Photo: Perth and the River Tay

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Introduction

The Law Society of Scotland is the professional body for over 13,000 Scottish solicitors.

We are a regulator that sets and enforces standards for the solicitor profession which helps people in need and supports business in Scotland, the UK and overseas. We support solicitors and drive change to ensure Scotland has a strong, successful and diverse legal profession. We represent our members and wider society when speaking out on human rights and the rule of law. We also seek to influence changes to legislation and the operation of our justice system as part of our work towards a fairer and more just society.

The Bankruptcy and Diligence (Scotland) Bill ("the **Bill"**) was introduced on 27 April 2023[1]. We responded to the Economy and Fair Work Committee of the Scottish Parliament's call for views on the Bill in July 2023[2] and provided oral evidence as part of the Committee's Stage 1 consideration of the Bill on 13 September 2023. We issued a briefing ahead of the Stage 1 Debate in February 2024.[3]

We welcome the opportunity to consider and provide comments on the Bill as amended at Stage 2 ahead of the Stage 3 debate scheduled for 6 June 2024.

General Remarks

The Bill seeks to amend the law of diligence in Scotland (comprising of formal debt recovery processes) and to amend parts of the Bankruptcy (Scotland) Act 2016 as well as proposing to establish a mental health moratorium on debt recovery action.

We support the introduction of the Bill. We believe that legislation on certain matters is overdue, and that it is desirable to update the pre-existing bankruptcy and diligence legislation.

We note that the Bill forms part of a wider exercise to review and reform the law of statutory debt solutions and diligence. The Bill deals with the areas requiring primary legislation from Stage 2 of the review and the intention is that other areas will be addressed by secondary legislation or through guidance. [4]

We have commented on specific provisions of the Bill below and the amendments at Stage 2.

We would also suggest that consideration be given to reform in the following areas:

[1] Bankruptcy and Diligence (Scotland) Bill

[2] Call for Views Response – Banking, Company and Insolvency Law Society sub-committee

[3] https://www.lawscot.org.uk/media/0joclcfk/24-02-06-bankruptcy-and-diligence-s-bill-stage-1-briefing.pdf

[4] Policy Memorandum

- In our view, progress needs to be made on reforming adjudication for debt or replacing it with land attachment (and residual attachment) or an equivalent. While we understand the difficulties surrounding diligences over residential property, these issues are also delaying desirable reform for diligences over commercial property.
- Further, we also consider that Information Disclosure Orders (**IDOs**), under the Bankruptcy and Diligence etc. (Scotland) Act 2007[5] should be made available by regulations to improve transparency and to assist the recovery of debts. We acknowledge that IDOs do not need to be included within the Bill, given the existing primary legislation, however it would be beneficial to bring them into being as soon as possible and, if achievable, around the same time that the Bill's provisions enter into force.

Specific Comments on the Bill and Stage 2 Amendments

Section 1 –Mental Health Moratorium

Section 1 concerns the moratorium on debt recovery actions – debtors who have a mental illness. Section 1(1) allows Scottish Ministers by regulations to make provision to establish a moratorium on debt recovery action by creditors against individuals who have a mental illness. Section 1(2) sets out the matters which may, amongst other things, be covered by Regulations. Section 1(4) provides that Regulations made under section 1 are subject to the affirmative procedure.

Much of the detail regarding how the proposed mental health moratorium will operate in practice is left to secondary legislation. Given the level of detail to be provided for in Regulations, we consider that the affirmative procedure is appropriate. In January 2024, we responded[6] to the Scottish Government consultation[7] on the proposed process for a Mental Health Moratorium (the **2024 Consultation**). We are aware that the draft regulations[8] have now been published and we will review them and consider providing comments in response to the proposed public consultation.

