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Enterprise Bill

Bill 115 of 2001-02

With the aim of boosting enterprise and productivity, the *Enterprise Bill* contains reforms to competition, consumer protection and insolvency law. In competition, decisions on mergers and new 'market investigations' will be taken by the competition authorities rather than ministers in almost all cases. Participation in some cartel arrangements will become a criminal offence. In consumer law, enforcement bodies are given stronger powers to stop illegal activities which are detrimental to consumers. Consumer bodies will be able to report markets where there are competition problems to the authorities ('super-complaints'). In corporate insolvency, administrative receiverships are to be abolished (except for certain limited transactions) while streamlining the administration process. The Crown's preferential rights are also being abolished. In personal insolvency, discharge from bankruptcy is to be reduced to a maximum of 12 months for an 'honest' bankrupt and new Bankruptcy Restriction Orders are to be introduced for 'culpable' bankrupts. Most of the Bill applies throughout the United Kingdom, except for the bankruptcy reforms (England and Wales only) and the corporate insolvency reforms (not Northern Ireland).

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Summary of main points

- The Bill forms a key part of the Government's programme to raise the underlying economic performance of the country by promoting enterprise and productivity. It contains a series of reforms to competition, consumer and insolvency law.

- On competition, the Bill reforms the merger regime and the residual anti-monopoly provisions of the *Fair Trading Act 1973* (re-named market investigations) by removing the decision-making powers of ministers, save in defined exceptional cases. Cases will be assessed by the Office of Fair Trading (OFT) and the Competition Commission using a new competition-based test (with powers to take into account countervailing consumer benefits).

- Criminal penalties will be introduced for individuals who participate in some types of cartel and breaches of competition law will become a ground for disqualification from acting as a director.

- The competition authorities will be given a role in scrutinising the competitive consequences of current and forthcoming legislation.

- In consumer law, Stop Now Orders will be extended to new areas outside the EC's Injunctions Directive.

- Consumer organisations will be able to present cases for competition investigation which will be prioritised by the OFT ('super-complaints'). They will also be empowered to bring representative actions on behalf of groups of consumers.

- In corporate insolvency, administrative receiverships (where control rests with a single creditor) will be abolished except for certain transactions, in a move towards administration which is a collective procedure regarded as fairer to creditors as a whole and which does not allow businesses to go to the wall unnecessarily.

- Other corporate insolvency reforms include abolishing the Crown's preferential right to recover certain unpaid taxes ahead of other creditors and modernising the financial regime of the Insolvency Service through changes to its fee structure and the Insolvency Service Account.

- Bankruptcy procedures will make a distinction between 'honest' bankrupts and those who are 'culpable'. The present three year bankruptcy discharge period will be reduced to a maximum one year for honest bankrupts while a new Bankruptcy Restriction Order (BRO) regime lasting between 2 and 15 years will apply to culpable or reckless bankrupts. The intention is to remove the stigma of bankruptcy and encourage entrepreneurs to try again.

- Commencement orders will bring the Bill into force. The majority of the Bill applies to England and Wales, Scotland and Northern Ireland (see clause 268 for full details). The provisions on discharge from bankruptcy apply only to England and Wales. Changes to corporate insolvency and the disqualification of directors do not apply to Northern Ireland.

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I Introduction

In June 2001, the Queen's speech included a commitment to introduce an *Enterprise Bill* in the current parliamentary session. The Bill forms a key part of the Government's programme to raise the underlying economic performance of the country and tackle those areas that hold back innovation, productivity and growth. On 18 June 2001, the Chancellor of the Exchequer, Gordon Brown, and the Secretary of State for Trade and Industry, Patricia Hewitt, announced their intention to make enterprise and productivity the cornerstone of the Government's economic reforms in this Parliament.[1]

On 22 July 1999, the Government published its Consumer White Paper, *Modern Markets: Confident Consumers* but a specific Consumer Bill did not follow, although some of the measures have been implemented already. The White Paper set a new agenda:

- to promote open and competitive markets;
- to provide people with the skills, knowledge and information they need to become demanding consumers;
- to encourage responsible businesses to follow good practice;
- to avoid burdening those businesses with unnecessary regulation; and
- to protect the public from serious trading malpractice and unsafe products.[2]

Following the 2001 Queen's Speech, two further White Papers have been issued, an Insolvency White Paper and a Competition White Paper: *Productivity and Enterprise: Insolvency a Second Chance* and *Productivity and Enterprise: A World Class Competition Regime*".[3] Further policy announcements, in which the Government responded to issues raised during the consultation, were published in late 2001 and early 2002.[4] In January 2002, the Department of Trade and Industry (DTI) also published *Empowering Consumers in the Enterprise Economy – The Enterprise Bill Consumer*

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[1] HM Treasury and Department of Trade and Industry, *Productivity in the UK: Enterprise and the Productivity Challenge*, June 2001. See also, HM Treasury press release 67/01, *Enterprise for all: The challenge for the next Parliament*, 18 June 2001

[2] Department of Trade and Industry, *Modern Markets: Confident Consumers*, Cm 4410, 22 July 1999 ('Consumer White Paper')

[3] Department of Trade and Industry, *Productivity and Enterprise – Insolvency a Second Chance*, Cm 5234, 31 July 2001 ('Insolvency White Paper') and *Productivity and Enterprise – A World Class Competition Regime*, Cm 5233, 31 July 2001 ('Competition White Paper')

[4] Department of Trade and Industry, *An update on the Corporate Insolvency Proposals*, 14 January 2002 and further material at www.insolvency.gov.uk; Department of Trade and Industry, *Productivity and Enterprise - A World Class Competition Regime: Government's Response to Consultation*, December 2001

Measures.[5] This short document set out the consumer measures to be contained in the *Enterprise Bill* with the stated aim of promoting consumer interests in competition, modernising consumer protection legislation and improving the performance of enforcement bodies.

During the debate on the Queen's speech, David Heathcoat-Amory for the official opposition observed:

> Competitiveness and productivity are down; we are running a record trade deficit; the savings ratio has collapsed; and our enormous public expenditure commitments go far beyond any anticipated growth in the economy. That is why we shall look critically at the enterprise Bill. We shall be constructive on bits of it that we approve of, but shall look critically at it to find out whether it will strengthen the sinews of the economy to see us through any economic downturn.[6]

He was critical of the Government's record on productivity, saying that the productivity gap had widened under the current administration despite the importance they accorded to it. Of the plans to criminalise cartels, he added:

> One of the puzzles about the whole debate is why it is that the Chancellor and other Ministers talk glowingly about the United States success in enterprise and venture capital, yet converge on a different economic model promoted by the European Union. It is true that the Government have picked out items from the American experience, such as the proposal to apply criminal sanctions against business people guilty of anti-competitive behaviour, but, if they want to pick out certain items such as that, why do they not buy the full American package and realise that American entrepreneurial success is built on low regulation and low business taxation?[7]

For the Liberal Democrats, Edward Davey said:

> I return to a matter that is not directly referred to in the Queen's Speech, but which was mentioned in briefings related to it and in speeches made today--the Chancellor's proposal that the economic theme for this Parliament will be competition and productivity. He made welcome announcements about how policy will change in the Department of Trade and Industry and the Treasury in order to promote competition and, thus, improve productivity.
>
> We welcome many measures in the package, but three omissions represent a real problem and the Government must focus on them if they are to reach their productivity goals. The first is education. Investment in education is the key to

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5 Department of Trade and Industry, *Empowering Consumers in the Enterprise Economy – The Enterprise Bill Consumer Measures*, URN/01/1462, 1 January 2002

6 HC Deb 19 June 2001 c479

7 *ibid*

> improving productivity and making our nation competitive, but it was not the centrepiece of the Chancellor's announcement. Secondly, the need to simplify regulation and the taxation system is also important, and the hon. Member for Sevenoaks (Mr. Fallon) made the same comment in his excellent speech. In this Parliament, we need a major change in the Treasury's attitude to the taxation system.
> The third omission is a debate about Britain joining the euro. If there is one measure that would change the way in which British industry and the British economy had to face up to competitive pressures in the world and promote its own productivity, it is joining the euro. [8]

The *Enterprise Bill* was introduced in the House of Commons on 26 March 2002. It is due to have its second reading on 10 April 2002. It is a substantial Bill which is divided into eleven parts:

Part 1: establishes the Office of Fair Trading (OFT) on a statutory footing, sets out its general functions, and provides for arrangements for making super-complaints to the OFT.

Part 2: establishes and makes provisions for proceedings before the Competition Appeal Tribunal (CAT).

Part 3: provides for a new merger regime. It gives the OFT responsibility for making references to the Competition Commission (CC) and sets the criteria for how such references are to be examined. Provisions for residual ministerial involvement in certain public interest cases, powers of enforcement, and powers to seek undertakings are all dealt with in Part 3.

Part 4: makes provision for market investigations which adapt former anti-monopoly powers. The OFT, sectoral regulators and the Secretary of State can make such references to the CC. Part 4 provides how the CC should scrutinise references and gives it a duty to remedy adverse findings. Again, special arrangements apply for certain public interest considerations.

Part 5: establishes the Competition Service and provides for rules of procedure for the CC.

Part 6: creates a criminal offence for individuals who participate in certain types of cartel.

Part 7: deals with a number of miscellaneous competition provisions, including powers to disqualify directors who have breached competition law.

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[8] HC Deb 25 June 2001 cc475-6

Part 8: deals with new procedures for enforcing certain consumer legislation, and miscellaneous related matters.

Part 9: provides for rules to govern the disclosure of certain consumer and competition information held by a public authority, covering the circumstances in which it is permissible to disclose such information.

Part 10: changes insolvency law by providing for a new corporate insolvency regime by restricting the use of administrative receivership and streamlining company administration; abolishing Crown preference; establishing a new regime for bankruptcy; and making changes to the operation of the Insolvency Services Account.

Part 11: contains a number of supplementary provisions, such as commencement and territorial extent.

The Bill encompasses a range of reforms all designed to enhance enterprise and which, broadly, fall under three main headings: competition law (Parts 1-7); consumer law (Parts 8-9); and insolvency (Part 10).

This paper sets out the background to the key changes which are to be made and provides detail on their content and comments from parties which will be affected. It does not provide an exhaustive account of every measure or clause in the Bill: for such a treatment see the *Explanatory Notes* prepared by the DTI to accompany the Bill.[9]

A Regulatory Impact Assessment is available for the Bill as a whole, and three more detailed RIAs have been issued for the competition, consumer and insolvency measures.[10]

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[9] Bill 115-EN

[10] Department of Trade and Industry, *The Enterprise Bill: Overarching Regulatory Impact Assessment*, 12 March 2002. See also www.dti.gov.uk/enterprisebill/ria.htm for the three other RIAs.

II Competition

A. Background

1. The Government's aims

Although it can be given different emphases, competition is fundamentally an economic concept. Where firms compete fairly in markets, competitive pressures are thought to promote the optimal use of resources and the keenest prices. In competitive markets, firms will produce those goods which they can produce most efficiently, while inefficient producers with higher costs will be priced out the market. Further, there may be an incentive for firms to innovate in order to build or retain their market share. From this perspective, there are also clear benefits for consumers in the form of lower prices and better products. In addition, the whole economy should benefit from the productive efficiency which is inherent when resource allocation and production decisions take place in a market where prices are determined by market forces.[11]

The Government has placed the reforms to the UK's competition regime which are contained in this Bill squarely within a context of improving productivity. The Government is committed to narrowing the gap between the UK's productivity and that of its major competitors:

> 1.7 Productivity is the main determinant of living standards. Raising productivity is the key to raising long-term prosperity.
>
> 1.8 Productivity refers to how well an economy uses the resources it has available by relating the quantity of inputs to outputs. There are several measures of this relationship:
>
> - output per worker – the productivity of each person in active employment;
> - output per hour – a related concept which takes account of part-time work and time not spent working; and
> - total factor productivity – this takes account not only of labour inputs, but also capital. It must, however, be estimated rather than directly measured and requires an accurate measure of the capital stock, which is often not available.
>
> 1.9 The Government's central measure is output per worker. This has the advantages of being the most straightforward to measure and also being immediately linked to the overall objective of raising trend growth. However, the

[11] For an introduction to the economic arguments which are used to support competition theory, see for example Mark Furse, *Competition Law of the UK & EC* (2000) pp6-16; Richard Whish, *Competition Law* (2001), pp1-43. Both works are to be recommended more generally. For a more detailed economic study, see Besanko and others, *Economics of Strategy* (1999)

> most important point is that no matter which measure is used, UK productivity lags that of other major industrialised countries.[12]

The joint strategy document issued by the Treasury and the DTI in June 2001 dedicated the Labour Government's second term to boosting enterprise and productivity: 'to succeed over the long term, Britain's productivity must rise faster than our industrial competitors''.[13] The generic title for consultations on the Bill's measures has been 'Productivity and enterprise'. As part of measures to boost productivity, the Government has said that one indicator of success would be, 'a step change in competitive pressures in the economy'.[14] As a counterpart to its mission to ensure macro-economic stability, the Government looks to address also those micro-economic structural barriers which hinder the competitive process:

> Strong competition drives improvements in efficiency and innovation across the economy. Competition reduces prices and improves the quality of service for consumers whilst rewarding companies that innovate and operate efficiently.[15]

The CBI has been sceptical of the link which the Government makes between its package of competition measures and its drive to close the productivity gap:

> We fully support the Government's goal of boosting the UK's productivity to the levels of our major competitors. However, we are not yet convinced that the changes proposed in the White Paper will help achieve this goal. We need to see clear and convincing evidence that the proposals will help close the productivity gap between the UK and its major competitors, principally the USA. The Government should instead be concentrating on other key policy areas, such as measures to boost investment, reduce the regulatory burden on business and encourage greater enterprise and risk-taking.[16]

The CBI adds:

> 10. In the White Paper and the joint Treasury and Department of Trade and Industry Paper "Enterprise and Productivity", the Government indicates that there is a major body of academic work supporting the specific proposed changes to competition law which will achieve their declared productivity goal. It even lists some key academics in the White Paper that prove that "vigorous competition is the lifeblood of strong and effective markets", and then goes on to assume an automatic link between these studies and its specific proposals in the White Paper to change competition law. The suggestion is that the changes will considerably help in "establishing strong competition in the UK economy".

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[12] HM Treasury and Department of Trade and Industry, *Productivity in the UK: Enterprise and the Productivity Challenge*, June 2001 paras 1.7-9

[13] *ibid*, Foreword

[14] *ibid*, Foreword

[15] *ibid*, para 1.5

[16] Confederation of British Industry, Position Paper, 28 September 2001 p4

> 11. However, our view is that different and not totally compatible strands of thinking have been pushed together in support of the Government's new strategy.
>
> 12. The academic work goes no further than highlight the link between competition and productivity and the benefits that a more open and competitive economy can deliver. The academics themselves keep to broad-brush advice on the specific competition laws that are needed to produce the type of conditions they view as essential to achieve gains in productivity growth.[17]

The Government has also stressed the benefits which the consumer receives from the competitive process in the form of lower prices and better quality goods and services. The Bill, in addition, gives new roles to consumers and their representatives in enforcing competition law. Consumer bodies will, for example, be able to refer their competition concerns direct to the Office of Fair Trading which will then investigate the complaint on a fast-track. They will also be able to bring representative actions to recover damages for market failures which, while they may cause relatively limited damage to individual consumers, nevertheless represent a serious competition problem cumulatively.

A further emphasis in the reforms is to make the UK's competition authorities stronger and more open. Additional resources are being allocated to both the Office of Fair Trading and the Competition Commission which reflect the new tasks and greater responsibilities each will assume. Some of these new responsibilities are derived from the move to have competition decisions actually taken by the authorities rather than taken by ministers on the authorities' recommendation or advice. The Government aims to make competition attain a higher profile among the public.

GOVERNMENT'S COMPETITION PRINCIPLES

- Competition decisions should be taken by strong, proactive and independent competition authorities.
- The regime should root out all forms of anti-competitive behaviour.
- There should be a strong deterrent effect.
- Harmed parties should be able to get real redress.
- Government and the competition authorities should work for greater international consistency and co-operation.
- Competition policy deserves a high profile – because of its importance for economic performance.

In its proposals the Government has pointed to a set of principles which are set out in the box above.[18] The Government and both the competition authorities are also to adopt 'mission statements' (reproduced in sections II.A.2, B.5 and C.1 of this paper) which aim to make explicit their respective objectives. These statements are intended to assist others

[17] *ibid*, p5
[18] Competition White Paper, para 3.3

in holding the competition authorities to account, including Parliament, which the Government would like to see play a more active part in scrutinising the competition regime.[19]

2. Recent UK competition reform

The current round of competition reform follows on the heels of the very significant changes to the UK's competition framework which although legislated for in 1998 only took effect in March 2000. Until then, the UK relied on what is sometimes known as an administrative competition regime. While powers existed to investigate and address competition failures in the market, those powers were only triggered by an investigation. When the competition authorities had investigated, and the DTI had considered what action to take in the light of their investigations, remedies could be applied. The separate regime for controlling restrictive agreements was labyrinthine in its bureaucratic complexity but opaque as to its aims and largely ineffective. The disadvantages of both systems included their essentially responsive nature, which were powerless to address previous conduct and slow to bite, and, in the case of restrictive practices, the poor differentiation between the handling of serious abuses from those which generated no real competition concerns. A further problem was the different character of the UK's domestic competition regime as compared to the EC's competition regime. A decade of consultation and re-consultation preceded the *Competition Act 1998*.

