

EVALUATION OF SUNDRY PROVISIONS – SECOND INTERIM EVALUATION REPORT

Section 1 - Purpose of the paper

1. To provide details of the on-going evaluation work being undertaken in respect of the sundry provisions of the Enterprise Act 2002.

Section 2 – Background and Purpose of Evaluation

2. The Enterprise Act 2002 introduced the following changes:

- Repeal of bankruptcy offences under sections 361 and 362 of the Insolvency Act 1986 - 'failure to keep proper accounting records' and 'gambling and rash and hazardous speculation'. Instead, conduct of this nature will be addressed under the Bankruptcy Restrictions Order (BRO);
- Repeal of the summary administration regime and the amendment of section 289, in order that the Official Receiver has discretion in whether to exercise his power to investigate a bankrupt's affairs. The criteria to be used will not be restricted to the issue of the size of deficiency (as was previously the case) but on the extent to which the initial information provided to him explains the causes of the bankruptcy and that these causes do not indicate misconduct or the commission of criminal offences; and
- Sanction is required for a trustee to pursue antecedent recoveries. It had been presumed that, with the necessary sanction, a trustee could use bankruptcy assets to bring such actions, but this appeared not to be the case following the decision in *Lewis v. Commissioners of Inland Revenue and Others* and subsequent legal advice. Therefore, following the Lewis case, a trustee could not use money available for distribution to fund an antecedent recovery and in effect, the EA provisions reverse this position.

3. The respective objectives of these sundry provisions are:

- To provide more effective protection of the public and the commercial community
- To enable the Official Receiver to allocate investigative resources to the cases that merit investigation, rather than based on the size of the bankrupt's deficiency
- To allow the creditors the choice as to whether estate funds should be used to fund antecedent recovery action

4. The principal aim of the evaluation is to provide a comprehensive assessment of whether, to what extent and how the sundry provisions meet these policy objectives. The evaluation also provides information and data that can be used to inform future policy decisions.

5. The Insolvency Service made a commitment to the Government to undertake an evaluation of the Enterprise Act 2002 within 3 years of commencement of the various provisions. The provisions of the Enterprise Act 2002 relating to the repeal of offences under sections 361/2 and discretionary investigation of a bankrupt's affairs by the Official Receiver commenced on 1 April 2004, and therefore, the evaluation is due to be completed by 31 March 2007. The provisions of the EA relating to sanction of

antecedent recoveries commenced on 14 September 2003, but the evaluation is not due until 31 March 2007. This is the second interim report to summarise the evaluation work and findings to date¹.

Section 3 – Approach

6. The evaluation uses both quantitative and qualitative evaluation methods, including:
- Analysis of data on individual insolvency cases held on The Insolvency Service's internal Information Technology system
 - Sampling and review of files on individual insolvency cases to supplement information from other sources
 - Meetings with professionals within the insolvency sector to seek their views regarding the appropriateness and impact of insolvency legislation
 - Structured questionnaires and interviews with bankrupts, creditors, and other members of the public to obtain their views and experience of the impact of insolvency legislation and to obtain feedback on the wider issues associated with bankruptcy
7. In order to ascertain the impact of the Enterprise Act 2002 provisions, benchmark information was obtained regarding the operation and effect of the existing legislation, i.e. before the implementation of the Enterprise Act 2002 provisions.
8. A copy of the evaluation planning paper is contained at [appendix 1](#).

Section 4 – Work Carried Out to Date

9. All benchmarking information, and information relating to the operation and effect of the Enterprise Act 2002, i.e. from 1 April 2004, has been, and continues to be collected.

Repeal of offences under section 361 and 362: To provide more effective protection of the public and the commercial community

10. The objective relates to the change in the nature of action that can be brought against a bankrupt whose conduct was punishable under sections 361/2. The evaluation looks at the level of protection offered and customer satisfaction with that protection.