In our response to the 2024 consultation, as in our written evidence to the committee, we highlighted the need for the moratorium to strike a balance between protecting vulnerable debtors and managing the impact on creditors. We also highlighted that people with a wider range of conditions, characteristics and disabilities could also benefit from the protections afforded by the proposed moratorium. In particular, we noted our concerns that the proposed initial mental health eligibility criteria would exclude any debtor receiving treatment on a

[6] Consultation Response – Banking, Company and Insolvency Law Society sub-committee

[7] Mental Health Moratorium: consultation

[8] Debt Recovery Mental Health Moratorium (Scotland) Regulations 2024 – Stage 3 Draft

voluntary basis. While we understand the desire for adopting a narrow approach (for now) with reference to particular legislative provisions, and the need to balance different interests, clarity is required on what the moratorium is seeking to achieve and why it ought to be limited only to those who meet the proposed mental health eligibility criteria. We understand that the intention is now to extend eligibility beyond those undergoing compulsory treatment to those voluntarily undergoing equivalent treatment. In light of our noted comments above, we welcome this development and believe that it addresses some of our concerns.[9]

We note that the Stage 1 Report asks the Scottish Government to reconsider its position that moratorium protection should not extend to preventing eviction or to people who are jointly and severally liable for debts. Whilst we are generally supportive of the proposed approach to qualifying debts set out in the 2024 Consultation, we consider that further consideration should be given to diligence protections for joint and severally liable debtors, particularly in relation to housing whether tenanted or owned. We agree with the Mental Health Working Party recommendations 9 and 10.

We note the comments in the Stage 1 Report regarding additional pressures on the money advice sector[10] and the need for guidance and training for mental health professionals and money advisers. We also consider that additional resources are required and should be made available for professionals and debt advisors dealing with vulnerable clients who are suffering from mental health issues and that debt advisors are sufficiently trained in this, as currently required.

We note the concerns highlighted in the Stage 1 Report that people in compulsory treatment who do not have the capacity to consent to a mental health moratorium or have a legally recognised representative to do so for them, will not be able to access the scheme.[11] In our response to the 2024 Consultation, we called for further clarity regarding this aspect of the proposal. The combined effect may mean that most people experiencing serious mental illness, including those most in need of protection, are excluded from the scope of the moratorium.

We also note the request for clarity in the Stage 1 Report regarding the proposals for a public register for the mental health moratorium.[12] In our response to the 2024 Consultation, we highlighted that further consideration would be required in relation to any proposal to require registration as mental health issues are a matter deserving of privacy and can be a disability and therefore a protected characteristic under the Equality Act 2010. We note from the draft regulations that the intention is to adopt a register that can only be searched by the individual debtor, their adviser, a relevant mental health professional and relevant creditors.

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[9] Debt Recovery Mental Health Moratorium (Scotland) Regulations 2024 – Stage 3 Draft

[10] Stage 1 report, para 85.

[11] Stage 1 report, para 98.

[12] Stage 1 report, para 102.

We shall examine the proposals carefully and will provide any comments in due course.

Finally, we welcome the Stage 3 amendment that provides for a review of the mental health moratorium every 5 years which will enable a check on whether the provisions achieve their intended purpose.

Section 2-5 Modification of the Bankruptcy (Scotland) Act 2016

We note in particular the insertion of section 2A (Recall of sequestration: payment of interest) which modifies the Bankruptcy (Scotland) Act 2016 with, amongst others, the insertion of Section 37A (Interest). These amendments reflect the comments we raised in relation to *The Advocate General for Scotland (for and on behalf of HMRC) v The Accountant in Bankruptcy*[13] where we suggested that statutory interest should be required to be paid if there is to be a recall of sequestration (by the Sheriff in terms of section 30 of the Act or by the Accountant in Bankruptcy in terms of section 31 of the Act) on the basis that the debtor had paid their debts in full. We considered this requirement could be limited to where such recall shall take effect on a date after a certain period from the date of the Award and suggested that an appropriate period would be six months and are pleased that this has been reflected in the Bill.

However, we also have concerns that the drafting of the new section 37A (3) (at Part 2 of the Bankruptcy (Scotland) Act 2016) may cut across any contractual right of a creditor (or a creditor in terms of a decree) to interest in terms of the contract with the debtor (or decree against the debtor). The current position is that statutory interest is recoverable when no interest is provided for by way of contract or decree and it was statutory interest that was the matter in issue in *The Advocate General for Scotland (for and on behalf of HMRC) -v- The Accountant in Bankruptcy*. It is this anomaly that we suggested was corrected in our Stage 1 Briefing and if the current wording is passed, it will have many potential implications, which we do not believe are reflective of the policy intention of the Bill. It should therefore be clarified that it is only statutory interest that does not need to be paid if a debtor is seeking recall of sequestration on the basis of debts having been paid in full within 6 months after the date of the award of sequestration. Other interest, whether the relevant rate is above or below the statutory interest rate, should remain payable in order for the debtor to obtain a recall of sequestration.