The 1998 Act replaced the *Restrictive Trade Practices Act 1976*'s cumbersome requirement that certain types of restrictive commercial agreement be registered (prior to

GOVERNMENT'S COMPETITION MISSION STATEMENT

The Government is committed to promoting competition in the economy to improve the UK's productivity performance and to make markets work well for consumers.
The Government will:

- Respect the absolute independence of our competition authorities.
- Not interfere in cases which are under investigation.
- Adopt remedies recommended by the Competition Commission except where there are exceptional public interest grounds not to do so – in such cases, Government will explain its reasoning fully.
- Ensure that the legal framework allows our competition authorities to address all forms of anti-competitive behaviour.
- Explain the importance of competition policy to the public, businesses and the media.
- Respond positively where the OFT, the Competition Commission or a sector regulator believes that regulations significantly undermine competition – publishing within 90 days a reasoned analysis of how Government intends to proceed.
- Appoint only those with expertise relevant to competition to the Competition Commission and only those with expertise relevant to competition or consumer protection to the OFT Board.
- Ensure that our competition authorities are properly resourced to meet their objectives.

[19] Competition White Paper, para 4.43

subsequent examination as to whether they were beneficial). Instead, trade agreements which restrict or distort competition are prohibited from the outset (the 'Chapter I Prohibition'). The Act also replaced the main tool for dealing with monopoly power - an investigation by the Monopolies and Mergers Commission - with a prohibition of abuse of a dominant market position (the 'Chapter II Prohibition'). Since the Act explicitly prohibits these types of anti-competitive abuse, firms which breach the prohibitions can be found to have been acting illegally from when their conduct began. This addresses one weakness of the previous system and gives firms an incentive to arrange their affairs in a manner which is compliant with the legislation. The behavioural incentive is strengthened by the capacity of the Office of Fair Trading to fine firms which breach the prohibitions by up to ten per cent of their annual turnover.[20]

Both the prohibitions are drawn almost word for word from the EC's competition regime. The Act also provides that the UK's competition authorities should be guided by the jurisprudence of the European Community's competition authorities and courts when they interpret the 1998 Act. This is a further advantage of the 1998 Act, then: that firms which are of a sufficient scale to be covered by both the UK's domestic competition regime and the EC's competition regime now face lower compliance costs because of the convergence of the two regimes.

3. Scope and jurisdiction

It is worth dwelling briefly on the differences in the jurisdiction of the UK and the EC competition regimes. The UK's competition regime has three main interests: mergers, cartels and monopolies. In the case of mergers, there is a fairly clear line between the jurisdiction of the UK authorities and that of the EC authorities. The EC's Merger Regulation provides that mergers which have a 'community dimension' fall to be considered by the European Commission.[21] In general, then, a merger will either be the exclusive responsibility of national competition authorities or the European Commission.[22]

In the case of cartels and monopoly power, the EC's competition rules (Articles 81 and 82) can only apply where there is an effect on trade between member states. The similarly-worded UK provisions (ss.2 and 18 of the *Competition Act 1998*) only govern behaviour which affects trade within the United Kingdom. These definitions are not however mutually exclusive. Even behaviour which occurs only within the UK *may* have an effect on trade between member states (for example by preventing access to the UK

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[20] Firms can be fined for breaches lasting up to three years. In other words, the maximum fine for long-lasting anti-competitive behaviour is 30 per cent of annual turnover.

[21] In some circumstances the Commission may allow such cases to be dealt with by national competition authorities instead.

[22] Mergers involving firms which operate in more than one state may be investigated by a number of national authorities. Revisions to the EC Merger Regulation now confer on mergers which involve significant activities in at least three member states a community dimension if specified thresholds are met.

market by firms from other states). EC law would take precedence over national law, according to well-established principles, where there is a clear conflict between the two. There are procedures to prevent conflicting decisions occurring; nevertheless, it is still possible for competition action to be taken in some circumstances under both a national and the EC regime in respect of the same behaviour. A proposed reform at EC level would seek to give primacy to EC law wherever there is an effect on trade between member states.[23]

UK competition law is concerned with distortions to the competitive process within the UK. EC law, while it is also concerned with competitive distortions, has an additional aim of market integration. That is, the EC's competition regime has a secondary aim of developing an integrated economic market in the EC.

4. Peer review

Within the context of the Government's aim to narrow the productivity gap between the UK and other developed countries, there is a specific target to improve the effectiveness of the UK's competition regime set as part of the Department of Trade and Industry's Public Service Agreement (PSA). The DTI's Objective C is 'to develop strong, competitive markets, within a regulatory framework which promotes fairness and sustainability'.[24] For 2001-2004, one of the targets within that objective is to:

> have the most effective competition regime in the OECD, as measured by peer review, and achieve a fairer deal for consumers, as measured by the level of consumer knowledge and understanding of rights and sources of information.[25]

In April 2001, the DTI published a peer review of the current regime.[26] This has helped to establish how the UK's competition regime is currently assessed and to set bounds for the target which is to be aimed at. The review was conducted for the DTI by consultants from PricewaterhouseCoopers. They surveyed over 100 competition lawyers, economists, officials and business and consumer representatives from a number of OECD countries. Each was asked to score aspects of competition regimes with which they were familiar. Since most respondents would at least be familiar with the EC's regime in addition to their own, the scores given by each respondent to the EC regime were used as a control against which their other assessments could be scaled.

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[23] European Commission, *Proposal for a Council Regulation on the implementation of the rules on competition laid down in Articles 81 and 82 of the Treaty*, 27 September 2000 (COM(2000) 582; 2000/0243) p14

[24] For how the DTI reports on its performance against this objective, see Department of Trade and Industry, *Government's Expenditure Plans for Trade and Industry for 2001-04*, Cm 5112, March 2001

[25] ibid.

[26] PricewaterhouseCoopers, *Peer Review of the UK Competition Policy Regime*, A report to the Department of Trade and Industry, 18 April 2001

The exercise found that the German and US competition regimes were both perceived to be markedly more effective than that of the EC. The UK's regime was placed third, slightly ahead of the EC and the remaining OECD countries. Although the UK was judged more effective than the EC for both its merger and its non-merger (cartels and monopolies) regimes, the UK's merger regime scored less well than the non-merger regime. The authors acknowledge that caution needs to be applied to some results because of low sample sizes. However, the assessments of both the UK and EC regimes were based on a much larger sample than those of other countries in the survey. The survey's authors draw the following policy recommendations from the exercise:

> The implementation of the proposed reform of UK merger control would enhance the status and effectiveness of the overall UK regime. This applies very much to the cornerstone of the planned reform which is designed to ensure political independence; and to replace the public interest test in favour of a competition test.
>
> Consideration should be given to the introduction of criminal sanctions for violations of the cartel provisions of the 1998 Competition Act. The deterrent effect of criminal sanctions is widely supported in the peer group, particularly for respondents from the UK and the USA.
>
> Measures should be taken to enhance the status and role of competition policy in the eyes of the public. There appears to be a significant difference in the perceptions of the peer group of the relevance of competition policy to the general public in the UK when compared to the US and Germany. The survey does not allow for a serious examination of the reasons behind these findings. The high profile of US antitrust policy is more easily explainable in terms of the history of high profile cases fought out in court; however, the reasons for the status of positive assessment of German competition policy in the eyes of the public are less obvious.
>
> Strengthening the role of the OFT through various initiatives seems to be a general conclusion that can be drawn from a number of responses. For example, the reform of the UK merger regime will strengthen the role of the OFT and the Director General of Fair Trading. Suggested measures to increase the visibility and transparency of the UK regime suggest a more pro-active role for the OFT.
>
> In addition to these positive recommendations, the survey suggests that the UK regime can build upon its perceived strengths (as well as weaknesses). The non-merger regime is considered to have the following strengths:
>
> - quality of economic analysis;
> - clarity of procedures; and
> - speed of decision-making.

> Finally, the survey results indicate that the UK regime should keep the monopoly provisions and remedial powers of the Fair Trading Act 1973.[27]

The review was completed before the main elements of the current Bill had been finalised. Many of the policy recommendations are reflected in the Bill, including the de-politicisation of the UK merger process and the introduction of criminal sanctions for individuals who participate in cartels. These elements are discussed in more detail below. While the UK might draw comfort from a generally favourable rating in the review, the target of overtaking both the US and Germany is a demanding one, not least because on the review's own findings there is a marked gap in the relative effectiveness of these regimes and that of the UK at the moment.

Some respondents have pointed to the already strong ranking of the UK competition authorities to question the need for the Bill:

> Overall, the Government's case for change so soon after the introduction of the Competition Act 1998 is not a strong one. There is no evidence that the 1998 Act has failed, and the Peer Review scarcely proves that the UK has a weak system of competition law, given that it ranked higher than most of its major competitors in the review.[28]

B. Part 1: Office of Fair Trading

1. Structure of the authority

The *Fair Trading Act 1973* created the office of Director General of Fair Trading. The Director was given wide-ranging responsibilities to scrutinise commercial behaviour with the main aims of protecting the interests of consumers and advising on and implementing aspects of competition policy in the UK. His duties have been added to over the years. In particular, the *Competition Act 1998* gave the Director General responsibility for taking many competition decisions himself rather than conducting investigations or negotiations and then providing advice to ministers. The department which the Director General heads, the Office of Fair Trading, is a non-ministerial Government department. The department is not currently a statutory creation although the 1973 Act allowed the Director General to appoint staff to assist him. In 2000, the OFT had nearly 450 employees; staff numbers increased significantly to take account of new responsibilities created by the 1998 Act.

The current Director General is John Vickers, an economist and academic who moved to the OFT in 2000 from his position as the Bank of England's Chief Economist. His predecessor, John Bridgeman, was an industrialist who had served on the Monopolies and Mergers Commission before becoming Director General. Mr Bridgeman was not reappointed by the current Government when his first term of office expired in October

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27 *ibid*, p4

28 Confederation of British Industry Position Paper, 28 September 2001, p3

2000 and there were reports that some in Whitehall felt he had not been sufficiently supportive of aspects of the Government's agenda, particularly its pro-consumer 'rip-off Britain' agenda.[29]

The Bill proposes to change the governance of the OFT and replace the former emphasis on the post of Director General. The Office of Fair Trading will now become a statutory body and competition interventions will be taken in its name rather than in the name of the Director General. The new statutory corporation will remain a non-ministerial Government department staffed by civil servants. It will be run by a board headed by a Chairman, thereby spreading responsibility for its work between all board members. The Secretary of State for Trade and Industry will appoint all board members, of whom there will be at least five including the Chairman. The Chairman must be consulted before the other board appointments are made (see **clause 1** and **Schedule 1**).

The Government announced its plan to reform the structure of the OFT in May 2000. The then Secretary of State, Stephen Byers, said:

> 'The new Authority will give greater transparency and accountability to the OFT. More board members will give a wider range of expertise to the organisation, rather than executive power resting with one person. This will give businesses and consumers a stronger voice at the heart of the OFT.'[30]

The move from a single regulator to a board structure reflects a change that has already been adopted at the merged gas and electricity regulator, Ofgem, which is now run by a board referred to as the 'Authority'.[31] It was welcomed by John Bridgeman as an appropriate development for a body which increasingly needed access to a wide range of skills and expertise.[32] Mr Bridgeman's successor has since set up a four member advisory panel which meets monthly to discuss policy, strategy, research and communication.[33] The panel includes a former editor of the *Financial Times* and a leading competition academic and author. The OFT describes the panel as strictly advisory: 'it is not a shadow

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29 Stephen Byers launched the Consumer White Paper in 1999 saying, 'Far too many people feel that they live in rip-off Britain' (HC Deb 22 July 1999 c1342). Differences of view between Whitehall and the OFT over competition allegedly included petrol prices and the price of soft drinks in pubs. See 'OFT chief fails to win a second term', *Guardian*, 25 February 2000; "'Soft' Bridgeman forced out of OFT after run-ins with the Government', *Independent*, 25 February 2000

30 Department of Trade and Industry press release P/2000/337, *Business and consumer given stronger voice in revamped Office of Fair Trading*, 18 May 2000. See also Department of Trade and Industry, *Proposed new structure for the Office of Fair Trading (OFT)*, September 2000

31 The new OFT is referred to in some of the consultation materials and the explanatory notes as the 'authority'.

32 OFT press release PN 20/00, *Proposals for change in status of the OFT*, 18 May 2000

33 OFT press release PN 18/01, *OFT advisory panel announced*, 2 May 2001. The panel members are Michelle Childs, John Mills, Sir Geoffrey Owen and Richard Whish.

board or precursor to the statutory board'.[34] The Trading Standards Institute has welcomed the move to a board for the OFT.[35]

2. Functions

The Bill sets out new definitions of the OFT's functions and powers. The specific functions of the OFT in relation to competition are set out in detail in the body of the Bill. Part 1 sets out its general functions (**clauses 5-8**), which include gathering information necessary to perform its other tasks, providing information and advice to the public and promoting good consumer practice (by encouraging and endorsing codes of practice). Two of the functions are distinctly new: providing advice to ministers on the competitive effects of legislation and promoting the virtues of competition.

3. Legislation

The OFT has long had a statutory role in scrutinising professional rule books, including those of the financial services regulators. Moreover, the competition authorities have at times recommended changes to legislation as part of the recommendations in competition reports. Recently, Don Cruickshank's March 2000 report on *Competition in UK banking*, although not carried out by the competition authorities, also emphasised the capacity of regulatory frameworks to create or entrench competitive distortions.[36] Cruickshank recommended that the Government should 'apply competition scrutiny systematically to all its policies and regulations in the financial services sector to ensure that they are proportionate and minimise distortions to competition'.[37] Subsequently, enhanced arrangements were made for the competition scrutiny of rules made under the *Financial Services and Markets Act 2000*.

In the Enterprise White Paper, the Government proposed that the Office of Fair Trading should be given a 'new pro-competitive role… to spot existing and proposed regulations which hold back dynamic and competitive markets'.[38] *Existing* regulations will receive scrutiny partly through market investigations, an area of activity which has been given heightened importance at the OFT by the creation of a new Markets and Policy Initiatives Division, and partly as an element of routine competition investigations. The competition authorities will not be able to alter anti-competitive legislation themselves but when they raise such issues with the Government, the Government is committed to responding to the authorities within 90 days.[39]

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[34] *ibid*

[35] Trading Standards Institute response to Competition White Paper, 3 October 2001

[36] Don Cruickshank, *Competition in UK banking: A report to the Chancellor of the Exchequer*, March 2000. See for example recommendations 32-35.

[37] *ibid*, Recommendation 32, pxiv

[38] Department of Trade and Industry, *Opportunity for all in a world of change: A White Paper on enterprise, skills and innovation*, (Cm 5052), February 2001 para 5.3. See also paras 5.18-20.

[39] The Government anticipates that changes to legislation which are made on the basis of competition recommendations could normally been made under the *Regulatory Reform Act 2001* procedure.

Competition scrutiny of *proposed* legislation is a new function for the OFT. **Clause 7** states:

> **7** (1) The OFT has the function of -
> (a) making proposals, or
> (b) giving other information or advice,
> on matters relating to any of its functions to any Minister of the Crown or other public authority (*including proposals, information or advice as to any aspect of the law or a proposed change in the law*).
> (2) A Minister of the Crown may request the OFT to make proposals or give other information or advice on any matter relating to any of its functions and the OFT shall, so far as is reasonably practicable and consistent with their other functions, comply with the request.[40]

It seems that the impact on competition of proposed legislation will primarily be considered within the Government department which is sponsoring the legislation as part of the regulatory impact assessment. Departmental economists will play a key role in such assessments. Where competition concerns are identified by an initial 'competition filter', departments will be required to carry out a detailed competition assessment of the impact of the legislation. Guidance has already been issued by the Office of Fair Trading on how the processes should be applied.[41] The OFT will staff a dedicated helpline for policymakers but it seems will only take a direct role in competition assessments where the competition considerations are particularly complex.[42]

4. Promotion of competition

On the promotion of competition, the Competition White Paper said:

> 4.12 The Government wants to see a step change with the authorities looking beyond enforcement to a role of advocacy and promotion. Historically, our authorities have tended to focus all their energies on implementing the law. They have found it hard to step outside this function – for example, by publicly explaining the importance of competition, the significance of decisions, or ways in which competition might be increased.
>
> 4.13 In other countries, for example the US and Australia, competition authorities have a clear role as advocates of competition.
>
> 4.14 In future, the Government would like our competition authorities to take on a high profile advocacy role, both by advising on the impact of the Government's

40 Emphasis added.
41 Office of Fair Trading, *Guidelines for competition assessment: A guide for policy makers completing Regulatory Impact Assessments,* OFT 355, February 2002
42 *ibid,* para 1.3

> own laws and regulations on competition; and more widely acting to promote competition in the economy in a variety of ways.[43]

Efforts to encourage public participation in the enforcement of competition were a feature of the OFT's work on implementing the 1998 Act. The Bill not only gives the OFT a formal role in publicising the benefits of competition, it also takes steps to make it easier for injured parties to claim damages on the basis of competition infringements and allows consumers to participate in representative actions sponsored by consumer organisations (see below).

5. Codes of practice

Clause 8 gives the OFT an enhanced role in respect of codes of practice. It states:

> 8(1) The OFT has the function of promoting good practice in the carrying out of activities which may affect the economic interests of consumers in the United Kingdom.
>
> (2) That function includes-
> (a) encouraging the making and use by relevant associations and other persons of consumer codes of practice;
> (b) making arrangements for approving (and for withdrawing approval from) consumer codes of practice.
>
> (3) The arrangements mentioned in subsection (2)(b) may include provision for the giving of permission (by the OFT or any person authorised to act on its behalf) for the use of an official symbol intended to signify that a consumer code of practice is approved by the OFT.

Currently, under the *Fair Trading Act 1973*, the OFT has a general duty to encourage the preparation and dissemination of codes of practice, and, according to the Government, has supported the development of codes by 42 trade associations in 24 sectors.[44] The purpose of clause 8 is to enable the OFT to encourage relevant associations to devise self-regulatory codes of practice that satisfy core criteria set by the OFT. The intention is that the OFT will approve and promote a trade's self-regulatory code of practice, but only when it is satisfied that this code meets its core criteria and is being properly acted on.

