



July 2003

BRIEFING

# Individual insolvency

The Enterprise Act 2002

## Executive summary

The government introduced changes to the personal insolvency regime, through the Enterprise Act 2002, in an effort to remove some of the stigma of bankruptcy, thus reducing entrepreneurs' fear of failure. The Act balances this against the need to protect the public from irresponsible or reckless bankrupts.

This briefing examines the new individual insolvency provisions.

The Enterprise Act 2002 (Act) received Royal Assent on 7 November 2002. It follows the government's White Paper, *Productivity and Enterprise, Insolvency – A Second Chance*, that was published on 31 July 2001 and proposed major changes to both personal and corporate insolvency.

The insolvency provisions of the Act are not yet in force as secondary legislation is required to implement them. The personal insolvency reforms are expected to come into force at the beginning of the 2004/2005 financial year.

## Reducing the stigma

One of the objectives of the personal insolvency reforms is to distinguish between 'innocent' and 'culpable' bankrupts and to reduce the stigma of bankruptcy in the case of the first category.

### Discharge period

In contrast with the current three-year period, bankruptcies will end automatically after one year – except in the circumstances described below.

The Official Receiver will make an initial inquiry into the circumstances of each bankruptcy including, for example, interviewing the bankrupt. If the inquiry reveals that further investigation is unnecessary, the Official Receiver will report this to creditors and the bankruptcy trustee, and then file notice at court before the end of the one-year period. On the filing of this notice, the bankrupt will be discharged early.

If the bankrupt fails to comply with his obligation to cooperate, the court may order that the automatic one-year

discharge period be suspended for a specified period or until a specified condition is met, thus extending the discharge period. The Official Receiver or bankruptcy trustee can apply for such a suspension.

### Automatic restrictions

The Act provides for restrictions to be imposed on culpable bankrupts after discharge. The criteria that the court will consider to establish culpability, and the restrictions that may be imposed as a result, are discussed in 'BROs and BRUs' below.

However, for most bankrupts the restrictions imposed automatically on bankruptcy will be reduced, not increased, following the implementation of the Act.

## Protecting the public

### Official Receiver investigation

If, after his initial inquiry, the Official Receiver concludes that further investigation into the conduct and affairs of the bankrupt is required, the Act gives him the power to undertake that investigation and make such report to the court. That report may lead to the secretary of state, or the Official Receiver acting on the direction of the secretary of state, applying for a bankruptcy restriction order (BRO).

### BROs and BRUs

A court can impose a BRO on a bankrupt for between 2 to 15 years, regardless of the intervening discharge of the bankrupt. This order will restrict the activities of the bankrupt.

The grounds on which a court will consider making a BRO include, but are not limited to:

- failure to co-operate with the Official Receiver or bankruptcy trustee;
- failure to be able to account for prior transactions causing loss;
- entering into a transaction at an undervalue;
- trading at a time when the bankrupt knew he was unable to pay his debts; and
- incurring a debt with no reasonable expectation of being able to repay it.

Previous bankruptcies will also be taken into account by the court.

Alternatively, a bankrupt can agree to give a bankruptcy restriction undertaking (BRU). In a BRU, a bankrupt agrees to be bound by specified restrictions. It will legally bind the bankrupt in the same way as a BRO, but without the court's involvement. Again, a BRU can be imposed for between 2 to 15 years.

If the Official Receiver thinks a BRO is appropriate and in the public interest, he will be able to apply to court for an interim BRO pending the full hearing of the application for a BRO.

## Other changes

### IPOs and IPAs

The court can make an income payment order (IPO) requiring a bankrupt to make affordable payments towards discharging his debts. Under the current regime, IPOs generally run until the bankrupt is discharged. In light of the Act's reduced discharge period, IPOs made under it will run for three years from the date of the IPO regardless of the date of discharge.

In addition, the Act makes changes to the IPO mechanism to ensure that bankrupts will pay – if they are able to.

Just as the Act provides for BRUs to be an alternative to BROs, it also enables the bankrupt to enter into an income payment agreement (IPA) rather than be subject to an IPO. While an IPA does not involve the court, it is still a legally-binding agreement in which the bankrupt agrees to make affordable payments. An IPA will last for three years from the date it is made.

## IVAs

An alternative to the current bankruptcy regime is for an individual to enter into an individual voluntary arrangement (IVA). An IVA is a legally-binding compromise reached between the bankrupt and his creditors for repayment of debts. It is overseen by a nominee or supervisor.

The Act seeks to encourage the use of IVAs by allowing the Official Receiver to put a bankrupt's IVA proposals to creditors and to act as supervisor of any IVA subsequently agreed. Such cases will not involve a creditors' meeting or any debate on the proposals. Instead the creditors will be invited either to accept or reject the proposals put to them. The goal is that the new process is faster and cheaper than pre-Act IVAs (such IVAs will remain available to debtors in the normal way).

## Overview

These personal insolvency changes should be implemented early in the 2004/2005 financial year.

It is understood that individuals made bankrupt before commencement, but who have not been discharged, will be discharged either one year after implementation or earlier if their discharge is due before then. If such an individual has been an undischarged bankrupt in the previous 15 years, they will be discharged five years after implementation of the relevant provisions of the Act, or when a court grants discharge under the current regime, whichever is earlier.

For the new system to operate effectively, the Official Receiver will need adequate resources.

*If you would like a copy of our client guide on the corporate insolvency provisions of the Enterprise Act, please contact Marjorie Hinds on +44 20 7427 3218.*

For further information please contact

Peter Bloxham  
T + 44 20 7832 7193  
F + 44 20 7832 7249  
E peter.bloxham@freshfields.com