11. Details of the evaluation information obtained in respect of this objective are contained at [appendix 2](#).

¹ The first interim report dated March 2005 is available on The Insolvency Service's website (www.insolvency.gov.uk).

Repeal of the summary administration regime: To enable the OR to allocate investigative resources to the cases that merit investigation

12. This objective relates to the change in the Official Receiver's duty to investigate. The evaluation looks at the working practices of the Official Receiver and the level of discretionary investigation work carried out by the Official Receiver.

13. As detailed in the first interim evaluation report dated March 2005, the evaluation planning paper has been amended. Details of the evaluation obtained in respect of this objective is contained at [appendix 3](#).

Sanction is required for a trustee to pursue antecedent recoveries: To allow the creditors the choice as to whether estate funds should be used to fund antecedent recovery action

14. This objective relates to the creditors committee agreeing to the trustee using money that would otherwise be available for distribution to fund antecedent recoveries. The evaluation looks at the impact (if any) on the level and results of antecedent recoveries.

15. The benchmarking information is defined as the number and results of antecedent recoveries made under a court order in the period November 2000 to 14 September 2003. In the absence of any appropriate records from which to extract this data, the Insolvency Service has sought case study material from insolvency practitioners. However, no example cases have been identified to date. Further, The Service is not aware of any cases where antecedent recoveries have been made with sanction since the implementation of the new provisions.

16. Therefore, there is no evaluation evidence available to assess the impact of these provisions. However, the amendment of the legislation to require creditors committee agreement to the trustee using money that would otherwise be available for distribution to fund antecedent recoveries does, in itself, fulfil the principal objective of the provision, i.e. to allow the creditors the choice as to whether estate funds should be used to fund antecedent recovery action.

Section 5 - Preliminary conclusions and recommendations

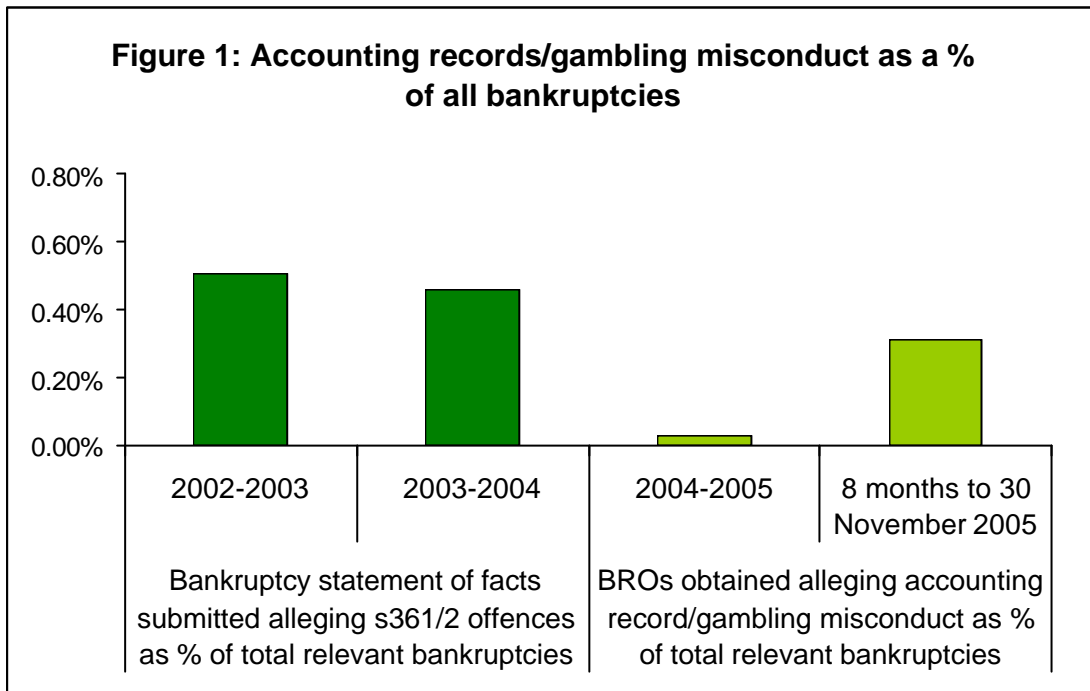
17. From the evaluation information available, the following observations can be made:

Repeal of offences under section 361 and 362: To provide more effective protection of the public and the commercial community

- Since the repeal of these offences, conduct which would have previously resulted in possible prosecution action has been addressed through the Bankruptcy Restrictions Order regime introduced by the Enterprise Act 2002².
- Since the introduction of the BRO regime, the level of BROs obtained where the main allegation relates to conduct which would have previously resulted in

² The Enterprise Act 2002 introduced provisions whereby the court can make a Bankruptcy Restrictions Order, which are designed to provide better protection for the public and a civil alternative to prosecution. Bankruptcy Restrictions Orders place restrictions on the most culpable bankrupts from between 2 and 15 years.

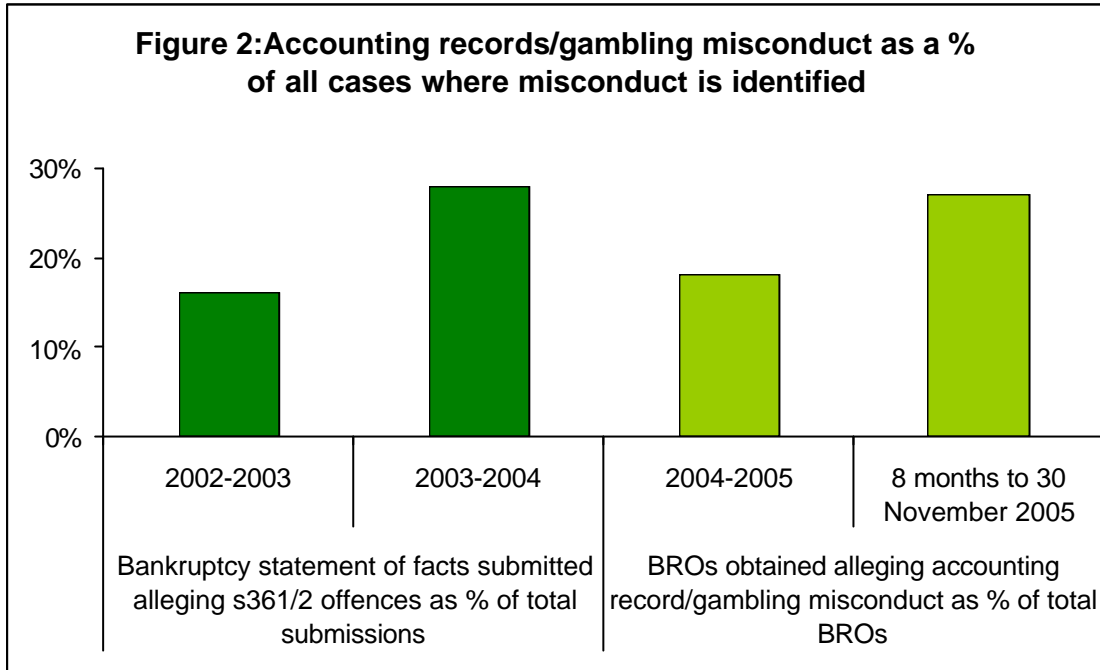
possible prosecution action under section 361 and 362, i.e. failure to maintain accounting records and gambling, is rising, but is currently below the expected level based on the level of potential offences under sections 361/2 (see Figure 1). However, as detailed in the evaluation planning paper (Appendix 1), as BRO action can only be taken in respect of conduct after 1 April 2004, it was anticipated that BRO figures for 2004/5 and 2005/6 would be lower than in future years.