The motive behind the OFT giving formal approval to good codes of practice is to help consumers identify reliable suppliers. According to the DTI:

> Self-regulation by means of an effective code of practice can be an excellent alternative to regulation. If codes of practice are strong, adhered to and include means of redress where things go wrong, they can offer effective protection for

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[43] Competition White Paper, paras 4.12-15

[44] Explanatory Notes to the *Enterprise Bill*, Bill 115-EN

> consumers and a good framework for business. Codes are more flexible than regulation, as they can be changed more quickly in response to the development of new business practices.[45]

It is clear from clause 8(2) that the OFT would be able to oversee the monitoring of the operation of the approved codes. It also follows that the OFT will be able to withdraw its approval from Codes that are not operating satisfactorily.

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[45] Department of Trade and Industry, *Empowering Consumers in the Enterprise Economy, The Enterprise Bill Consumer Measures*, URN/01/1462, 1 January 2002

The OFT's Mission Statement complements similar competition mission statements from the Government and the Competition Commission which are meant to provide a framework for Parliament and others to hold the competition authorities to account.

Office of Fair Trading: Statement of purpose

1. The OFT's goal is to make markets work well for consumers. Markets work well when there is vigorous competition between fair-dealing businesses. When markets work well, good businesses flourish.

2. The OFT's activities in pursuit of this goal involve:

   1. enforcement - of competition and consumer protection rules;
   2. investigation - into how markets are working;
   3. communication - to explain and improve awareness and understanding.

Enforcement

3. The OFT will uproot and deter all forms of anti-competitive behaviour, including cartels and the abuse of market power. The OFT will advise referral to the Competition Commission (CC) of all mergers that might substantially lessen competition and, where appropriate, will refer to the CC markets where competition may not be working well.

4. The OFT will lead other enforcers in robust application of the rules that protect consumers against unfair trading, taking court action where necessary. The OFT will also take practical steps to encourage self-regulation such as codes of practice.

5. The OFT will work with its international partners to ensure effective enforcement.

Investigation

6. The OFT will investigate markets proactively to see whether they are working well for consumers. As well as business behaviour, investigations will cover government laws and regulations to ensure a competitive environment for business and consumers. Where appropriate, investigations will lead to enforcement action or to recommendations to government, which will be published.

Communication

7. The OFT will communicate clearly in order to:

   1. show how competitive markets that work well are important for consumers, fair dealing businesses and economic performance;
   2. explain its decisions transparently;
   3. promote compliance by explaining to business what the law is and how the OFT will apply it;
   4. promote consumer awareness and confidence;
   5. co-ordinate effectively with enforcement partners locally, nationally and internationally; and
   6. advise government on how to achieve the most effective regime for competition and consumers.

8. The OFT has a leading role in promoting competition and consumer interests in the UK. The OFT is an independent and professional organisation but has no monopoly of wisdom. The OFT and its staff will be open and receptive to the ideas and concerns of business, consumer groups and others. The OFT will evaluate its own performance and will be accountable to Parliament and the public.

6. Super-complaints

The Government has declared its aim of 'strengthening the voice of the consumer in competition'.[46] One measure which addresses this aim is the new concept (**clause 11**) of the 'super-complaint'. It is thought that in consumer markets competitive failings may not be easily recognised by customers (for example where many suppliers operate in similar ways) and that consumers will find it hard to marshall the necessary information for the OFT to take action. Super-complaints will be referred to the OFT by specially-designated consumer bodies. At the OFT such complaints will be 'fast-tracked' and the OFT will be required to tell the referring organisation within 90 days whether it plans to take further action on the complaint or not. The OFT will issue guidance to consumer organisations on how such complaints should be presented. The Secretary of State has responsibility for choosing which consumer organisations are able to make complaints. The Competition White Paper suggests that the list could include such bodies as the Consumers' Association, the National Consumer Council, consumer councils in regulated sectors such as energy and postal services, and the Financial Services Consumer Panel.[47]

The National Consumer Council described the proposals as 'an imaginative and welcome step…. [we] will certainly consider using this new 'super-complaints' procedure if our work reveals examples of serious market malfunction.'[48] The National Association of Citizens Advice Bureaux, which is not mentioned as a possible super-complainant, favours the procedure and sees merit in NACAB, with its broad base of clients, also being designated.

The Consumers' Association (CA) too has welcomed the new power:

> CA welcomes the opportunity to work with the OFT to improve competition across markets. We will use the powers to ensure that markets work for consumers and we are currently carrying out cross sector analysis of markets and hope to issue super-complaints where we identify problems. We have already issued a super-complaint concerning dentistry. The complaint follows revelations in *Which?* and *Health Which?* of huge disparities in tariffs between dentists and a lack of transparency in charging. Consumers' Association has also been exposing the difficulty of getting redress for private dental patients who wish to complain about poor treatment.[49]

The CBI was initially cautious about the development of super-complaints and super-complainants:

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[46] Competition White Paper, para 4.25

[47] *ibid,* Box 4.2

[48] National Consumer Council press release, *Welcoming the reforms to competition rules in today's competition White Paper…*, 31 July 2001

[49] Consumers' Association briefing paper, 'Super-complaints: taking action on behalf of consumers', 2002

> 32. …. if the Government is minded to introduce this procedure, the fact that the OFT will be obliged to respond within a fixed time-period is welcome, to avoid companies being put at risk of open-ended jeopardy of investigation. We do however consider the 90-day period to be too long, and would urge the Government to impose a shorter time-limit within which the OFT must respond.
>
> 33. However, in order for the power not to be brought into disrepute, it must be used sparingly and only where the consumer organisation has a reasoned, justifiable prima facie case of competition law infringements. Likewise, as a more general point, specific organisations should not be granted preferential treatment under the law, and all parties must have the right to have their case heard and treated equally. If consumer organisations are given preferential treatment, this could re-introduce political involvement in the system via the back door.[50]

The way in which the dentistry complaint has been handled illustrates how super-complaints will be dealt with. It was made on a non-statutory basis by the Consumers' Association on 25 October 2001, the OFT having agreed that it would consider super-complaints before legislation was enacted.[51] On 23 January 2002, 90 days after the complaint, the OFT announced in a reply to the Consumers' Association that the issues merited further investigation and that it would carry out a full market investigation. The investigation is expected to be concluded before the end of 2002, during which time the Consumers' Association will be kept informed of progress.

C. Parts 2 and 5: Competition Commission & Appeals Tribunal

1. Background

Until the *Competition Act 1998*, the Monopolies and Mergers Commission (MMC) existed to carry out investigations into merger situations and other areas of competition concern such as monopolies, anti-competitive markets and licence disputes in the regulated utilities. It had no power to initiate its own enquiries (which were referred to it by the Secretary of State or the Director General of Fair Trading) and no role in implementing its recommendations (which were largely subject to the Secretary of State's discretion). The 1998 Act renamed the MMC the Competition Commission (CC) and gave it an appeals function in addition to its traditional reporting role. Within the CC, a new Competition Commission Appeals Tribunal (CCAT) was created to hear appeals from decisions made by the OFT. The CCAT was required because the Act gave the primary role in enforcing new prohibitions of abusive market dominance and anti-competitive agreements to the OFT. Previously the CC would have conducted investigations into these areas if they had been referred to it. The reporting side of the CC

[50] Confederation of British Industry Position Paper, 28 September 2001, paras 32-3

[51] For more information and copies of the OFT's reponse to the super-complaint see the OFT website: www.oft.gov.uk/Market+investigations/Super-complaints/private+dentistry.htm

retained responsibility for merger investigations and for a few scale and complex monopoly investigations (but only those made under residual powers).

The Bill, in **Part 2** and **Part 5**, makes further reforms to the Competition Commission. Since the Bill largely ends ministerial decision-making in competition investigations, its reporting side will now make binding decisions rather than recommendations in merger and market enquiries. There is to be a limited right of appeal from those decisions to the Appeals Tribunal. To prevent the CC conducting appeals into its own decisions, the appeals side of the CC is to be separately constituted as the Competition Appeal Tribunal (**clause 12**). Part 5 of the Bill completes the reforms by making the reporting side another independent body, the Competition Commission (**clause 177**). Both the Competition Appeal Tribunal and the new Competition Commission will have a very focused remit. Responsibilities for their staffing, funding and administration will now be carried out by another new corporate body, the Competition Service (**clause 175**).

COMPETITION COMMISSION STATEMENT OF AIMS AND OBJECTIVES

The Competition Commission (CC) is an independent body. Its reporting side is responsible for carrying out inquiries operating under statute. The Government is envisaging enhanced powers for the CC in relation to mergers and monopolies. The CC will use its powers rigorously and effectively. The outcome of its activities will contribute to an increase in the level of competition in the UK economy and to the UK's economic performance and productivity. It will also make markets work well for consumers. In many cases consumers will benefit from lower prices and a wider range of choice. In the longer term greater competition will also lead to more innovation and higher quality products and services.

The Competition Commission will:

- Carry out the inquiries referred to it in a fair, thorough and robust manner
- Appoint high calibre staff with expertise and skills relevant to competition
- Employ rigorous methodology in investigation and analysis
- Consult widely among all interested parties to an inquiry including consumer groups and the wider public and deploy methods to enable them to participate effectively
- Be open and transparent in its investigations, whilst maintaining confidentiality of material provided
- Give anyone who may be affected by its findings a fair opportunity to present their case
- Reach sound conclusions based on the evidence and analysis gathered
- Where an adverse finding is reached, develop remedies that address the problems identified. The remedies will be workable and encourage effective competition
- Move towards a regime within which its provisional findings on a merger or monopoly will be published prior to consideration of any possible remedies
- Bring to the attention of Government, through CC reports, regulations that may hinder competition
- Publish its reports by the statutory deadline, or earlier whenever this is possible
- When publishing its reports, disseminate its conclusions and underlying reasons to the media, business community and wider public
- Carry out high quality work on the basis of value for money
- Ensure that its staff are highly trained, and encourage diversity throughout the organisation

2. Competition Appeal Tribunal

The Competition Appeal Tribunal will like its predecessor the Competition Commission Appeals Tribunal be led by a President. It sits in three person panels, each headed by the President or a legally-qualified chairman. The President and the chairmen are appointed by the Lord Chancellor, while the other members of the tribunal are to be appointed by the Secretary of State who also appoints the Tribunal's registrar. Provisions for the qualifications and terms of appointment of the tribunal members are set out in **Schedule 2**.

Although many of the rules and functions of the new Tribunal are carried forward from its predecessor, the Tribunal will have a broader role than before, including hearing appeals from Competition Commission decisions as well as decisions by the OFT; hearing claims for damages incurred as a result of competition infringements, and hearing complaints brought on behalf of consumers by designated representative bodies. These new tasks are part of the Government's agenda to provide redress for parties harmed by unfair competition and to encourage competition enforcement by making business and consumers more aware of the value of competition.

It was anticipated as part of the *Competition Act 1998* that harmed parties should have a right to seek redress for competition breaches through a civil action in the UK courts. The 1998 Act, however, makes only oblique reference to this right. To facilitate civil actions, findings of fact by the Office of Fair Trading were made binding on some UK courts under the 1998 Act (s.58).

The Government remains convinced of the value of private enforcement of competition law through such actions and the Bill therefore includes a number of proposals to encourage private actions. The Competition White Paper noted that in July 2001, there had as yet been no successful private actions for breaches of the 1998 Act (in force since March 2000) and more significantly no reported cases for damages based on European Community competition law (in force since 1973). To encourage private actions, the White Paper proposed allowing the Competition Commission Appeals Tribunal to hear damages claims, making decisions of infringements by the competition authorities binding on all courts, and giving the Tribunal the power to enforce its own orders.[52]

In consultations prior to the 1998 Act, the Government had ruled out giving the Tribunal a role in awarding damages on grounds of cost and speed:

> 7.25 We have considered carefully the option of making the Competition Commission, as opposed to the Courts, the forum to hear private law actions for breach of the prohibition, such as claims by third parties for damages or interim

[52] Competition White Paper, paras 8.1-10

> relief. We have concluded that there are significant drawbacks to such private actions being heard in the tribunal. In practice the application of the prohibition would often be one of many areas of the commercial dispute to resolve which, in turn, could lead to an unnecessary duplication of fact finding as the tribunal heard competition law points and the courts heard other aspects of the same case. Moreover, if the tribunal were to hear such private law actions, this could prejudice its primary objective of providing a quick and efficient review of DGFT decisions. We have therefore decided that such private actions should be heard in the courts.[53]

The Competition White Paper shows a change of heart:

> 8.7 The Government proposes to expand the role of the Competition Commission Appeal Tribunals enabling them to hear claims for damages in competition cases brought by harmed parties. This would make better use of existing judicial resources. It is also likely to reduce the costs for the parties. The Tribunals currently do not award costs and operate less expensive procedures. Although their rules on costs would need to be revised in light of their new powers, it might be possible to retain some flexibility in awarding costs where a private action is also in the public interest.
>
> 8.8 The Tribunals could hear damages claims both immediately after considering the substantive appeal against a decision of the OFT and in cases where the OFT's decision is accepted and no appeal is subsequently made. This would bring procedural efficiencies as the Tribunal would be able to act more swiftly where they are already familiar with the facts of a case against an undertaking. Clear tests of whether a claimant had just cause and the formula by which Tribunals would calculate damages would be laid out.[54]

Clause 16 amends the 1998 Act to allow the Tribunal to hear damages claims. Cases can only be brought to the Tribunal after a finding - by the UK or the European authorities - of an infringement of either the UK competition prohibitions or those in the EC Treaty. Claims for damages are to be decided on 'the same principles as would be applied by a court in awarding damages for a claim in tort or, in Scotland, delict' (c.16(3)). The Tribunal will not be able to hear damages claims until any possible appeal has been heard.

The Tribunal's decisions will be enforceable as if they had been made by the High Court (or the Court of Session) (**Schedule 3, para 2**). Findings of infringement by the OFT and the Tribunal are to be binding on all courts (unless the possibility of an appeal remains): this will facilitate civil claims in the courts (as an alternative to damages claims in the Tribunal) (**clause 18**).

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[53] Department of Trade and Industry, *A prohibition approach to anti-competitive agreements and abuse of dominant position: draft Bill*, August 1997, para 7.25

[54] Competition White Paper paras 8.7-8

3. Representative claims

The Competition White Paper indicated that the Government wished to allow representative claims to be brought on behalf of consumers in cases where although there might be a large number of affected consumers each would have only a fairly small individual loss. Since individuals are unlikely to bring claims in such cases on practical grounds, the Government proposed that representative organisations, such as the National Consumer Council or the sectoral consumer panels in the utility sector, should be able to bring cases on behalf of consumers where they could identify the number of consumers falling into the class and the overall economic harm suffered.[55] The application of damages in such cases was thought to be problematic. The White Paper suggested either holding an award in trust and allowing claimants to make an application to the trust for their share, or using the award to benefit the affected class of claimant indirectly by using it for purposes which benefit consumers in that market (such as consumer information or community facilities).[56]

Following 'mixed' responses to these suggestions, the Government decided that representative claims can only be brought on behalf of named (as distinct from identifiable) consumers. New claims can be brought on behalf of two or more individuals (with their consent) and existing claims can be taken over by the designated bodies (**clause 17**). The designated bodies, to be specified in secondary legislation, will bring the representative claim to the Tribunal and not in ordinary court system. This type of claim can only be made on behalf of consumers against businesses (as defined in the clause).

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[55] Competition White Paper para 8.21
[56] *ibid,* 8.22

D. Part 3: Merger regime

The UK's domestic merger regime is currently based on the provisions of the *Fair Trading Act 1973*.[57] Unlike elements of the anti-cartel and monopoly regime, the merger regime was not affected by the reforms of the *Competition Act 1998*.

Three bodies may be involved in merger scrutiny: the Secretary of State for Trade and Industry, the Director General of Fair Trading (who leads the Office of Fair Trading) and the Competition Commission (formerly the Monopolies and Mergers Commission). The Director General monitors business activity to identify prospective mergers assisted by advance notifications from merging companies.[58] Only mergers of a certain scale fall within the scope of the regime, based either on the value of the worldwide assets involved (£70 million plus) or the share of supply of goods or services (25 per cent plus). The Director General advises the Secretary of State on whether the merger merits further investigation on competition grounds. If the Secretary of State decides that it does, she then refers it to the Competition Commission which carries out an enquiry as to whether the merger may or may not be against the public interest. This assessment measure is known as the public interest test.

At the end of its investigation, the Competition Commission's recommendations and report are delivered to the Secretary of State. If the Commission makes a finding that the merger operates or may be expected to operate against the public interest, the Secretary of State can either adopt the Commission's recommendations, substitute her own solution, or amend the Commission's recommendations. If the Commission clears the merger, however, the Secretary of State may take no further action. In practice, the Secretary of State has tended to accept at least the thrust of Commission recommendations.

As an alternative to a formal Competition Commission investigation, but where a referral would otherwise be recommended by the Director General, it is possible for undertakings to be sought from the company in lieu of a reference.

1. Political involvement before 1997

Merger decisions have very tangible effects in the commercial world: a decision to permit or to prevent a merger may have significant and immediate effects on the stockmarket value of the firms involved, on the job security of their employees, on the local economies in which they operate and on the wealth of their shareholders, to say nothing of the longer term implications for corporate earnings and the performance of sectors of the economy. On the other hand, competition decisions are necessarily made with

[57] Businesses in the UK are also subject to the European Community's merger regime for larger mergers which have a 'community dimension'.

[58] Notification is optional but most mergers are pre-notified to the OFT. Such mergers have an accelerated timetable for initial scrutiny. Pre-notification also avoids the danger that the merger might be scrutinised after completion which would be more disruptive to the businesses involved.

imperfect information about the present and the future, and may involve contentious assumptions about economic and market theory and the role of the state in industrial policy. In the past the magnitude of the decision on whether to allow a merger (or prescribe its terms) has been used to justify that decision being taken by elected politicians who are accountable through Parliament and the ballot box. Yet Governments have been regularly criticised for using competition decisions as an arm of industrial or social policy (which may or may not reflect competition considerations). Those occasions where the Secretary of State has chosen to depart from the recommendations of his officials in the competition authorities tend to be particularly criticised, not least by political opponents.