We welcome the new provision after section 5 on Protected Trust Deeds and that certain information and time is to be given to a debtor by the trustee so that they can consider the debt advice and material accordingly.

[13] [2020] SAC (CIV) 5

Sections 6-10 Diligence Reforms

We have been generally supportive of the diligence reform proposals and note that their effects will be positive overall in enabling diligence to be undertaken successfully by creditors, albeit that certain parties may be negatively affected.

Regarding the arrestee's duty of disclosure (sections 6 and 7 of the Bill), we note the amendments to these sections and continue to see merit in requiring arrestees to disclose that an arrestment has been unsuccessful (a nil return), and we support the policy behind this. Arrestees already need to determine whether they hold relevant property when served with an arrestment.

However, we continue to note the proposed disclosure requirement is an unfunded obligation which places a financial burden on an arrestee and may even lead to speculative fishing diligences. The increased costs that this would create is of particular concern given that many arrestments presented to banks result in a nil return as matters stand.

Banks and others could seek to pass these increased costs on to consumers and businesses, and so, while we agree with the reform in a broad sense, we believe that the requirements of disclosure here should be as light touch and non-onerous as possible. Forms and paperwork should be as straightforward as possible and clear for the parties involved, and the possibility of an arrestee using a simple electronic communication to specify that no property has been arrested could be considered. We are therefore seeking clarity on the extent of disclosure that will be required on an arrestee served with an arrestment schedule and what guidance will be issued to enable them to be clear on the disclosure required.

Whilst we support electronic format for communication, this must be accessible to all parties and persons with protected characteristics.

We are aware of other suggestions to give effect to a duty of disclosure where an arrestment is unsuccessful (e.g. as noted in the Economy and Fair Work Committee's Stage 1 Report). We think that these could help to address our concerns about increased costs and the onerous requirements for banks (and others) but we are relatively agnostic as to which of these is the most suitable in the circumstances. However, in the event that no single model identified commands sufficient support, some form of hybrid model might be considered instead. For example, there could be a requirement to respond to arrestments arising from individual warrants rather than bulk warrants, while for the latter category, there could be a requirement to respond within a reasonable time to specific requests. In any event, the requirements for specific requests should be as straightforward as possible for a creditor, to avoid them incurring unnecessary time and expense.

We also note that the changes to the duty of disclosure on arrestees also raise a legitimate question about individual rights to privacy & compatibility with Data Protection legislation. Under these proposed provisions, the arrestee or account

holder would be compelled to volunteer facts about an individual to the person executing the arrestment (including where they do not have their banking). That person executing the arrestment and the creditor have a right to recover money held on account for the debtor. However, we have concerns as to the justification for the professionals and creditors involved (which will include Government bodies) to maximise the data gathered in the exercise.

We are therefore of the view that it may be better to point the arresting creditor to using information that they already retain. For example, in the case of a Local Authority pursuing a defaulting tenant, they could look to seek an arrestment from a known source such as the bank account from where they previously paid rent. This would avoid any practice where an arrestment schedule is served on every Bank rather than a targeted known source of property or funds. We would therefore welcome further clarity, and potentially the issuing of guidance, on what data can be disclosed by an arrestee. In addition, the matters noted above provide more support for the introduction of Information Disclosure Orders (see our General Remarks, above), which would help avoid and address some of the issues identified.

We note that the amount payable by an arrestee where they have failed to disclose relevant information has been reduced to £500. We remain uncertain as to what the justification is for this and why the link to the protected minimum amount has been removed, and we would request further clarity on this matter.

In relation to the arrestment provisions, we continue to suggest that the Explanatory Notes should make clear that the applicable property is not just funds but also other corporeal and incorporeal moveable property in the hands of a third party. For the changes regarding diligence on the dependence, we continue to be of the view that it should be made clearer that the date before which the debt advice and information package requires to be served is the date of the hearing (rather than e.g. the date when the diligence is executed).

We continue to consider that the proposed amendments for money attachments (section 10) are sensible.

Sections 11-13 Final Provisions

These Sections of the Bill deal with ancillary provision, commencement and short title.

We have no further comments on these sections.

For further information, please contact:

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