- Looking at the level of BROs where the main allegation relates to conduct which would have previously resulted in possible prosecution action under section 361 and 362 compared to the total number of BROs obtained, it appears that accounting record and gambling misconduct is being alleged in an appropriate proportion of cases³ where misconduct has been identified, based on the proportion of potential 361/2 statement of facts⁴ compared to the total number of statement of facts submitted (see Figure 2).

³ Taking into account that BRO action can only be taken in respect of conduct after 1 April 2004.

⁴ A Statement of Facts is submitted by an Official Receiver to The Insolvency Service's Criminal Allegations Team where there is evidence of possible criminal misconduct.



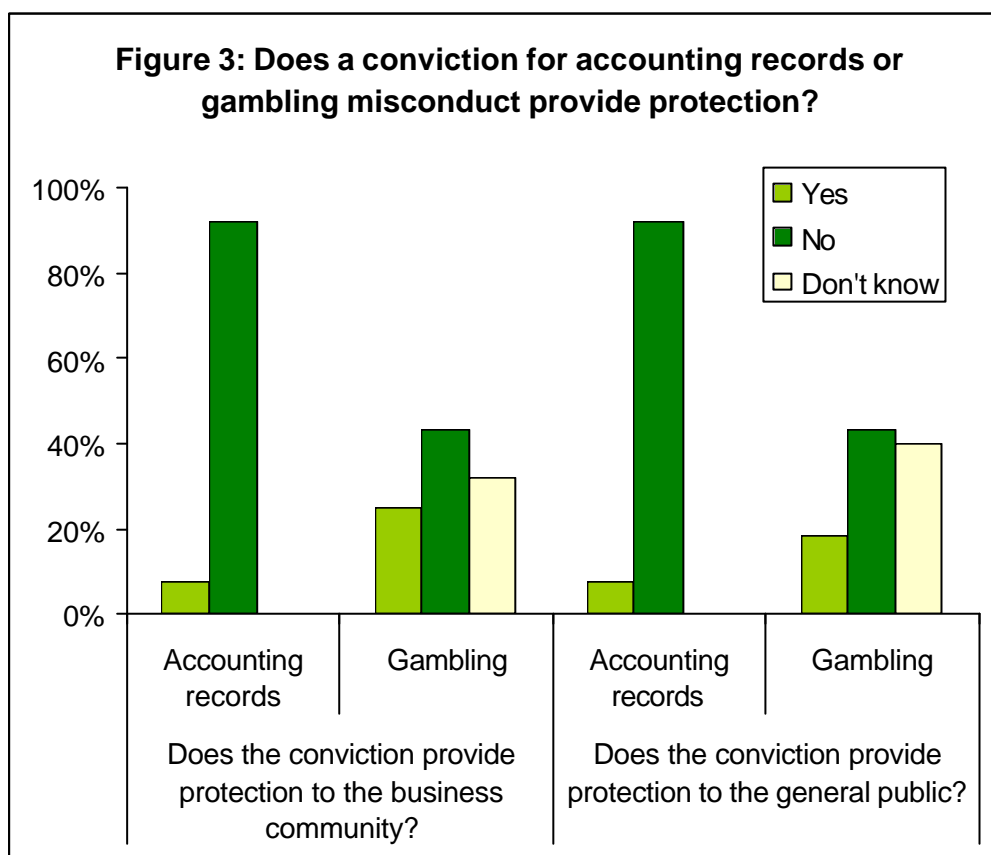
- Based on the information obtained to date, it would appear that the BRO regime is more effective in action being taken against a bankrupt where accounting record/gambling misconduct is alleged. Under the criminal prosecution regime, about a half of statement of facts submitted alleging a section 361 (accounting record) offence resulted in no action, and just over two-thirds of statement of facts submitted alleging a section 362 (gambling) offence resulted in no action (see Table 1). In comparison, no BRO applications where accounting records or gambling misconduct is the main allegation have been rejected - 60% have resulted in a BRO being made⁵, with the remainder on-going.