A recent account of the Competition Commission (and its predecessor the Monopolies and Mergers Commission) has observed that political differences do not appear to have a significant impact on the number of references to the Commission but that there is noticeable variation between individual Secretaries of State:

> In total up to 1997 the Secretary of State rejected the advice of the [Director General] in twenty three cases. In fourteen he refused to refer cases and in nine cases he referred them in spite of advice not to. Three of these incidents were prior to 1979, and fourteen have come since 1990. In some cases a refusal to refer appeared part of a systematic policy relaxation, as with Heseltine's rejection of advice to refer GEC/ Philips and Airtours/ Owners Abroad (both in February 1993). In others the initiation of references was a deliberate refocusing of policy, as with Peter Lilley's opposition to bids by foreign state-controlled companies. He regarded such bids as nationalisation by the back door. The so-called 'Lilley Doctrine' (or perhaps the Lilley/ Redwood Doctrine) was announced in January 1990 and resulted in a spate of five references, three made against the advice of the DGFT. Four of the Lilley references were cleared by the Commission and the fifth, *Kemira Oy/ ICI*, was found against the public interest on conventional competition analysis. This effectively spelled the end of the policy and is rightly taken as proof of MMC independence.
>
> Analysis of merger references by government does not indicate any striking party-political pattern. Labour is slightly less likely to refer than the Conservatives but both the highest and the lowest reference rates occurred during the 1979-97 Conservative period of office. Reference rates peaked during 1987-92. Neither does the record show any particular pattern in MMC decisions, although …there has been a recent increase in the proportion of cases allowed by virtue either of not being found against the public interest, or found against the public interest but with a recommendation for the acceptance of various conditions.[59]

[59] Wilks, *In the public interest: Competition policy and the Monopolies and Mergers Commission* (1999) p226

Merger references to Monopolies and Mergers Commission 1979-1995

Year	OFT advised reference	Not referred despite OFT advice	Referred against OFT advice
1979	5	Thorn/ EMI; Calor gas/Glogas	
1980	5		
1981	8		
1982	8		1
1983	9	Blue Circle/Aberthaw; Dalgety/part of Rank Hovis McDougall	1
1984	5	Nestle/ Carnation	
1985	6		
1986	15	Cannon/ Screen Entertainment; Owens Corning Fibreglass/ part of Pilkington	
1987	6		
1988	10		
1989	15		
1990	23		4
1991	8	BPB Industries/ part of Poliet Group	
1992	11		
1993	5	GEC/ Infra Red (Phillips); Airtours/ Owners Abroad	
1994	7		
*1995**	9	Hasbro/ Waddington Games; North West Water/ Norweb	

Source: HC Deb 22 November 1995 cc202-3W
*To 21 November 1995

2. Labour Government and OFT advice

The Labour Government's decisions to refer mergers to the Competition Commission have been closely scrutinised, initially when commentators suspected that it had a greater propensity to make such references than its predecessors, and later when in 1999 plans to remove politicians from such decisions were announced.

> **Mr. Waterson**: To ask the Secretary of State for Trade and Industry on how many occasions since May 1997 (a) she and (b) her predecessors have overruled the advice of the Director-General of the Office of Fair Trading.

> **Miss Melanie Johnson**: My right hon. Friend the Secretary of State for Trade and Industry has overruled the advice of the Director General of Fair Trading regarding mergers of enterprises on eight occasions and on monopoly reports on three occasions since May 1997.[60]

Occasions on which the Secretary of State overruled the OFT's advice included proposed mergers between National Express Group and both ScotRail and Central Trains. The OFT had recommended that the ScotRail deal should only be referred to the Commission if National Express would not agree to sell a subsidiary and that the Central Trains deal should not be referred at all.[61] The Commission made an adverse public interest finding on the ScotRail merger (and called for the divestment of the same subsidiary that the OFT had recommended).[62] The Commission cleared the Central Trains merger.[63]

In August 1997, Margaret Beckett as Secretary of State referred a bid by Pacificorp for electricity supplier Energy Group.[64] The OFT had recommended that the merger be cleared (if assurances could be secured from the bidder). The Secretary of State based her decision to refer on the policy implications of what was the first significant merger in an economically important sector:

> "My general policy continues to be that I will refer mergers primarily on competition grounds. However, I shall continue to examine mergers on a case by case basis and where, as here, I believe that as part of a wider public interest scrutiny, important regulatory issues are raised, I may decide that a reference is warranted."[65]

The merger was subsequently cleared by the Monopolies and Mergers Commission although it did identify a number of matters which it believed could be addressed by the sectoral regulator.[66]

Mrs Beckett gained the soubriquet 'Mrs Blockit' in response to her decisions to make references to the Office of Fair Trading or to block mergers after investigations by the Monopolies and Mergers Commission. She maintained that her critics were misinformed:

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[60] HC Deb 12 December 2001 c944W

[61] DTI press release P/97/336, *Margaret Beckett announces reference to MMC of certain National Express acquisitions of rail franchises*, 22 May 1997

[62] Monopolies and Mergers Commission, *National Express Group Plc and Scotrail Railways Limited*, Cm 3773, 16 December 1997

[63] Monopolies and Mergers Commission, *National Express Group Plc and Central Trains Limited*, Cm 3774, 16 December 1997

[64] DTI press release P/97/526, *Margaret Beckett refers Pacificorp's Bid for the Energy Group to MMC*, 1 August 1997

[65] *ibid*

[66] Monopolies and Mergers Commission, *Pacificorp and the Energy Group Plc*, Cm 3816, 19 December 1997

> Some have argued that companies should be allowed to escape competition scrutiny at home in the belief that protecting them at home will better equip them to prosper overseas. I do not subscribe to this point of view. I believe competitiveness both at home and in overseas markets is enhanced by competition in our domestic markets.
> (…)
> I have made clear that in assessing mergers my primary concern will be competition, although of course every case will always be considered on its merits. Cases are often complex and judgements may be finely balanced.
>
> Some of you may find it a little hard to reconcile this with the confused view that some, mainly city journalists, have taken of my approach to mergers. You may be wondering whether this is a second case of Dr Jekyll and Mr Hyde: that while Mrs Beckett may have an encouraging message for companies, her alter-ego Mrs Blockit will still put a stop to all their plans.
> (…)
> Since last May I have considered over 200 mergers and prohibited only four - in all four cases this was in accordance with the advice of the DGFT, and in three cases it was the MMC's recommendation. Prohibition has been very much the exception and not the rule.[67]

As Secretary of State, Stephen Byers first published the proposal to hand merger decisions to the competition authorities rather than politicians save in exceptional cases.[68] This meant that his subsequent reference policy received particularly close scrutiny. In 1999, a merger was proposed between British Aerospace (BAe) and Marconi Electronic Systems. The merger was sufficiently large to fall within the scope of the European Community Merger Regulation and the non-military aspects of the merger were duly considered and cleared by the European Commission. The UK used powers which exist in the EC Treaty, however, to scrutinise the military aspects of the merger domestically on the grounds that it involved the UK's essential security interests. In relation to these military aspects, the OFT recommended that the merger should be scrutinised by the Competition Commission. That advice was over-ruled by the Secretary of State who directed that undertakings from the company should be sought instead of a reference.[69] Undertakings were later agreed.[70] Although the Secretary of State acted against the advice of the Office of Fair Trading on the reference, the case is arguably of limited significance since even under the proposed reforms an exception will be made for cases where national security is involved.

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67 Department of Trade and Industry press release P/98/480, *Fair Competition Good For Business,* 17 June 1998

68 Department of Trade and Industry, *Mergers: A consultation document on proposals for reform*, August 1999

69 Department of Trade and Industry press release P/99/731, *British Aerospace/ GEC Marconi: Stephen Byers asks DGFT to Seek Undertakings*, 9 September 1999

70 Department of Trade and Industry press release P/2000/220, *Stephen Byers accepts undertakings from BAE Systems*, 28 March 2000

In November 1999, Mr Byers referred the proposed acquisition of part of Cable and Wireless by NTL Inc. He cited concerns about the market for the delivery of Pay TV:

> Effective competition in these growing markets is of central importance to the consumer. I have considered carefully the DGFT's advice but am concerned about the possible effects on this developing market of the reduction in the number of cable operators from three to two. These concerns are in my view sufficiently serious to warrant thorough examination by the Competition Commission and I am therefore referring this acquisition so that it can be fully investigated.[71]

The Office of Fair Trading had advised against a reference. When the Competition Commission reported it concluded that the merger:

> *(a)* does not adversely affect competition in supply of pay-TV services (paragraphs 2.73 to 2.79);
> *(b)* does not have a material adverse effect on the market power of NTL relative to content providers (paragraphs 2.94 and 2.95);
> *(c)* does not adversely affect competition between platforms (paragraph 2.104);
> *(d)* does not adversely affect consumers (paragraph 2.107); and
> *(e)* does not adversely affect competition in telecommunications (paragraph 2.116).
>
> 2.118. We therefore conclude that the merger may not be expected to operate against the public interest. The question of remedies does not therefore arise.[72]

The DTI justified the original decision to refer by noting the many concerns raised by third parties about the merger.[73] Press commentators were critical of the handling of the case, suggesting that OFT and Treasury officials were less than happy with the decision, and hinting at a possible connection with the media interests of Rupert Murdoch.[74] A competition lawyer is reported as saying:

> 'This was an extraordinary decision from a Government that is promoting consistency and openness. It was overtly political in the narrow sense that it has

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[71] Department of Trade and Industry press release P/99/921, *Stephen Byers Refers Proposed Acquisition By NTL Inc*., 12 November 1999

[72] Competition Commission, *NTL Incorporated and Cable & Wireless Communications Plc*, Cm 4666, 22 March 2000 para 2.117

[73] A DTI press release quoted from the Competition Commission's analysis of the views of third parties: "The Competition Commission reported that, 'contrary to the views widely expressed by media commentators that the need for a reference was difficult to understand, the reference elicited strong expressions of concern about a number of issues'". See para 2.19 of the report and Department of Trade and Industry press release P/2000/200, *Competition Commission Clears CWC/NTL Merger,* 22 March 2000

[74] See for example, 'Did Blair order Byers' block?', *Observer*, 21 November 1999 and 'A Byers market… Stephen Byers is making a mess of competition policy', *Economist*, 12 February 2000

> not been left to the professionals. Whether it is in the wider sense in that Murdoch is looming is not for me to judge. But it can certainly be perceived that way.'[75]

The Competition White Paper noted that between October 2000 and July 2001, 150 decisions on merger references had been made on the basis solely of the OFT's advice; it gave this as an illustration that the new policy would not prove difficult to operate.[76]

The removal of politicians from merger decisions has been broadly welcomed. The Consumers' Association has described it as 'a very welcome step'; the Institute of Chartered Accountants in England and Wales believes it 'will assist in the consistent application of competition law in all circumstances'; and Allen & Overy has welcomed the enhanced independence of the competition authorities, which will eliminate 'a layer of political risk from the investigation process'.[77]

3. Reform

The key elements to the reforms proposed by this Bill are to make merger scrutiny more transparent by changing the test against which they are assessed and by leaving decisions on investigations and remedies to the competition authorities in all but a few cases. These changes reflect the reforms which have already been applied to the cartel and monopoly regime under the *Competition Act 1998*. They are mirrored by similar proposals for powers on scale and complex monopolies which have been retained from the *Fair Trading Act 1973* for special purposes (see below). The Government has been able to anticipate some elements of the new regime on a non-statutory basis since its policy was shaped. In particular, since October 2000 the DTI has committed itself to act on the basis of the Director General's advice (on reference decisions) except in exceptional circumstances.

The Government consulted on its merger reforms in August 1999.[78] In the introduction to the consultation, the Secretary of State for Trade and Industry said:

> I believe that merger cases should be taken out of the political arena. The system would be significantly improved if the vast majority of decisions were taken by independent competition authorities rather than politicians. I also want to clarify the framework for decisions, and to give business more certainty about the timetables for investigations.[79]

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[75] 'Did Blair order Byers' block?', *Observer*, 21 November 1999
[76] Competition White Paper, para 5.6
[77] Consumers' Association briefing paper, *The Enterprise Bill: taking action on behalf of consumers*, 2002; ICAEW Tech 15/01, para 3; Allen & Overy, Response to Competition White Paper, 9 October 200, para 4
[78] Department of Trade and Industry, *Mergers: A consultation document on proposals for reform*, August 1999
[79] *ibid*. p1

More detailed policy, based on the response to that consultation, was then announced in October 2000 and in the Competition White Paper of July 2001.[80]

In the White Paper, the Government said:

> 5.3 Removing Ministers from most decisions will bring the UK's merger regime into line with best practice in other countries. Decisions will be taken by those best qualified to make them – namely the expert competition authorities – in line with one of the Government's principles for competition policy.
>
> 5.4 This change will clarify arrangements and make decision-making more predictable. Business will no longer need to factor in the possibility that decisions will be influenced by political considerations.
>
> 5.5 The new regime will, however, allow Ministers to continue to take final decisions on the small minority of mergers raising defined exceptional public interest issues. National security, covering essential defence interests and other public security concerns, will be defined as an exceptional public interest from the outset. Ministers will be able to define further criteria subsequently, but only by statutory instrument subject to the affirmative resolution procedure in both Houses of Parliament.[81]

Whereas now the Office of Fair Trading (in the person of the Director General of Fair Trading) performs an initial investigation into a merger before making a recommendation to the minister who takes the final reference decision, the OFT will take the decision to refer by itself. The referral would be made to the Competition Commission as now. However, the Competition Commission's conclusions will be final and will no longer be subject to ministerial approval or alteration.[82]

As the White Paper had explained, ministers will continue to take decisions in cases which raise issues of national security. There is a power to add other categories of case to this list. Powers are also set out to allow for scrutiny of a merger (of any size) where the company has classified information by virtue of being a Government contractor and its disclosure could compromise national security interests.

4. Competition test

At the moment mergers are assessed against a public interest test. The *Fair Trading Act 1973* requires the Competition Commission to take into account 'all matters which appear

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[80] Department of Trade and Industry, *Mergers: The response to the consultation on proposals for reform*, URN 0/805, October 2000

[81] Competition White Paper, p23

[82] See the Annexes A and B to the Explanatory Notes which accompany the Bill for flow diagrams of this procedure and that for market investigations (Bill 115 EN)

to them in the particular circumstances to be relevant'; it then directs the Commission to have regard to the desirability:

> (a) of maintaining and promoting effective competition between persons supplying goods and services in the United Kingdom;
>
> (b) of promoting the interests of consumers, purchasers and other users of goods and services in the United Kingdom in respect of the prices charged for them and in respect of their quality and the variety of goods and services supplied;
>
> (c) of promoting, through competition, the reduction of costs and the development and use of new techniques and new products, and of facilitating the entry of new competitors into existing markets;
>
> (d) of maintaining and promoting the balanced distribution of industry and employment in the United Kingdom; and
>
> (e) of maintaining and promoting competitive activity in markets outside the United Kingdom on the part of producers of goods, and of suppliers of goods and services, in the United Kingdom.[83]

For many years references to the Competition Commission have been made primarily on competition grounds (the so-called 'Tebbit Guidelines') rather than the broader interests provided for in the statutory test.[84] The Bill will now formally recognise this trend by replacing the public interest test with a test based on whether a merger would result in a substantial lessening of competition. As the government noted in October 2000:

> The objective of the test will be to establish whether a merger will give rise to market power, enabling the merged business to raise prices, reduce choice, or operate inefficiently, without being punished by the market.[85]

While the DTI found strong support for this competition test, there were some supporters of a test which would be based on that used in the EC's Merger Regulation. That test is based on dominance (that is, market power). The government noted that since mergers fall to be handled under either the UK regime or the EC regime but not both, arguments for using the same test were less strong than in other parts of competition control where dual jurisdiction could arise. It also pointed to concerns about the ability of the EC dominance test to address adequately joint or collective dominance. In its response, the ICAEW was concerned that competition authorities should not focus exclusively on

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83 *Fair Trading Act 1973*, s.84

84 Strictly, these criteria only apply to the CC but the OFT has regard to them when it advises on whether a reference should be made. However, the competition ground is normally the basis of any decision.

85 Department of Trade and Industry, *Mergers: The Response to the Consultation on Proposals for Reform*, October 2000, para 2.18

domestic economic concerns.[86] There were also those ('a few respondents') who were concerned about the narrowing of the public test to focus exclusively on competition.[87]

Under the Bill, both the OFT (in deciding whether to make a reference to the Competition Commission) and the Competition Commission (in deciding whether remedial action is required) will apply the same competition test. This is that the merger has resulted, or may be expected to result, 'in a substantial lessening of competition' within markets in the UK for goods or services (OFT: **clauses 20 and 31**; CC: **clauses 33 and 34**).

While competition is therefore the primary consideration in deciding whether a merger requires investigation or remedial action, it is not always the exclusive consideration. First, there is a de minimis threshold, so that only mergers of a certain scale fall to be examined. Only when a merger exceeds the specified turnover or share of supply limits (**clause 21**) does it become a 'relevant merger situation' and hence eligible for scrutiny. Second, there is provision for both the OFT at reference stage, and the CC at the investigation stage, to take into account countervailing consumer benefits which may justify not referring or taking remedial action even against a merger which would fail the competition test. Third, where a specified public interest consideration (such as national security) applies, the merger may be referred, investigated and remedied on that public interest ground (see below and **clauses 40 and 56**) even in the absence of competition concerns. Fourth, where the merger involves government contractors or sub-contractors who hold confidential information related to defence, the merger can be referred and investigated on public interest grounds even though the merger does not satisfy the scale tests of clause 21 (see below and **clause 57**). Fifth, in deciding whether to make a reference, the OFT can choose not to refer on the grounds that even though a substantial lessening of competition would result, the market is not of sufficient importance to justify a reference (c.20(2)(a)). Subject to these provisions, the competition test is strictly applied and the Bill is worded to prevent exceptions - such as the limited public interest provisions - from being applied in other than a narrow sense.

