The City of London Law Society

4 College Hill
London EC4R 2RB

Tel +44 (0)20 7329 2173
Fax +44 (0)20 7329 2190
DX 98936 – Cheapside 2

mail@citysolicitors.org.uk

www.citysolicitors.org.uk

City of London Law Society Insolvency Law Committee response to the Insolvency Service call for evidence on "Insolvency Proceedings: Debt relief orders and the bankruptcy petition limit"

INTRODUCTION

1. The City of London Law Society ("CLLS") represents approximately 15,000 City lawyers through individual and corporate membership including some of the largest international law firms in the world. These law firms advise a variety of clients from multinational companies and financial institutions to Government departments, often in relation to complex, multi-jurisdictional legal issues.

2. The CLLS responds to a variety of consultations on issues of importance to its members through its 19 specialist committees. This response, in respect of the Insolvency Service call for evidence on "*Insolvency Proceedings: Debt relief orders and the bankruptcy petition limit*" issued in August 2014 (the "**Consultation**") has been prepared by the CLLS Insolvency Law Committee. Members of the working party listed in the Schedule attached will be glad to amplify any comments if requested.

OVERVIEW

3. We believe that there are two key principles which should shape any consideration of the relationship between the Debt Relief Order (DRO) and bankruptcy regimes, namely that:-

- *An individual in severe financial difficulties should always be able to apply for either a Debt Relief Order or a bankruptcy order*. Perhaps the most alarming consequence of the piecemeal approach that has historically been adopted in relation to personal insolvency is that it is possible, under the current legislative regime, for an insolvent individual to find that they are ineligible for a DRO but that the alternative option of bankruptcy is also unavailable to them, as they cannot afford the necessary £705 deposit and court fee; and
- *As a general rule, an individual in severe financial difficulties should not be forced to choose bankruptcy rather than a DRO, where their bankruptcy is unlikely to result in any repayment for creditors, given the value of that individual's assets*.

4. Expanding on the second bullet point in paragraph 3 above, the Consultation indicates (at Table 11) that around a third of those made bankrupt during FY 2013/2014 had assets worth between £301 and £2000. Bankruptcy was, presumably, the only realistic option for those individuals, as their assets exceeded the DRO threshold. In our view, it makes little sense to expose an individual to the "*potentially devastating effect*" of bankruptcy, where the value of their assets is so low that the bankruptcy process is unlikely to result in any repayment to that individual's creditors.

5. Adjusting the minimum asset value for a DRO would not in itself resolve this concern. Table 12 of the Consultation suggests that a (perhaps significant) proportion of those whose bankruptcy would not have resulted in any repayment to their creditors would, even if the minimum DRO asset level had been £2,000, still have been ineligible for a DRO as they had debts in excess of £15,000. There is clearly a moral hazard risk in making the DRO process available to an individual with few or no assets, whatever the size of their debt, as this may simply encourage reckless borrowing, but we believe that a case can be made for increasing the maximum debt level for DRO purposes from £15,000 to £30,000.

6. This increase would seem, based on the figures cited in the Consultation, to allow significantly more individuals with few or no valuable assets to apply for a DRO, rather than being forced into an expensive and distressing bankruptcy procedure which would ultimately be of little or no benefit to their creditors.

7. The final general point that we would make in respect of DROs is that it may be beneficial to adjust the existing provisions dealing with what happens when there is a change in the individual's circumstances while a DRO is in force. Specifically:-

- where an individual receives a windfall which brings the value of their assets above the maximum level, creditors may legitimately expect such windfall to be made available to meet their claims. There is, however, an inherent unfairness in the DRO falling away entirely in such circumstances, with the result that the beneficiary of the windfall has to begin the financial rehabilitation process afresh. We believe that there would be merit in introducing a transition mechanism, providing that, in such circumstances, if an individual chooses to go into bankruptcy immediately the DRO ceases, that individual should emerge from the resulting bankruptcy at the same time that he or she would have emerged from the DRO process.

- it may be helpful to provide clearer guidelines as to what would happen when an individual who is subject to a DRO gets a better job or a promotion. We note the suggestion contained in the Consultation that "*the typical low skilled job that someone subject to a DRO is more likely to acquire, may be insufficient to move someone outside of the DRO qualifying parameters*", but (under the current thresholds) even someone on minimum wage might technically breach the maximum asset level at least once a month, if paid monthly. While this should become less of an issue if the maximum asset level were to be increased, it might be helpful to make it clear that, when exercising its discretion, the Official Receiver would focus on the individual's asset position immediately prior to payday (i.e. their excess cash), rather than their position on payday.

8. Turning to the minimum debt level for a creditor's bankruptcy petition, we view the choice as being between £2,000 (which would have been just over the threshold level,

had the current £750 limit been pegged to inflation in 1986) and £3,000, this being the limit which has been applicable in Scotland since 2008. On balance, given that (as noted in the Consultation) bankruptcy is "*largely ineffective*" as a tool for returning money to creditors in low value cases, we would prefer that the £3,000 limit be adopted.

RESPONSE

9. We have seen the proposed response by the Association of Business Recovery Professionals ("R3") to the Consultation (the "**R3 Response**"). We believe that the proposals set out in the R3 Response in relation to DROs and the creditor's bankruptcy petition limit would address the concerns outlined above, while, at the same time striking an appropriate balance between the need to assist and protect individuals who have encountered significant financial difficulties and the need to protect their creditors.

10. In particular, we agree, for the reasons set out in the R3 Response, that:-

- The current DRO debt threshold should be increased to £30,000 and the current DRO asset threshold should be increased to £2,000, in order to ensure that those individuals who need access to debt relief are able to enter the most appropriate debt relief solution given their circumstances.
- The DRO surplus income threshold should be maintained at a maximum of £50 per month, rather than increase the existing disparity between the position of a bankrupt individual and the position of an individual who is subject to a DRO.
- Where an individual's circumstances change, as a result of events such as an increase in salary or an asset windfall, and the Official Receiver chooses to exercise its discretion to revoke a DRO as a result, that individual should be offered the option to transfer into bankruptcy, with the relevant date of discharge for the bankruptcy being the anniversary of the date on which the DRO was made.
- Revocation of a DRO should apply retrospectively where the individual has provided false information or deliberately sought to mislead or leave out information on their DRO application form.

The creditor's bankruptcy petition threshold should be raised to £3,000 (thereby tracking the current level applicable in Scotland), and should be reviewed on a regular basis.

2nd October 2014

THE CITY OF LONDON LAW SOCIETY
INSOLVENCY LAW COMMITTEE

Individuals and firms represented on this Committee are as follows:

Hamish Anderson (Norton Rose Fulbright LLP) (Chairman)

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P. Wiltshire (CMS Cameron McKenna LLP)
M. Woollard (King & Wood Mallesons SJ Berwin)

Working party members for this consultation:

Jo Windsor (Linklaters LLP)
Stuart Frith (Stephenson Harwood)