Table 1: Results of 361/2 submissions of statement of facts for the two-year period ended 31 March 2004 (where the case has been concluded)

	Results of section 361 submission of statement of facts	Results of section 362 submission of statement of facts
No action taken	51%	69%
Convictions	49%	31%

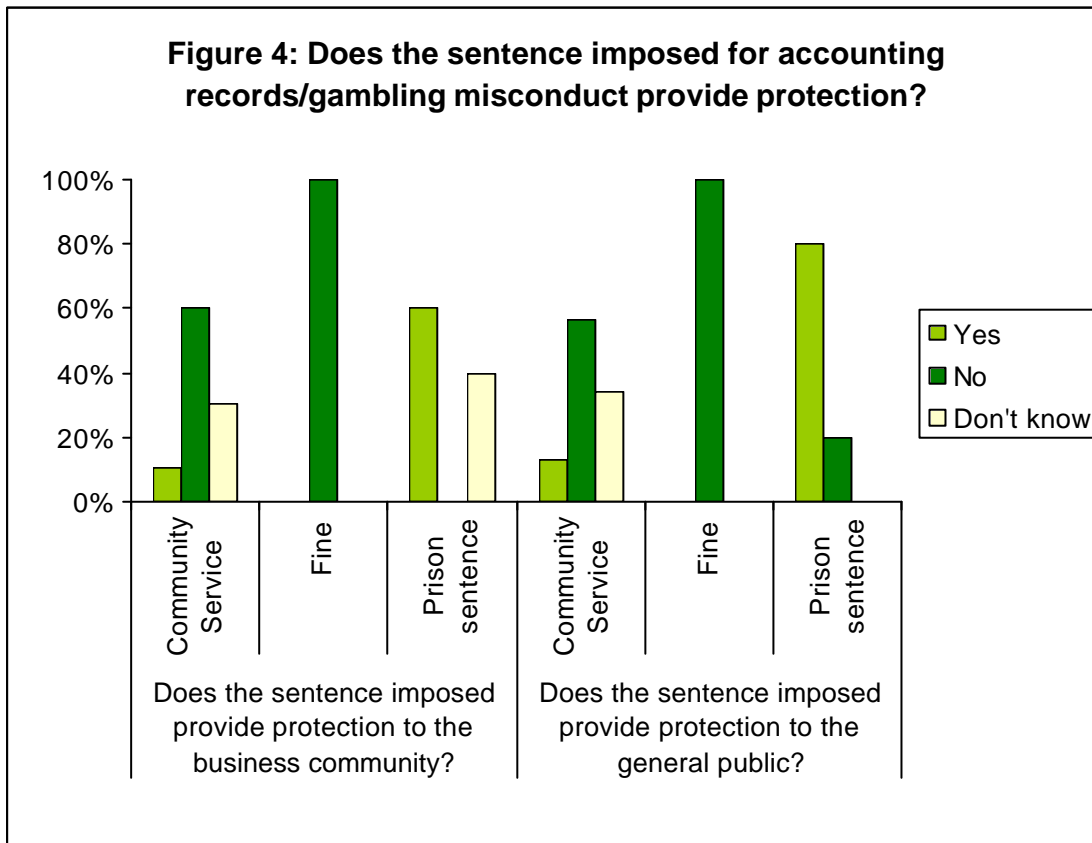
⁵ For the period 8 months ended 30 November 2005, there were 145 draft BRO applications (where accounting record or gambling misconduct was the main allegation) submitted by Official Receivers to the Authorisations Team. To date, BROs have been obtained in 86 cases.

- The Insolvency Service has carried out a survey of creditors in bankruptcy cases where a criminal conviction has been obtained against the bankrupt under section 361 or 362 of the Insolvency Act 1986, to establish whether such prosecution action provides protection to the business community and more generally, the general public.
- The survey of creditors in bankruptcy cases where such a criminal conviction was obtained shows that overall, creditors do not feel that the conviction obtained against the bankrupt provided protection to the business community and general public (see Figure 3). Creditors of cases where a conviction was obtained under section 361 (accounting records) feel less protected than creditors of cases where a conviction was obtained under section 362 (gambling).