The ability of the competition authorities to take countervailing benefits into consideration is probably the most important of the exceptions. As an example, consider the provision as it applies to the OFT's duty to refer completed mergers (c.20). The clause permits the OFT not to make a reference if it believes that 'any relevant customer benefits

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[86] 'Competition issues should be considered in the context of the market in which the particular product is traded. UK firms acting in an international arena should not be prejudiced by competition authorities whose remit is inappropriately limited to consideration of the UK market. Retention of a "national champion" can be in the interests of the maintenance of competition on a global basis, even where this may not be apparent if considered on a UK basis alone.' Institute of Chartered Accountants in England and Wales, Tech 15/01, para 8

[87] The Green Party's economics spokesperson, Dr Molly Scott Cato, has said: 'It's scandalous that the DTI has decided to formally abandon the "public interest" test in merger decisions, and to do so without a proper public debate…..Merging of companies results in more transportation costs and huge unaccounted environmental costs, and the effect of takeovers on communities can be devastating.' Green party press release, *Greens call for tighter rein on "merger mania"*, 11 December 2001

in relation to the creation of the relevant merger situation concerned outweigh any adverse effects of the substantial lessening of competition concerned'. These benefits are defined as 'lower prices, higher quality or greater choice of goods or services in any market in the United Kingdom… or greater innovation in relation to such goods and services' (**clause 28**). To apply this provision, the OFT must also believe that the benefits will be derived within a reasonable period and are unlikely to accrue without the merger or a similar lessening of competition.[88]

5. Public interest exception

The Government intends to retain ministerial decision-making in a limited class of merger, described as public interest cases. Because any unnecessary widening of the scope of this exception would blunt the Bill's delivery of a key policy aim - that competition decisions should be taken by strong, independent competition authorities - the scope of the exception and its use are strictly circumscribed. This has, however, added to the complexity of the Bill, since with the exception comes the need for alternative decision-making procedures and provisions to limit the exercise of that discretion on various emergent occasions.

The only public interest consideration which is defined in the Bill is 'national security' which is expressed to include 'public security' (**clause 56**). The latter phrase is also used in the EC's Merger Regulation. New public interest considerations can be created by order, including for the purpose of a specific investigation and for an investigation which is already under way. Such orders require the approval of both Houses of Parliament, and expire after 28 days if not approved (**clause 116(6)**).

In ordinary merger cases, the OFT will take a decision on whether to refer without consulting ministers. Similarly, the CC will investigate and impose remedies independently of Government. Where a public interest consideration arises, though, different procedures are required. The OFT is placed under a duty to bring cases which seem to raise material public interest considerations to the attention of the Secretary of State (**clause 55**). Where the Secretary of State believes that a merger situation exists to which a public interest consideration applies (or should apply), she issues an 'intervention notice' under clause 40.[89] An intervention notice can only be issued if the merger has not yet been referred to the CC by the OFT. When an intervention notice has been issued, the OFT instead of taking a reference decision by itself, prepares a report for the Secretary of State which includes advice on the normal competition elements of a reference decision and a summary of representations received by the OFT on the public interest point. The Secretary of State then takes the decision as to whether to refer or not (**clause 43**).

[88] Clause 28(1)(b) is curiously expressed, requiring the OFT to believe 'as mentioned' in a later subsection.

[89] If the minister needs to specify a new public interest consideration, an order will need to be laid before Parliament promptly.

If a reference is made, again the Competition Commission will not take its own decisions on the case. At the conclusion of its investigations, it reports to the Secretary of State on both the competition and public interest concerns (where applicable) with recommendations as to remedies. The Secretary of State then takes the final decision as to whether to make a finding that the merger is against the public interest. Such a finding could be made either on the basis of national security (or another pre-designated public interest consideration) or on competition grounds, or both (**clause 52**). The Secretary of State also takes the decision as to how an adverse public interest finding should be remedied (**clause 53**).

6. Special intervention notices

In its response to the Competition White Paper, the Government announced a further new area for which ministerial decision-making would be retained:

> The Government intends to take powers to allow for the scrutiny of any merger involving a company (regardless of its size) with classified information whose disclosure would compromise the UK's essential national security interests.[90]

The provision is aimed at mergers of government contractors and subcontractors where they may pose a risk to the security of classified information. The key distinction between this power (**clause 57**) and the public interest considerations described above is that it applies to companies of any size, however small (i.e. the threshold test does not apply). The procedures are in other respects similar to those on public interest considerations: the Secretary of State issues a 'special intervention notice' and although the OFT and CC carry out any necessary investigations, each reports to the Secretary of State who takes any relevant decision.

7. Appeals

A statutory right of appeal from merger decisions will be created for the first time. Reporting back on the Competition White Paper consultation, the Government said:

> A few respondents suggested that the new merger regime should incorporate a right of appeal. One suggested that this would be necessary whenever a divestment remedy was recommended. Others thought that a robust appeals process was needed for all merger and markets cases.
>
> **Government response**
>
> **The Government intends to introduce a statutory right of appeal on limited grounds to the Competition Commission Appeal Tribunals (CCAT) which**

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[90] Department of Trade and Industry, *Productivity and Enterprise - A World Class Competition Regime: Government's Response to Consultation*, December 2001 ('Government's response to consultation'), para 27

> **will be subject to some institutional re-organisation. The grounds of appeal will be closely modelled on judicial review. Routing appeals this way will ensure they are dealt with impartially, speedily and by experts in competition law.**[91]

Clause 114 provides that an application for a review of a decision made as part of the merger process, whether by the Secretary of State, the OFT or the CC, lies to the Competition Appeal Tribunal. As with judicial review, appeals have to be made without unreasonable delay, and a three month upper limit is set. Rather than set out the grounds for a review, clause 114(6) explicitly provides that the Tribunal should apply 'the same principles as would be applied by a court on an application for judicial review'. The Tribunal has the power to quash the decision which is appealed against or to remit it to the decision-maker for reconsideration.

8. Water mergers

Water mergers are subject to a regime which has some unique features. Those features are to be retained under the Bill but in other respects the water merger regime will be altered in line with changes to the main regime (**clause 66**). Decisions to make water merger references to the CC will now be taken by the OFT rather than the Secretary of State. If a reference is made to the CC, and there is an adverse finding, the CC will decide what remedies should be applied rather than the Secretary of State. Water references are currently subject to a threshold test of £30m of relevant water assets. That test will now be a turnover test which will initially be set at £10m. The change is expected to have an identical effect to the previous test; its purpose is to prevent the scrutiny of mergers where one of the parties is a small water company.

Water mergers are subject to special provisions which are meant to ensure the availability of comparative information about water company performance to the water regulator. **Schedule 5** of the Bill inserts a new Schedule in the *Water Industry Act 1991* which sets out how the assessment of a water merger is modified from the main regime. Competition is not a significant feature of the water sector which is characterised instead by strict regulation. The competition authorities' assessment of water mergers therefore involves balancing factors which could make it more difficult for the water regulator to carry out his work (such as the loss of a comparator) against countervailing consumer benefits.[92]

9. Other changes

Among other changes to the merger regime included in the Bill are:

- The **threshold** test will remain as two alternatives: one based on a 25 per cent share of supply (unchanged), the other on a total UK turnover of £45 million (formerly

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[91] Government's response to consultation', para 26
[92] See also OFWAT's response to the Competition White Paper, October 2001

worldwide assets in excess of £70 million) (**clause 21**). The turnover test is meant to have broadly the same scope as the old assets test but to be more relevant to modern business entities. The Government has decided against introducing a third threshold test which would have caught mergers in linked (but separate) markets.

- The list of **remedies** will be updated to allow some which are less far-reaching than those on the current list but are not currently permitted (for example, to require transport companies to be obliged to maintain frequency of service commitments) (**Schedules 7 and 8**).

- The **handling periods** for mergers will be reduced. There will remain two regimes for the initial OFT investigation, one statutory timetable which applies where a voluntary notification has been made (down from 35 to 30 working days) and one administrative timetable for non-notified mergers (for which the target will be reduced from 45 working days to 40) (**clause 93**). The Competition Commission will have a statutory maximum timetable of 24 weeks which can exceptionally be extended by a further eight weeks (**clause 37**).

- The CC will now impose **remedies** on companies at the end of its investigations rather than recommending remedies to the discretion of the Secretary of State. These powers are set out in **clauses 78 and 80** and in **Schedule 7**. Although these remedies have been updated in places it is the fact that the CC will apply them rather than their nature that is significant. Although CC recommendations have generally been adopted in recent years, it will face a challenge to establish and maintain its reputation once it acquires executive responsibility for its actions. The pressure on it may be more acute than that faced, for example, by the Bank of England when it acquired responsibility for setting interest rates, since CC decisions will have a much more direct effect, albeit on a small class of undertakings.

- The CC can by notice require attendance at hearings and the production of information for the purposes of its investigations (**clause 105**). It will also have, for the first time, power to impose **fines** on those who do not comply with such notices (**clause 106**). The level of such fixed or daily fines will be set by order but may not exceed £30,000 for a fixed fine or £15,000 for a daily default fine.

E. Part 4: Market investigations

1. Background

The *Competition Act 1998* provides the main route for controlling monopoly power, or as that Act phrases it, abuse of a dominant market position (the Chapter II prohibition). The Chapter II prohibition is based on Article 82 of the EC Treaty and is therefore at one with EC provisions on market dominance. The latter apply where abusive dominance has an effect on trade between member states.

When the 1998 Act was passed, the Government opted to retain the anti-monopoly powers of the *Fair Trading Act 1973* in addition to the new prohibition of abuse of a dominant market position. The 1973 Act contained powers to control monopoly behaviour by single entities (scale or structural monopolies) and behaviour by two or more entities which conduct their affairs in such a way as to distort competition (complex or behavioural monopolies). The system is different in kind to the powers which have been introduced by the 1998 Act. Whereas the 1998 Act prohibits abusive behaviour from the outset, the 1973 Act relies on an investigation of the specified market. Nothing is prohibited in advance and there is no power to take action in respect of conduct before the investigation. When the investigation is concluded, the Competition Commission makes recommendations to the Secretary of State on how to address any findings of conduct which operates against the public interest. While the 1998 Act applies an economic test for dominance, the 1973 Act relies instead on a statutory market share test and uses a very general concept of market failure.

The 1973 Act possesses a number of useful qualities. The broad scope of its reference criteria means that it is much simpler to determine whether a reference may be made since a detailed economic analysis is not required at that stage. Since the 1973 Act specifies a 25 per cent supply share it allows dominance to be scrutinised at a lower threshold than under the 1998 Act where dominance is unlikely to be found below a 40 per cent market share. More importantly, the 1973 Act allows parallel conduct by firms in markets which are dominated by a few firms (oligopolies) to be scrutinised without having to show either collusion (as would be required under Article 81 and the Chapter I prohibition) or economic links or connecting factors (which may be necessary to show collective dominance under Article 82 and the Chapter II prohibition).[93] In addition, remedies under the 1973 Act can include structural measures (such as the compulsory disposal of assets and businesses) which are particularly useful in addressing serious market failure rather than the essentially behavioural remedies which can be applied under the 1998 Act.[94]

For these reasons, the Government chose to retain the anti-monopoly provisions of the 1973 Act when it brought in the *Competition Act 1998*. It envisaged that scale monopolies would only exceptionally be investigated under the 1973 Act (for example where remedies under the 1998 Act had been tried and proved ineffective). The complex monopoly provisions were retained to deal with situations that could not be appropriately addressed using the 1998 Act, particularly market investigations which called for structural remedies. Recent examples of investigations which have been conducted using

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[93] While the European Commission is prepared to use Article 82 for markets characterised by collective dominance, and has received some support from the courts for this approach, this is a developing area of the law whose scope is not clearly defined. See further Whish, *Competition Law* (2001) pp471-82

[94] See Whish, *op.cit.*, pp383-5

the 1973 Act powers include Competition Commission investigations into the supply of new cars and supermarkets.[95]

Under the Bill, the essential nature of the 1973 Act powers will be retained but they will be modernised. Moreover, the Competition Commission will now take final decisions on remedies rather than referring decisions to the discretion of the Secretary of State. In other words, the new regime - which is now described as for 'market investigations' - will adopt similar procedures to those being introduced for mergers under Part 3 of this Bill.

2. Reference decisions

Market investigation references may be made to the Competition Commission by the Office of Fair Trading (**clause 123**). Within their areas of responsibility, the sectoral regulators (including the telecommunications, rail, energy and postal regulators) have concurrent responsibility for competition enforcement with the OFT: these regulators will also be able to make market references to the Competition Commission (**clause 160(10)** and **Schedule 8**, **Part II**)).

The Bill introduces a new test for making a reference: it replaces the former criterion of the behaviour of market participants with an apparently structural definition:

> The OFT may… make a reference to the Commission if the OFT has reasonable grounds for suspecting that any feature, or combination of features, of a market in the United Kingdom for goods or services, restricts or distorts competition … [96]

The test is not, however, purely structural as clause 123(2) provides that a 'feature' includes market structure, and the conduct of market participants and their customers.

Where any feature or features in fact have these effects, the Bill states that there is an *adverse effect on competition* (clause 126(2)).[97] This then is the real test against which a reference decision is taken, and in due course, against which the Competition Commission assesses the market. In the Competition White Paper, the Government sought views on whether the test should be identical to the merger test ('a substantial lessening of competition') or should instead require 'an adverse effect on competition'. While most responses to the White Paper preferred the merger test, largely because by including the word 'substantial' it incorporates a threshold of materiality, the Government chose the adverse effects test instead:

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[95] Competition Commission, *New Cars: A report on the supply of new motor cars within the UK*, Cm 4660, 10 April 2000; Competition Commission, *Supermarkets: A report on the supply of groceries from multiple stores in the United Kingdom*, Cm 4842, 10 October 2000. These enquiries pre-date the entry into force of the *Competition Act 1998*.

[96] clause 123

[97] Emphasis added.

> It is easier to say with certainty and precision that competition in a market will be substantially lessened if two companies operating in a market merge, than it is to say that competition in a market is substantially less than it would be if the market structure or the behaviour of players in the market was different in some hypothetical way.
>
> The Government does not consider that such a test will lead to references being made where the economic impact of any adverse effects on competition are trivial. The OFT will be required to consider that a reference is an appropriate response to any competition concerns about a market.[98]

The OFT will have to publish the reasons for which it makes a market reference and consult with parties who will be substantially affected by the reference decision (**clauses 161 and 164**). Similar obligations apply to the Commission when it takes decisions on the conclusion of its investigation.

There is a reserve power for ministers also to make market references (**clause 124**). Ministers may currently make such references (for example the reference of banking services to small and medium enterprises was made by the Secretary of State for Trade and Industry jointly with the Chancellor of the Exchequer). Under the Bill, ministers' powers would be limited to situations where either the OFT has decided not to make a reference (and the minister is not 'satisfied' with that decision), or the minister has placed information relevant to a possible reference decision before the OFT and is not 'satisfied' that the OFT will act on it.

3. Market investigations

When the Competition Commission receives a market reference, it first must decide whether there are in relation to the specified market features which have an adverse effect on competition (**clause 126**). If it finds an adverse effect, the CC then decides whether action should be taken by it or others:

> for the purpose of remedying, mitigating or preventing the adverse effect on competition concerned or any detrimental effect on customers so far as it has resulted from, or may be expected to result from, the adverse effect on competition [99]

A detrimental effect on customers takes the form of higher prices, lower quality, less choice or less innovation (c.126(5)). On the other hand, in making its decision, the CC can also take into account any countervailing benefits to customers which may be caused by the uncompetitive features which have been identified. In other words, as in the new merger regime, the CC need not act to address features of markets which have an adverse

[98] Government's response to consultation, para 30
[99] clause 126(4)(a)

effect on competition if those features also result in specified benefits to consumers which are dependent on the same market features. The list of countervailing benefits is quite limited: they are the corollaries to the detrimental benefits listed above, that is, lower prices, higher quality, greater choice and greater innovation (c.126(8)).

The EC regime - under Article 81(3) - allows a greater range of beneficial factors to be offset against anti-competitive elements. While the majority of respondents to the Competition White Paper favoured a broader EC-style definition of consumer benefits, the Government rejected this. Its chosen model was adopted because it 'takes into account factors on which a competition authority's judgement can be readily considered authoritative and ensures consistency across both the markets and mergers regimes'.[100]

The CC has routinely made recommendations in its monopoly reports under the 1973 Act although it was not formally required to do so. Under the Bill, the CC will be under a duty not just to specify remedies but to take action to remedy those adverse effects which it has identified (**clause 130**). This is a key element of the new procedure since it makes the CC the final decision taker and not the Secretary of State. Its remedial actions must - governed by what is reasonable and practical - remedy, mitigate or prevent the adverse effects and any consequential detrimental effects on consumers. As part of this, the CC will announce the results of its market investigation publicly and then consult openly on remedies.

4. Public interest considerations

As under the merger regime, market investigation decisions may revert to the Secretary of State where public interest considerations are triggered. Again, national security will be the only public interest consideration to be specified but there is a power to add further considerations by order (subject to Parliamentary approval within 28 days). The procedure is not quite the same. It is thought that public interest considerations will be less apparent in market investigations than in mergers. Therefore, instead of requiring an intervention notice to be issued before a reference is made, the Secretary of State will be able to issue an intervention notice at any time during the first four months of a market investigation (**clause 131**). A notice can also be issued if the OFT is considering seeking undertakings in lieu of making a reference and if so the Secretary of State will have a veto over the acceptance of undertakings.

The four month limit is more restrictive on the Government than the original proposals. At the time of the Competition White Paper, the intention was that the Secretary of State would be able to issue an intervention notice at any stage of a market investigation and even in the 30 days after the publication of a market report.[101] In response to

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[100] Government's response to consultation, para 37. Note however that if proposed reforms of the EC regime go ahead, decisions on Article 81(3) will in any case fall to be decided by the domestic courts and domestic competition authorities rather than the European Commission.

[101] Competition White Paper, para 6.44

representations that this was unsatisfactory since it would create uncertainty for businesses, the Government acted to limit its timeframe for intervention.[102] Note that the OFT and the CC are under a duty to bring any material public interest considerations to the attention of the Secretary of State during the period in which such information could be acted on.

When an intervention notice is served, the CC still carries out the investigation. If it identifies adverse effects on competition which need addressing, it passes the report to the Secretary of State who then takes the final decision on what action is required within a 90 day period (**clauses 135 and 138-9**). The CC's findings on competition cannot be overturned by the Secretary of State.

5. Other provisions

Unlike the merger regime where a tight statutory timetable will be imposed for investigations, market investigations - which tend to be of greater complexity - will be bound only by an upper statutory limit of two years (**clause 136**). In practice, a shorter administrative timetable is likely to be set for each market investigation.[103]

The OFT is able to accept undertakings in lieu of a market reference (**clause 146**) and the authorities can also seek interim undertakings to prevent an investigation from being pre-empted (**clause 149**). At the end of an investigation, remedies can be imposed by seeking binding undertakings (which are actionable by third parties) or by order (**clauses 151 and 153**). The OFT is expected to monitor undertakings and orders, for which purpose it has to compile a register (**clause 158**). As under the merger regime, the CC acquires powers to fine parties which do not comply with its notices requiring attendance or information (**clause 168**).

An appeal, again analogous to judicial review proceedings, on decisions made as part of a market investigation lies to the Competition Appeal Tribunal (**clause 169**). The right of appeal was not formerly part of the 1973 Act's regime but Competition Commission findings were amenable to judicial review (although such claims were rarely successful).

F. Part 6: Cartels: a criminal offence

A small number of competition regimes apply criminal sanctions to those who are involved in cartel activity. The example most often cited is the US regime. The UK proposes to apply criminal sanctions to individuals (not companies) where that individual

[102] Government's response to consultation, para 41

[103] Clifford Chance, in its response to the Competition White Paper, had argued that statutory maximum timetables should be applied for market investigations in the same way as for mergers to prevent enquiries being needlessly drawn out and to give businesses greater certainty. Clifford Chance response to Competition White Paper, 5 October 2001

dishonestly engages in what are described as 'hard-core' cartels. Those are cartels which exemplify the more flagrant breaches of competition law, including price fixing and market sharing. The powers from the *Competition Act 1998* to apply substantial fines to companies found to have breached the Chapter I prohibition will remain in force as a distinct but parallel sanction.

In the Competition White Paper the Government explained the background to its thinking:

> 7.3 Hard-core cartels involve firms making a network of agreements, often in secret, which are deliberately designed to ensure that unsuspecting enterprises and individuals get a raw deal. They are highly damaging to their customers and to the economy in general.
>
> 7.4 The OECD defines the essence of a "hard-core" cartel as being:
>
> > • "an anti-competitive agreement, anti-competitive concerted practice or anti-competitive arrangement by competitors to fix prices, make rigged bids (collusive tenders), establish output restrictions or quotas, or share or divide markets by allocating customers, suppliers, territories, or lines of commerce"[104]
>
> 7.5 Hard-core cartels either raise or maintain prices at higher levels than they would be if competition were not distorted. They can restrict the supply of goods and services to consumers and businesses or make them unnecessarily expensive. The money that leaves consumers' pockets simply becomes extra profit for the firms involved.
>
> 7.6 The US competition authorities estimate that cartels, on average, lead to a 10% increase in the price of the goods or services affected. By adversely affecting the efficient running of the economy, the potential harm to society could be much greater – a cartel can affect up to 20% of the volume of commerce.
>
> 7.7 The OECD estimates that the drain to the US economy from recently exposed cartels runs into billions of dollars. But academics estimate that the US authorities, even with their stronger investigation powers, only manage to detect around a sixth of cartel activity.[105]
>
> 7.8 In the past year, the OFT has launched investigations into eight possible cartels in such diverse markets as services to domestic consumers and services to local authorities, milk, construction materials and fabricated metal. These show that cartels may be operating in the UK at the local level in major cities as well as across the whole economy.

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[104] OECD, *Hard Core Cartels: Meeting of the OECD Council at Ministerial Level*, 2000

[105] PG Bryant and EW Eckhard, "Price Fixing: The Probability of Getting Caught", *1991 Review of Economics and Statistics* 531

> 7.9 Some countries take a tougher line on hard-core cartels than the UK has done so far. In the US, for example, criminal penalties have been on the statute book for antitrust offences since 1890, and these penalties have been applied actively. During the 1990s, the US Department of Justice successfully prosecuted thirty five people a year on average. This has helped to raise the profile of competition law within the business community. The US authorities believe that, as a result, business executives understand the harm that cartels can cause, and the risks associated in engaging in them. The importance of strong competition between firms is therefore much more ingrained in the US than in the UK.
>
> 7.10 The US authorities are also able to take action against cartels which have worldwide effects. In the recent Vitamins cartel case, the US authorities imposed fines of $500 million and $225 million respectively against a Swiss and a German firm. They also obtained criminal convictions against six European executives for engaging in price-fixing. These executives have subsequently agreed to serve their sentences in US jails.
>
> 7.11 Other countries also have criminal sanctions against individuals involved in hard-core cartels. Canada has long criminalised serious competition breaches. Japan also has criminal sanctions and Australia is considering introducing them.
>
> 7.12 Within Europe, Austria, France, Norway and Ireland all have a criminal offence covering cartels and in Germany bid-rigging is a criminal offence. Sweden is currently considering introducing a criminal offence for cartels.[106]

The Bill in **clause 179** makes participation in certain types of cartel a criminal offence which is punishable by up to five years in prison and/ or an unlimited fine on a conviction on indictment.[107] The offence is committed where a person

> dishonestly agrees with one or more other persons to make or implement, or to cause to be made or implemented [one of the arrangements specified in the Bill][108]

The concept of dishonesty is one which is common in the criminal law and forms, for example an element of the offence of theft: theft is the dishonest appropriation of property belonging to another with the intention to permanently deprive that other of the property. While it is a matter for juries to decide whether conduct on any particular occasion constitutes dishonesty, the courts have given some guidance on how to assess whether conduct was dishonest in theft and deception cases:

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106 Competition White Paper, paras 7.3-12

107 The offence may also be prosecuted in the magistrates' court or equivalent, in which case the maximum penalty is six months imprisonment and/ or a £5,000 fine.

108 Clause 179(1)

> [the] jury must first of all decide whether according to the ordinary standards of reasonable and honest people what was done was dishonest. If it was not dishonest by those standards, that is the end of the matter and the prosecution fails. If it was dishonest by those standards, then the jury must consider whether the defendant himself must have realised that what he was doing was by those standards dishonest.[109]

Dishonest participation in the following activities will be an offence:

- Price-fixing
- Limiting production
- Market-sharing
- Bid-rigging

According to the Explanatory Notes, the offence only applies to agreements made across the same level of the supply chain (i.e. horizontal agreements). For price-fixing and limiting production or supply, the offence requires that the other party must have also intended that these results should flow from the agreement. This requirement does not apply to bid-rigging or market-sharing which are inherently reciprocal activities. Bid-rigging is said to indicate almost invariably a dishonest intention and hence the commission of the offence.[110] Prosecutions can be brought by the Serious Fraud Office or the Office of Fair Trading (**clause 181**).[111]

The Bill gives the OFT powers to investigate suspected infringements, including the power to require the answering of questions and the production of documents (**clause 184**) and the power to enter premises with a warrant (obtained from the High Court and its equivalents) (**clause 185**). The OFT can authorise non-OFT personnel to gather information for such an investigation (**clause 186**). The OFT can also acquire information obtained by covert surveillance, subject to various restrictions (**clause 190**). Before the Bill was introduced, the OFT commissioned a report from a former Government lawyer and a former senior police officer, which made a number of recommendations about how a cartel offence might be framed.[112] The report was made available to the DTI's Bill team, which was also considering the offence; many of the report's recommendations are now part of the Bill.

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[109] *Re Ghosh* [1982] QB 1053, 1064. This test is only given here by way of guidance on the concept of dishonesty. It will not necessarily be adopted for the cartel offence.
[110] Bill 115-EN paras 392-3
[111] In Scotland the offence will be prosecuted by the Lord Advocate: this does not need to be provided for in legislation.
[112] Office of Fair Trading, *Proposed criminalisation of cartels in the UK: A report prepared for the Office of Fair Trading by Sir Anthony Hammond KCB QC and Roy Penrose OBE QPM*, OFT 365, November 2001

CARTEL FINE

On 30 January 2002, the OFT announced fines for two bus companies which had admitted a market sharing agreement for bus routes in the Leeds area. Arriva plc was assessed for a fine of £318,175 (reduced to £203,632 under the leniency scheme because of co-operation) and FirstGroup plc a fine of £529,852 (reduced to nil, because the company was the first to approach the OFT). Both companies had had compliance programmes designed to ensure staff were aware of the law in this area, and provided forms for staff to report contact with competitors internally. No staff reported the relevant meetings which were held in a hotel in Wakefield. The fine was payable on 3 April 2002, subject to any appeal. This is the first fine to be imposed under the 1998 Act.

The creation of the criminal offence has been one of the more controversial elements of the Bill. Some argue that the offence is not needed (since cartel activity is not thought to be particularly prevalent). Others argue that now is not the time to introduce the offence since the already severe civil penalties for cartel participation have been in force for barely two years. Since the power to fine companies for breaches of the Chapter I prohibition came into force in March 2000, only one fine has been imposed by the Office of Fair Trading (see box above). It is also argued that there is a danger that if the UK has a criminal penalty for cartel activity while the European Commission does not, information exchange and co-operation between the UK and the EC will be adversely affected.[113]

The law firm Allen & Overy noted at the consultation stage that the criminal cartel offence did not depend on a prior civil infringement of competition law by the individual or an undertaking. It was concerned that juries in criminal courts could have had to decide what may be complex questions of civil competition law as part of a cartel offence.[114] It also raised questions about how the criminal and civil regimes will relate: will private actions connected to the same event have to be stayed pending any criminal proceedings? could a director be convicted by a criminal court of the cartel offence even though his company is not found liable for a civil infringement under the 1998 Act?[115]

The CBI has said:

> 99. The CBI urges caution and restraint before the Government decides to introduce a criminal offence for cartels. Although criminalisation is a superficially attractive option, there are numerous problems which may flow from it, which could end up undermining, not enhancing, the effectiveness of the UK's regime.

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[113] See for example 'Anti-cartel plans clash with Brussels rules', *Financial Times*, 21 February 2002

[114] Allen & Overy, Response to Competition White Paper, 9 October 2001, para 5. The Government opted to create a separate offence of dishonest participation in a cartel which may mitigate this risk.

[115] *ibid*

> (…)
> 102. In the CBI's view, business is entitled to a better argument for changes in the law than this.
>
> 103. In urging restraint, it should be stressed that the CBI in no way speaks for cartels: indeed, we have a long and consistent record of arguing for tough and effective anti-trust law enforcement, seen for example in our consistent support for the radical strengthening of UK law in the Competition Act 1998. After all, businesses as well as individual consumers are harmed by anti-competitive practices.
>
> 104. We fully agree that there would be a strong case for introducing criminal penalties if there was evidence of widespread cartel activity across the UK economy. However, the Government has produced no evidence of such activity, and has failed to establish a clear link between the various theses cited in the White Paper and the need to introduce a criminal offence.[116]

Clifford Chance argued that the measures in the 1998 Act should be given time to prove their worth before a decision is taken on criminalisation. Noting that the desire to introduce a cartel offence is apparently influenced by perception of the effectiveness of the US competition regime (which criminalises cartels), it points to other factors which have raised awareness of competition in the US. In particular, it suggests that competition litigation has had an important role in awareness-raising in the US and may have a similar effect in the UK.[117]

The Institute of Chartered Accountants in England and Wales is more positive:

> Our initial concern over the proposed introduction of a criminal offence of involvement in an anti-competitive cartel has been ameliorated by the strength of the Government's arguments. Nevertheless, it is very important to ensure that the offence only applies where there has been culpable knowledge. That is that only those who are intentionally and knowingly involved should be able to be convicted.
> (…)
> We suggest that the proposed criminal offence should be capable of applying to vertical agreements as well as horizontal ones, where substantial market abuse has occurred. Many anti-competitive agreements include an element of both, and they should be able to be treated with equal rigor.[118]

The Consumers' Association is very strongly in favour of the measure:

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[116] CBI Position paper, September 2001
[117] Clifford Chance response to Competition White Paper, 5 October 2001
[118] 'Productivity And Enterprise: A World Class Competition Regime TECH 15/01', ICAEW, October 2001

> The proposals are a necessary addition to the OFT's powers and will change the risk analysis for companies and encourages companies to set up a comprehensive compliance programme to ensure it will never be their company and their executives being investigated by the OFT. The perpetrators of a cartel will no longer evaluate the cartel and its maintenance as pure cost benefit to the company itself knowing that soon they will personally face financial penalties and imprisonment.[119]

On the question of a possible adverse effect on co-operation with European authorities, the Government has said:

> In a global economy effective national and international coordination and cooperation between enforcement agencies is essential to combat anti-competitive behaviour and abuses of consumer rights, which constitute an obstacle to the achievement of economic growth, trade expansion and consumer protection. Therefore the Government proposes to legislate to allow increased sharing of competition and consumer information between the UK authorities, and between them and overseas authorities for the purpose of criminal and civil investigations and proceedings, where appropriate.
>
> Any such disclosure will be discretionary and subject to appropriate safeguards. Information will only be disclosed for the purpose for which it was requested. The Secretary of State will have the power to prevent disclosure to overseas authorities on jurisdictional grounds and OFT will publish guidelines on the criteria which it will follow when determining whether the discretion to disclose information should be used. It is not proposed to allow increased disclosure to overseas authorities of information obtained through a merger or markets investigation.[120]

G. Part 7: Miscellaneous competition provisions

1. Directors disqualification

Under the *Company Directors Disqualification Act 1986* (CDDA 1986), directors of companies can be disqualified from being a director of a company, or being concerned in the formation, promotion or management of a company without leave of the court. Disqualification orders can currently be made on a number of grounds which are listed in the 1986 Act, including conviction for an indictable offence connected with managing a company, persistent breaches of company filing obligations, and, where a company has become insolvent, where the director's conduct makes him unfit to be concerned in the

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[119] 'Criminalisation of cartels: what is all the fuss about?', Consumers' Association briefing
[120] Government's response to consultation, para 80

management of a company.[121] The duration of a disqualification order depends partly on the ground on which it is made and also on the seriousness of the underlying misconduct: the maximum period of disqualification is 15 years.[122]

Disqualification orders are made by the court. Since the *Insolvency Act 2000*, it has also been possible for the same aim to be achieved without a court process. The Secretary of State can as an alternative to seeking an order accept an undertaking from the director not to act as a director for a specified period.

The Bill (**clause 195**) inserts new clauses into the CDDA 1986 to make it possible for directors to be disqualified on the ground of a breach of competition law ('competition disqualification order'). Courts will be required to disqualify directors when two criteria are satisfied: (1) a company of which they are a director commits a breach of competition law, and (2) the court considers that the director's conduct as a director makes him unfit to be concerned in the management of a company. Competition breaches which are covered by the ground are a breach of either of the Prohibitions in the *Competition Act 1998* and a breach of either of the similar provisions of EC law, Articles 81 and 82 of the EC Treaty. Some guidance on what may constitute unfitness is given in the new clauses. Where a competition disqualification order is made, the maximum period of disqualification is 15 years.[123] It will be possible for 'competition undertakings' to be accepted by the OFT or sectoral regulators as an alternative to seeking an order.

2. Professional rules

Although the Chapter I Prohibition of the *Competition Act 1998* prohibited agreements which have the effect of preventing, restricting or distorting competition, certain types of agreements could be excluded from the Act altogether. The rules of various professional bodies (including the legal, healthcare, architectural, engineering and surveying professions) are eligible to be excluded by Schedule 4 of the 1998 Act. Such rules had been excluded from earlier legislation on restrictive trade practices but could be subject to separate scrutiny by the OFT. Under the 1998 Act, professional bodies could apply to have their rules 'designated', which would happen as of right, subject to the possibility of de-designation.

As part of the Bill, the Government has accepted a recommendation from the OFT that the exclusions for professional rules which are set out in Schedule 4 should be repealed (**clause 198**). The OFT noted that:

[121] See, for example sections 2, 3 and 6 of the CDDA 1986. Note that because the new cartel offence of Part 6 will be an indictable offence, a person convicted of that offence could be also be disqualified under the CDDA 1986 without any need for changes to the law.

[122] For unfitness under s.6, there is also a minimum period of disqualification of two years.

[123] Although the ground is based on 'unfitness', no minimum period of disqualification appears to apply.

> LECG [a firm of consultants retained by the OFT] recommends that the procedure entitling specified professions to seek exclusion by designation as described above should be removed. No profession has yet applied for designation of any of its rules. However, if any did, designation would in effect be automatic. Although Schedule 4 does provide a mechanism by which designation may be revoked, the procedure appears cumbersome. Moreover, the fact that rules were designated and were excluded from the application of the prohibition would mean that any parties otherwise in breach of Chapter I prohibition were not – while the rule remained designated – liable to penalties for breach. Penalties, in accordance with the guidance would apply only once the rules were actually in breach of the prohibition, and the period during which the rules had been designated would be left out of account in determining the duration of the infringement. In addition, while a rule is excluded, it is not open to a private litigant to launch a suit under the Chapter I prohibition of the CA98 for damages suffered as a consequence of the restriction, and to argue that a court should rule the restriction void. All this weakens the incentives, which generally exist elsewhere in the economy, not to engage in anti-competitive activity.[124]

Even where restrictive agreements fall within the scope of the 1998 Act they will not necessarily be prohibited. The Chapter I Prohibition allows agreements to gain exemption from the Prohibition if they are necessary for economic efficiency and consumer benefits.[125] In other words, restrictive rules may be able to persist if they can demonstrate beneficial effects.