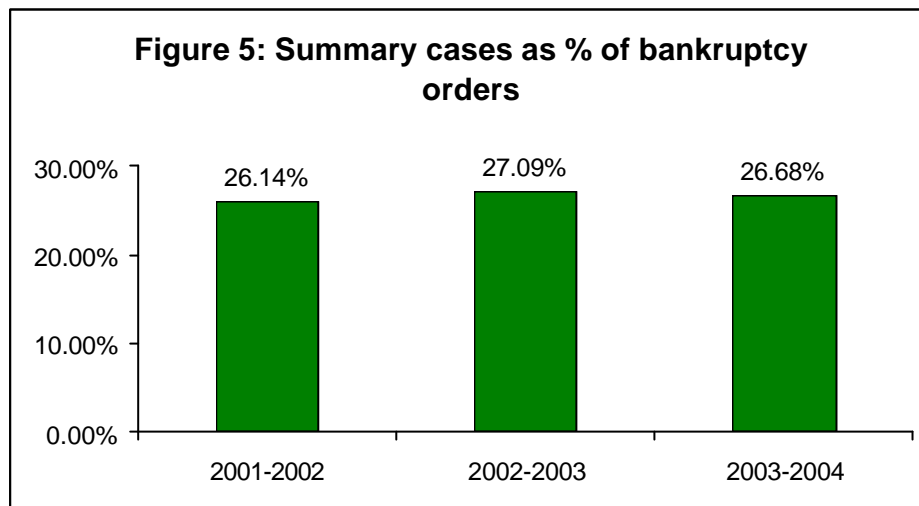
- The most common result following a criminal conviction under section 361 or 362 against a bankrupt was community service. An order for community service is seen as providing more protection to the business community and general public than a fine, whereas a prison sentence is seen as the most effective (see Figure 4).

- Just under 70% of creditors in bankruptcy cases where a criminal conviction was obtained under section 361 or 362 would feel more protected if the bankrupt's discharge had been suspended.
- Just over 75% of creditors in bankruptcy cases where a criminal conviction was obtained under section 361 would feel more protected if restrictions were imposed on the bankrupt.
- Just under 70% of creditors in bankruptcy cases where a criminal conviction was obtained under section 362 would feel more protected if restrictions were imposed on the bankrupt.
- The results of this survey suggest that addressing conduct under the BRO regime, rather than by way of criminal proceedings, should make creditors feel more protected and a further survey of creditors in cases where a BRO is obtained and the main allegation relates to accounting records or gambling misconduct is on-going.



Repeal of the summary administration regime: To enable the Official Receiver to allocate investigative resources to the cases that merit investigation

- Prior to the repeal of the summary administration regime, the level of summary administration cases compared to all bankruptcy orders remained consistent (see Figure 5).



- No new business processes for Official Receivers have been introduced as a result of the repeal of the summary administration regime.
- No new investigation processes for Official Receivers have been introduced as a result of the repeal of the summary administration regime.
- As detailed in the first interim evaluation report, due to process changes introduced, there is no further reliable comparative information available from which the impact of the repeal of the summary administration regime can be evaluated.
- Prior to the Enterprise Act 2002, the insolvency legislation only permitted the Official Receiver to exercise discretion as regards whether to investigate a bankrupt's affairs in summary cases. This equated to about 27% of cases and the criteria was mainly based on the size of the debts owed by the bankrupt. The repeal of the summary administration regime has allowed the Official Receiver discretion to investigate based on a more sensible criteria - the extent to which the initial information provided to him explains the causes of the bankruptcy and that these causes do not indicate misconduct or the commission of criminal offences.

18. I would recommend no further changes to the evaluation planning paper at this time.

Caroline Burton
March 2006