In the case of restrictions in the professions, the Government may later take further action in respect of some professional rules (assuming that they cannot demonstrate the criteria need to gain an exemption). Some of the restrictions identified in the OFT report arise not from rulebooks, but from legislation or market features. The Government or the competition authorities may take further action in these areas too. Among restrictions mentioned in the OFT report which could perhaps receive further scrutiny are issues relating to access from members of the public to certain professionals (including access to barristers without having to be referred by solicitors), advertising restrictions (the report's examples include rules set for barristers, accountants and solicitors), and fee guidance (non-mandatory fee guidance from the Royal Institute of British Architects is one instance).

3. Reform of EC competition law

Clause 200 allows the Government to modify the *Competition Act 1998* to eliminate or reduce differences between the 1998 Act and EC competition law as it develops. The two Prohibitions of the 1998 Act are themselves based on EC provisions and there is an

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[124] Office of Fair Trading, *Competition in professions A report by the Director General of Fair Trading*, OFT 328, March 2001 para 43

[125] i.e. the criteria set out in s.9 of the *Competition Act 1998* and Article 81(3) of the EC Treaty.

obligation on courts and competition authorities to take account of EC jurisprudence in applying the Act. The Explanatory Notes say:

> 430. The European Commission has made a proposal for a Council Regulation under Article 83 that would substantially revise the way EC competition law is enforced (the 'Modernisation' regulation). This proposal is currently under discussion in the EU Council.
>
> 431. If adopted by the Council, the Modernisation regulation would give national competition authorities and courts a much greater role in the enforcement of Articles 81 and 82, and would also transform the way in which the exception provided by Article 81(3) is applied. Under the current system (the 'notification system'), agreements may be notified to the Commission in order to obtain an individual exemption granted under Article 81(3), and agreements or conduct may be notified in order to obtain a decision that the agreement or conduct does not infringe Article 81(1) or Article 82. Under the new system, such procedures would be abolished. Instead, Article 81 in its entirety would be applied directly by national courts and authorities (as well as by the Commission), and businesses would no longer be able to apply to the Commission to obtain such exemptions or decisions.
>
> 432. Although some provisions of the regulation would be directly applicable in UK law, others would require further implementation to be given effect. Measures that are required in order to give effect to the EC provisions (e.g. by setting out the powers of the OFT in applying Articles 81 and 82) can be made under the powers given by the European Communities Act 1972.
>
> 433. If, however, it is judged desirable to keep UK competition law in step with the EC system, as so reformed, it will be necessary to make appropriate changes to the UK system, and in particular to CA 1998. The powers provided by this clause are designed to enable the appropriate amendments to be made. Thus the Secretary of State will have the power to eliminate or reduce any differences that would result from Modernisation, or from any subsequent further changes to EC competition law following a regulation or a directive made under Article 83 of the Treaty.[126]

4. Vertical agreements

The Competition White Paper announced another significant reform to competition law which does not form part of this Bill but which had been much discussed in the 1998 Bill. The Government intends to repeal the current exclusion which vertical agreements (that is, agreements between undertakings at different levels of the same supply chain) enjoy from the Chapter I Prohibition.[127] Instead, UK undertakings will rely on the recently

[126] Bill 115-EN paras 430-3

[127] The UK exclusion for vertical agreements was made by order (under section 50 of the *Competition Act 1998*). This Bill presumably does not need to make provision for its repeal.

introduced EC block exclusion for vertical agreements which is directly applicable in the UK. In the Competition White Paper, the Government said:

> 8.14 In 1997, the Government decided that vertical agreements should be excluded from the Competition Act in order to guard against the risk of large numbers of notifications of benign agreements. Along with the decision to allow the OFT to charge for notifications, and the OFT's campaign to discourage notifications, this policy has been successful – with only 12 notifications in the first year of operation of the new legislation.
>
> 8.15 In June 2000, the European Commission brought into force a block exemption which covers vertical agreements. The Commission's block exemption is more narrowly drawn than our domestic exclusion – in particular, it does not cover agreements where one of the parties has a market share exceeding 30%.
>
> 8.16 The Government believes that there is a risk that the more permissive domestic exclusion may have the effect of discouraging some private actions. Now that a European-level block exemption is in place (with parallel effect in the UK), there is no strong case for retaining the domestic exclusion. Therefore, the Government intends to repeal the domestic exclusion of vertical agreements.[128]

III Consumer protection

A. Background

This part of the Paper is concerned with the consumer measures proposed in the *Enterprise Bill*. Melanie Johnson, Minister for Competition, Consumers and Markets, has described the *Enterprise Bill* as being very much a consumer Bill:

> Consumers would have a stronger voice in the economy as a whole – empowering consumers and placing them at the centre of competition. We will take the Bill forward in partnership with consumer organisations, business and local authorities. Together we will create a modern framework to make consumers stronger, and to help build productive businesses, able to compete successfully against the best in the world.[129]

In its 1999 Consumer White Paper, *Modern Markets: Confident Consumers*, the Government made it clear that:

> …a fair deal for consumers and prosperity go hand in hand. We want to reinforce a virtuous cycle of strong consumers and strong business. Confident, demanding

[128] Competition White Paper, paras 8.14-6

[129] Department of Trade and Industry, *Empowering Consumers in the Enterprise Economy-The Enterprise Bill Consumer Measures*, URN/01/1462. 1January 2002

> consumers are good for business. They promote innovation and better value and in return they get higher quality products at lower prices.[130]

Since 1999 certain reforms mentioned in the White Paper have already been introduced. They include:

- the introduction of new consumer councils for the energy and postal industries;
- the creation of a more modern and stronger National Consumer Council;
- the launch of Consumer Support Networks to improve on the information and redress available to consumers;[131]
- the implementation of the Distance Selling Directive 97/7/EC;[132]
- the introduction in June 2001 of new Stop Now Orders to stop rogue traders infringing certain consumer protection legislation.[133]

In January 2002, the DTI published *Empowering Consumers in the Enterprise Economy – The Enterprise Bill Consumer Measures*.[134] This document sets out the consumer measures to be contained in the *Enterprise Bill*, specifically in Parts 1, 8 and 9 of the Bill.

Part 1 of the Bill has already been discussed in detail in section IIB of this Paper. However, it should be noted that all references to the OFT in Parts 8 and 9 of the Bill are to the new corporate authority to be set up under Part 1.

It is also worth mentioning that there is an overlap in the Bill between certain consumer protection measures and certain competition measures. For example, many of the competition measures in the *Enterprise Bill*, such as tougher action against cartels, would benefit consumers.

Commenting on the consumer proposals, Patricia Hewitt said:

> I want UK firms to get to the future first – an environment which encourages enterprise is central to that.

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130 Department of Trade and Industry White Paper, *Modern Markets: Confident Consumers*, Cm 4410, 22 July 1999

131 Department of Trade & Industry, *Empowering Consumers in the Enterprise Economy-The Enterprise Bill Consumer Measures*, URN/01/1462, 1 January 2002

132 In the UK, the Distance Selling Regulations 2000 implement Directive 97/7/EC on the Protection of Consumers in Respect of Distant Contracts (known as the Distance Selling Directive)

133 The *Stop Now Orders (EC Directive) Regulations 2001*

134 Department of Trade and Industry, *Empowering Consumers in the Enterprise Economy – The Enterprise Bill Consumer Measures*, URN/01/1462, 1 January 2002

> Driving competition into every part of our economy is the key to closing the productivity gap and creating a true enterprise culture in this country. Small businesses are the drivers of enterprise. These measures will give them better chances to compete.
>
> The Government is determined to strip away obstacles to competition and put the consumer first. That is good for business, the consumer and the country as a whole.[135]

B. Part 8: Improving enforcement procedures

The aim of **Part 8** of the Bill is to improve consumer protection by giving enforcement bodies strengthened powers to obtain court orders against businesses that do not comply with their legal obligations to consumers. The intention is that Part 8 of the Bill should replace Part III of the *Fair Trading Act 1973* (FTA 1973) and the *Stop Now Orders (EC Directive) Regulations 2001* while continuing to fully implement the requirements of the Injunctions Directive.[136] In effect, Part 8 would introduce a single enforcement structure.

The Government sees improving enforcement as a logical follow-on to the changes to consumer protection legislation:

> Well informed consumers and competitive markets need responsive and targeted enforcement mechanisms. Changes to Part III of the Fair Trading Act would provide a more comprehensive enforcement framework. To ensure that it is enforced fairly and consistently the Government is proposing to reform the structures of the OFT. It is also proposing to improve quality and consistency of enforcement of the trading standards service, and improve the means and level of co-operation between enforcement agencies.[137]

Originally, Part III of the FTA 1973 was intended to provide a means of dealing with traders who operate in a way that is unfair and detrimental to the interests of consumers. Under the FTA 1973, the Director General of Fair Trading (DGFT) can apply for a court order (effectively an injunction) that the trader stop a course of conduct that is unlawful and detrimental to consumers. However, it is now generally accepted that there are three principal defects with the Part III enforcement regime:

- First, most rogue traders whose behaviour raises concerns for the purposes of Part III of the FTA 1973 operate at a local (and not a national) level. This means that local

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[135] Department of Trade and Industry press notice P/2001/413, *Radical steps to build enterprise culture*', 31 July 2001

[136] EU Directive 98/27/EC on Injunctions for the protection of Consumers' Interests, OJ No L166, 11 June 1998, p.51 (referred to as the 'Injunctions Directive')

[137] Department of Trade and Industry press notice P/2001/413, *Radical steps to build enterprise culture*', 31 July 2001

authority trading standards officers, responsible for enforcing consumer protection legislation within a locality, must refer cases suitable for action to the DGFT.

- Second, the DGFT can only apply for a court order if, after using his best endeavours, he has been unable to obtain a satisfactory written assurance from the rogue trader in question that he will stop a particular course of conduct, or that such an assurance has been broken. This procedure is problematic because it can give traders scope for delay by entering into protracted discussions about the terms of the assurance.

- Third, the OFT have reported that the courts considering applications for Part III orders often require evidence of a large number of instances of unlawful conduct before they are satisfied that a person has 'persisted in a course of conduct'.

The *Stop Now Orders (EC Directive) Regulations 2001* (the SNORs 2001) have, in part, reformed Part III of the FTA 1973 but only in respect of certain legislation specified in the Injunctions Directive.

Briefly, the SNORs 2001 came into force on 1 June 2001 and implement the Injunctions Directive. [138] Under the Regulations, the OFT and named 'qualified entities' (consumer protection bodies) can apply to the courts for Stop Now Orders to stop traders from infringing specified legislation where those infringements harm the collective interests of consumers. Qualified entities can bring proceedings in their own Member State and in another Member State if an infringement there has effects on consumers in the qualified entity's home state.

Stop Now Orders are significantly different from orders sought under Part III of the FTA 1973. Stop Now Orders:

- extend the enforcement jurisdiction to trading standards officers and other designated bodies;

- limit the time during which voluntary compliance must be sought to two weeks; and

- replace the 'persistent in a course of conduct' test with a requirement that the enforcement authority demonstrate that the trader has engaged, or is likely to engage, in conduct that constitutes an infringement of one of the specified Directives as implemented in the UK and the infringement harms the <u>collective interests</u> of consumers.

The problem, however, is that the SNORs 2001 are strictly limited to the Directives specified in the Injunctions Directive (and also listed in Schedule 13 to the Bill), namely:

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[138] SI 2001 No. 1422. The Injunctions Directive was added to the European Economic Area Agreement by Decision No 121/1999 of the EEA Joint Committee, which came in to force on 1 July 2000

1. Council Directive 84/450/EEC of 10 September 1984 relating to the approximation of the laws, regulations and administrative provisions of the Member States concerning misleading advertising.

2. Council Directive 85/577/EEC of 20 December 1985 to protect the consumer in respect of contracts negotiated away from business premises.

3. Council Directive 87/102/EEC of 22 December 1986 for the approximation of the laws, regulations and administrative provisions of the Member States concerning consumer credit as last amended by Directive 98/7/EC.

4. Council Directive 90/314/EEC of 13 June 1990 on package travel, package holidays and package tours.

5. Council Directive 93/13/EEC of 5 April 1993 on unfair terms in consumer contracts.

6. Directive 94/47/EC of the European Parliament and of the Council of 26 October 1994 on the protection of purchasers in respect of certain aspects of contracts relating to the purchase of the right to use immovable properties on a timeshare basis.

7. Directive 97/7/EC of the European Parliament and of the Council of 20 May 1997 on the protection of consumers in respect of distant contracts.

8. Directive 1999/44/EC of the European Parliament and of the Council of 25 May 1999 on certain aspects of the sale of consumer goods and associated guarantees.

And the following provisions of Directives:

9. Articles 10 to 21 of Council Directive 89/552/EEC of 3 October 1989 on the co-ordination of certain provisions laid down by law, regulation or administrative action in Member States concerning the pursuit of television broadcasting activities as amended by Directive 97/36/EC.

10. Articles 86 to 99 of the Directive 2001/83/EC of the European Parliament and of the Council of 6 November 2001 on the Community code relating to medicinal products for human use.

The result has been the creation of two separate enforcement regimes aimed at rectifying similar conduct by rogue traders.[139] This co-existence of Stop Now Orders and Part III of the FTA 1973 is regarded as a problem by the Government:

> The possibility of reforming Part III of the Fair Trading Act was proposed in the 1999 Consumer White Paper. With the introduction of Stop Now Orders the need is even more pressing: it is confusing and onerous for business and enforcers to be faced with two parallel enforcement regimes applying similar tests and remedies.[140]

The aim of **Part 8** of the *Enterprise Bill* is to solve this problem by creating a single enforcement structure to provide for injunctive orders against rogue traders who are infringing consumer protection laws. The remedies to be available to enforcing bodies and the procedures to obtain them will be based on those currently provided for in the SNORs 2001.

Clause 201 defines the class of consumers who are to benefit from Part 8 of this Bill. A clear distinction is made between a ‘consumer’ for the purposes of domestic infringement and a ‘consumer’ for the purposes of an infringement of legislation to which the Injunctions Directive applies (i.e. a Community infringement’). A ‘consumer’ in relation to a domestic infringement is an individual who receives, or seeks to receive, goods or services other than in the course of a business or with a view of setting up a business from a person who supplies them in the course of a business. (In other words, business customers are not covered). Under clause 201(5) it is not relevant if the supplier has a place of business in the UK or not.

For the purposes of Community infringements, ‘consumers’ must include all persons who are consumers for the purposes of the individual Directives listed in the annex to the Injunctions Directive. Clause 201(6) provides that the meaning of consumer is to be determined by the Injunctions Directive and the listed Directives.[141]

The scope of Part 8 is deliberately broad. It would not be sufficient for Part 8 of this Bill to apply only to UK law transposing the listed Directives because the Injunctions Directive would not then be properly implemented. Part 8 of the Bill must be capable of providing for the situation where a UK court decides that the law of another EEA State

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[139] The SNORs 2001 were made under section 2(2) of the *European Communities Act 1972*, and as such could not have dealt with the defects in Part III of the *Fair Trading Act 1973* in respect of unlawful behaviour, since it would be outside the scope of the Injunctions Directive.

[140] Department of Trade and Industry, *Empowering Consumers in the Enterprise Economy-The Enterprise Bill Consumer Measures*, URN/01/1462, 1 January 2002

[141] Schedule 13 to the *Enterprise Bill* lists the individual Directives, or parts of individual Directives, to which the Injunctions Directive applies. Clause 201(9) provides the Secretary of State with an order-making power to modify Schedule 13 by adding or removing Directives to reflect further amendments to the Injunctions Directive

should apply. (For example, the DTI describes a situation where a trader's unlawful conduct in the UK harms consumers in another EEA State).

Hence **Clause 203(1)** and **(2)** provide a definition of a 'Community infringement' that reflects the requirements of Article 1(2) of the Injunctions Directive. It states:

> 203(1) In this Part a Community infringement is an act or omission which harms the collective interests of consumers and which-
>
> (a) contravenes a listed Directive as given effect by the laws, regulations or administrative provisions of an EEA State, or
>
> (b) contravenes such laws, regulations or administrative provisions which provide additional permitted protections.
>
> (2) The laws, regulations or administrative provisions of an EEA State which give effect to a listed Directive provide additional permitted protections if-
>
> (a) they provide protection for consumers which is in addition to the minimum protection required by the Directive concerned, and
>
> (b) such additional protection is permitted by that Directive.

'Additional permitted protections' mentioned in clause 203 (2) are provisions that have been adopted or retained by an EEA State pursuant to the so-called 'minimum clause' contained in most Directives. These clauses enable EEA States to adopt provisions that provide greater protection for consumers, provided the protection does not breach the rules in the EU Treaty (for example, on the free movement of goods).

For a Community infringement to have occurred it is not sufficient that there has been an act contrary to one of the Directives listed in the Injunctions Directive. The act must also harm the 'collective interests of consumers'. For both Community and domestic infringements, this is taken to mean a continuation or repetition of an act or omission contrary to any of the national measures implementing the listed Directives (or acts or omissions specified as domestic infringements).

Clause 202 defines the type of detrimental conduct by a rogue trader that would constitute a 'domestic infringement' and in respect of which an enforcement order under Part 8 of the Bill could be made:

> 202(1) In this Part a domestic infringement is an act or omission which-
>
> (a) is done or made by a person in the course of a business,
>
> (b) falls within subsection (2), and
>
> (c) harms the collective interests of consumers in the United Kingdom.

> (2) An act or omission falls within this subsection if it is of a description specified by the Secretary of State by order and consists of any of the following-
>
> (a) a contravention of an enactment which imposes a duty, prohibition or restriction enforceable by criminal proceedings;
>
> (b) an act done or omission made in breach of contract;
>
> (c) an act done or omission made in breach of a non-contractual duty owed to a person by virtue of an enactment or rule of law and enforceable by civil proceedings;
> (d) an act or omission in respect of which an enactment provides for a remedy or sanction enforceable by civil proceedings.

The DTI intends to make statutory instruments defining UK law for the purpose of the definition of a Community infringement and listing the UK legislation and civil law obligations to which the definition of a domestic infringement will apply before this Part of the Act comes into force.[142]

Clause 204 of the Bill deals with those bodies who are to have enforcement powers under Part 8 of the Bill. Three categories are defined: general enforcers, designated enforcers and Community enforcers.

General enforcers are the OFT and every weights and measures authority in Great Britain (in other words, local authority trading standards departments).

The Secretary of State will have an order-making power to confer enforcement powers upon other UK public bodies and private consumer organisations that have as one of their purposes the protection of the collective interests of consumers. These bodies collectively are defined as designated enforcers. [143]

Community enforcers are entities from other EEA States that are listed in the Official Journal of the European Communities under Article 4.3 of the Injunctions Directive.

Clause 205 of the Bill applies if an enforcer thinks that an infringement has occurred, is occurring, or, in the case of Community infringement, is likely to occur. The enforcer must first consult the OFT (if it is not the enforcer) and the person against whom the enforcement order may be made and give the latter the opportunity to stop the infringement. If the infringement stops immediately, the enforcer may decide that no further action is necessary or may accept an undertaking from the trader under clause 210.

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142 Explanatory notes to the *Enterprise Bill*, Bill 115-EN

143 An order may designate a body for the purposes of domestic and/or Community infringements (and for different types of infringement within each of those categories). It is anticipated that the Secretary of State will set out criteria for designating private consumer organisations for the purposes of Community infringements (this may be different to the criteria to be used in respect of domestic infringements).

If the infringement is not stopped within 14 days after the request for consultation is received, the enforcer may make an application for an enforcement order under clause 208(4)(a) without further delay. This period is reduced to 7 days where the enforcer intends to make an application for an interim enforcement order.[144]

General enforcers may make applications for enforcement orders in respect of all infringements to which Part 8 of the Bill applies.[145] However, a designated enforcer may make an application for enforcement orders only in respect of those infringements for which it is designated.[146] A Community enforcer may make an application for an enforcement order only in respect of a Community infringement.[147]

An application for an enforcement order can be made in either the High Court or the County Court if the person against whom the order is sought carries on business or has a place of business in England and Wales, and to the Court of Session of the Sheriff if a person carries on business or has a place of business in Scotland.

The purpose of enforcers being required to consult with the OFT before making an application for an enforcement order is to enable the OFT to perform a co-ordinating role in relation to proceedings. This will enable the OFT to facilitate the sharing of information between enforcers to promote consistent enforcement throughout the country and to make directions under clause 207 of the Bill to avoid the risk of traders facing multiple actions in relation to the same infringement. However, it is not the intention that the OFT should become directly involved in the consultations with the trader except where the OFT is the enforcer or has been asked to become involved by the trader.

Under **Clause 207,** the OFT may, in circumstances where it is not acting as the enforcer, give directions regarding a particular application for an enforcement order:

> 207 (1) This section applies if the OFT believes that an enforcer other than the OFT intends to apply for an enforcement order.
>
> (2) In such a case the OFT may direct that if an application in respect of a particular infringement is to be made it must be made-
>
> (a) only by the OFT, or
> (b) only by such other enforcer as the OFT directs.
>
> (3) If the OFT directs that only it may make an application that does not prevent –

[144] Clause 209(4)(b)
[145] Clause 206(2)
[146] Clause 206 (3)
[147] Clause 206 (4)

> (a) the OFT or any enforcer from accepting an undertaking under section 210, or
> (b) the OFT from taking such other steps it thinks appropriate (apart from making an application)for the purpose of securing that the infringement is not committed, continued or repeated.

Again, the purpose of this clause is to prevent a number of applications being made by different enforcers against the same trader in respect of the same infringement. It is clear that where the OFT directs that only it may make an application it may, instead of doing so immediately, seek a voluntary undertaking from the trader that he will stop the infringement. Alternatively, the OFT may decide to refer the matter to another regulatory or self-regulatory body to deal with.[148]

However, clause 207 does not prevent an application for an enforcement order being made by a Community enforcer. This is because the only constraint permitted by the Injunctions Directive on such bodies is the requirement to give the OFT two weeks' notice of their intention to make an application to the courts.[149]

In considering whether to make an enforcement order under **clause 208** the court must have regard to whether the respondent:

(a) has given an undertaking under clause 210 in respect of such conduct; and

(b) has failed to comply with the voluntary undertaking.

If the court makes an enforcement order it must indicate the nature of the conduct that constituted the infringement. It must also require the respondent:

- not to continue or repeat the conduct;
- not to engage in the conduct if it has not yet occurred;
- not to engage in conduct of the nature indicated in the course of the business concerned or another business carried out by him; and
- not to consent to or connive in the carrying out of such conduct by a body corporate of which he is a director or which he controls.[150]

The Court may also order the respondent to publish the court's decision (in full or in part) and/or a corrective statement with a view to reducing the continuing effects of the infringement.[151]

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[148] Under Clause 207(4), the OFT may vary or withdraw any direction made under this clause
[149] Clause 207(6)
[150] Clause 208(5)-(7)

As an alternative to making an enforcement order, the court has the discretion to accept an undertaking from the respondent. In which case, the court may also accept a further undertaking from the respondent to publish the terms of the undertaking (in full or in part) or a corrective statement.[152]

Clause 208(12) is important. It states that an enforcement order made under Part 8 will apply throughout the UK. It will therefore stop a rogue trader who is the subject of an order in one jurisdiction of the UK from harming the collective interests of consumers in the other two jurisdictions.

In serious cases, an enforcer can apply to the court for an interim enforcement order under **clause 209**. However, before the court will make an interim order certain conditions must be satisfied:

> 209(1) The court may make an interim enforcement order against a person named in the application for the order if it appears to the court-
>
> (a) that it is alleged that the person is engaged in conduct which constitutes a domestic or Community infringement or is likely to engage in conduct which constitutes a Community infringement,
>
> (b) that if the application had been an application for an enforcement order it would be likely to be granted,
>
> (c) that it is expedient that the conduct is prohibited or prevented (as the case may be) immediately, and
>
> (d) if no notice of the application has been given to the person named in the application that it is appropriate to make an interim enforcement order without notice.

Although an interim enforcement order may be made without notice being given to the person named in the application, clause 209(6) requires that the application must explain why no notice has been given. According to the DTI, a typical example of where an application for an interim enforcement order without notice may be necessary, is where a misleading advertisement is about to be published in a national newspaper. Another example would be where a trader sets up in temporary premises to sell goods of unsatisfactory quality.

An interim enforcement order may be applied for before an application for an enforcement order is made and at any time until an application for an enforcement order is determined. The court may vary or discharge an interim enforcement order on the application of either the enforcer who applied for the order or the person against whom it

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[151] Clause 208(8)
[152] Clause 208(9)-(10)

is made.[153] Again, instead of making an interim enforcement order the court may accept an undertaking from the respondent.[154]

Clause 211 is concerned with the situation where an enforcer believes that an enforcement order (including an interim order) or an undertaking given to the court has been breached. In any such case, either the relevant enforcer or the OFT will be able to make a further application to the court. If the court finds that a breach has been committed, and on the basis that the respondent is in contempt of court, the court can impose a fine or a term of imprisonment not exceeding two years.

Where a further application is made to the court in respect of a failure to comply with an undertaking given to the court, instead of enforcing the undertaking, the enforcer may make an application for an enforcement order (or an interim order). Similarly, the court may make an enforcement order (or interim order) instead of, or as well as, finding that the respondent is in contempt.[155] An application to enforce an undertaking given to the court must be made to the court that accepted the undertaking.

Clause 212 is concerned with Community infringement proceedings. It has two purposes:

- First, it provides general enforcers and designated enforcers that are public bodies with any necessary additional powers to their existing statutory powers to enable them to bring proceedings under the legislation implementing the Injunctions Directive in any EEA State. The aim being to stop Community infringements that originate there but that harm the collective interests of consumers in the UK.[156]

- Second, it enables general enforcers and designated enforcers to co-operate with each other and with any Community enforcer for the purpose of bringing proceedings in other EEA States and to bring proceedings in the UK jointly with, or on behalf of, a Community enforcer.[157]

Under **Clause 213**, an application can be made under clause 206 for an enforcement order against an 'accessory' who consents to or connives at conduct that constitutes a domestic or Community infringement. An accessory may be either a controller of a company or a director or other similar officer (or a person purporting to act in such a capacity).

Clause 214 deals with a situation where an enforcement order is made against a company. It states:

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[153] Clause 209(7)
[154] Clause 210
[155] Clause 211 (3)-(4)
[156] According to the Department of Trade and Industry, whether private designated enforcers will have these powers will depend upon their own constitutions
[157] Whether a body is entitled to bring proceedings will be determined by clause 204 of the Bill

> 214(1) This section applies if a court makes an enforcement order or an interim order against a body corporate and-
>
> (a) at the time the order is made the body corporate is a member of a group of interconnected bodies corporate,
>
> (b) at any time when the order is in force the body corporate becomes a member of a group of interconnected bodies corporate, or
>
> (c) at any time when the order is in force a group of interconnected bodies corporate of which the body corporate is a member is increased by the addition of one or more further members.
>
> (2) The court may direct that the order is binding upon all of the members of the group as if each of them were the body corporate against which the order is made.

In effect, this clause empowers the court, when making an enforcement order or interim enforcement order under clause 208 or 209 respectively, to direct that the order be binding upon all other members of a group of interconnected bodies corporate.[158] Moreover, if a body corporate subject to an enforcement order subsequently becomes a member of a group of interconnected bodies corporate, or the group is enlarged, the OFT will be able to apply to the court for a direction that the order be binding on the new members.

Under **clauses 215** and **216**, the OFT and those designated enforcers that are public bodies are given a statutory power to request information by means of a notice served on any person. The purpose is to enable them to consider whether to exercise their functions under Part 8 of the Bill.

The remedies that are to be available to the OFT and designated enforcers if a person fails to comply with a notice to provide information are set out in **clause 218**:

> 218(1) If a person fails to comply with a notice given under section 215 or 216 the enforcer who gave the notice may make an application under this section.
>
> (2) If it appears to the court that the person to whom the notice was given has failed to comply with the notice the court may make an order under this section.
>
> (3) An order under this section may require the person to whom the notice was given to do anything the court thinks it is reasonable for him to do for any of the purposes mentioned in sections 215 or 216 (as the case may be) to ensure that the notice is complied with.

[158] 'A group of interconnected bodies corporate' are defined by reference to the definition of 'subsidiary' in section 736 of the *Companies Act 1985*

> (4) An order under this section may require the person to meet all the costs or expenses of the application.
>
> (5) If the person is a company or association the court in proceedings under subsection (4) may require any officer of the company or association who is responsible for the failure to meet the costs or expenses.

Finally, the OFT is required, as soon as is reasonably practicable, to prepare and publish advice and information explaining the provisions of Part 8 of the Bill and indicating how it expects them to operate in practice. The intention is to promote consistent enforcement across the UK.[159]

Reform of the FTA 1973 is expected to lead to important new responsibilities being given to local authorities trading standards departments. To ensure that they undertake their proposed new role with consistency and effectiveness, the Government has stated its intention to introduce a new National Performance Framework with core standards for the service.[160] The framework will require:

> …trading standards authorities to work to national standards but will be flexible and capable of meeting local priorities and needs. The standards cover both advice given to consumers and business and a modernised approach to enforcement based on fair and consistent risk assessment.[161]

C. Part 9: Disclosure of competition and consumer information

Part 9 of the *Enterprise Bill* sets out general restrictions and conditions for the disclosure of competition and consumer information held by public authorities.[162] All of the provisions in Part 9 are subject to the provisions of the *Data Protection Act 1998*.

A general restriction on the disclosure of information by a public authority is set out in **Clause 227**. It states:

> 227 (1) This section applies to information which is consumer information or competition information and which relates to-
>
> (a) the affairs of an individual;
> (b) any business of an undertaking.

[159] Clause 220

[160] This new framework was developed in partnership with local government and the trading standards profession

[161] Department of Trade & Industry, *Empowering Consumers in the Enterprise Economy-The Enterprise Bill Consumer Measures*, URN/01/1462, 1 January 2002

[162] The term 'public authority' is defined in clause 228 by reference to the *Human Rights Act 1998*

> (2) Such information must not be disclosed-
>
> (a) during the lifetime of the individual, or
> (b) while the undertaking continues in existence,
>
> unless the disclosure is permitted under this Part.
>
> (3) But subsection (2) does not prevent the disclosure of any information if the information has on an earlier occasion been disclosed to the public in circumstances which do not contravene-
>
> (a) that subsection;
> (b) any other enactment or rule of law prohibiting or restricting the disclosure of the information.

The general restriction on disclosure only applies to information classed as 'consumer information' or 'competition information'. These terms are defined in **clause 228** as:

> 228 (1) Information is consumer information if it comes to a public authority in connection with the exercise by it of any function it has under or by virtue of –
>
> (a) Part 8;
> (b) an enactment specified in Part 1 of Schedule 14.
>
> (2) Information is competition information if it comes to a public authority in connection with the exercise by it of any function it has under or by virtue of-
>
> (a) Part 3, 4, 6 or 7;
> (b) an enactment specified in Part 2 of Schedule 14.
>
> (3) It is immaterial whether information comes to a public authority before or after the passing of this Act.[163]

The general restriction on the disclosure of consumer or competition information relates to either the affairs of an individual or to those of any business of an undertaking.[164] However, clause 227(3) provides an important exception to this general restriction: it states that disclosure is permitted where the information concerned has already been placed in the public domain by any lawful means.

Clauses 229-233 set out further exceptions to the general restriction.

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[163] Parts 3, 4, 6 & 7 of the Bill referred to in clause 228(2)(3) deal with mergers, market investigations, cartel offences and miscellaneous competition provisions respectively

[164] Clause 227(2) provides that the restriction will apply throughout the lifetime of any individual who is the subject of the information, or while any undertaking to which the information relates continues in existence.

Clause 229 (1) provides that disclosure of consumer and competition information will be permitted where the authority wishing to disclose the information obtains the necessary consent(s). It states:

> 229 (1) This Part does not prohibit the disclosure by a public authority of information held by it or any other person if it obtains each requested consent.
>
> (2) If the information was obtained by the authority from a person who had the information lawfully and the authority knows the identity of that person the consent of that person is required.
>
> (3) If the information relates to the affairs of an individual the consent of the individual is required.
>
> (4) If the information relates to the business of an undertaking the consent of the person for the time being carrying on the business is required.
>
> (5) For the purpose of subsection (4) consent may be given-
>
> (a) in the case of a company by a director, secretary or other officer of the company;
>
> (b) in the case of a partnership by a partner;
>
> (c) in the case of an unincorporated body or association by a person concerned in the management or control of the body or association.

Clause 230 permits the disclosure of consumer and competition information where it is necessary for the authority to disclose the information for the purpose of fulfilling any obligation under European Community law.

Clause 231 enables public authorities holding information to disclose consumer and competition information to persons exercising specified statutory functions. It states:

> 231 (1) A public authority which holds information to which section 227 applies may disclose that information for the purpose of facilitating the exercise by the authority of any function it has under or by virtue of this Act or any other enactment.
>
> (2) If information is disclosed under subsection (1) so that it is not made available to the public it must not be further disclosed by a person to whom it is so disclosed other than with the agreement of the public authority for the purpose mentioned in that subsection.
>
> (3) A public authority which holds information to which section 227 applies may disclose that information to any other person for the purpose of facilitating the exercise by that person of any function he has under or by virtue of-

(a) this Act;
(b) an enactment specified in Schedule 15;
(c) such subordinate legislation as the Secretary of State may by order specify for the purposes of this subsection.

(4) Information disclosed under subsection (3) must not be used by the person to whom it is disclosed for any purpose other than a purpose relating to a function mentioned in that subsection.

(5) In subsection (1) the reference to an enactment includes a reference to an enactment contained in-

(a) an Act of the Scottish Parliament;
(b) Northern Ireland legislation;
(c) subordinate legislation.

Clause 232 of the Bill permits disclosure of consumer or competition information to another public authority for the purposes of criminal proceedings. Disclosure may be made for the purposes of investigating whether there have been breaches of the criminal law; assisting in the bringing or conducting of criminal proceedings; or deciding whether to commence or terminate such investigations or proceedings.

Finally, **clause 233** specifies the circumstances under which information may be disclosed to overseas authorities. [165] A public authority is permitted to disclose consumer or competition information to any overseas public authority for the purpose of any criminal or civil investigations or proceedings that relate to consumer or competition matters.[166]

However, clause 233(3) prevents the disclosure to any overseas authority of information that is held by any person or body that has been designated as an enforcer by the Secretary of State for the purposes of Part 8 of the Bill under clause 204(4). It also prevents the disclosure to any overseas authority of any competition information obtained under the *Financial Services and Markets Act 2000* and certain sensitive commercial information.

The Secretary of State can also prevent disclosure of information overseas if he thinks the proceedings or investigation for which the information has been requested would be more appropriately carried out by authorities in the UK or in another country.[167]

Clause 233(7) prevents information that is disclosed to overseas authorities from being further disclosed (without the permission of the UK authority from whom the information

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[165] An overseas public authority is defined by clause 233(8)
[166] Clauses 233(1), (2) and (9)
[167] Clause 233(4)

came). It also provides that should the overseas authority wish to use the information for a different purpose than that originally specified a further request to the UK authority would have to be made.[168]

A legal requirement will be placed on the OFT, by **clause 234**, to issue and publish the criteria that will be used by UK public authorities when making decisions on the disclosure of information. It also allows the OFT to vary the criteria.

There are other considerations that public authorities must have regard to before disclosing any competition information. **Clause 235** states:

> 235(1) A public authority must have regard to the following considerations before disclosing any competition information in pursuance of this Part.
>
> (2) The first consideration is the need to exclude from disclosure (so far as practicable) any information whose disclosure the authority thinks is contrary to the public interest.
>
> (3) The second consideration is the need to exclude from disclosure (so far as practicable)-
>
> (a) commercial information whose disclosure the authority thinks might significantly harm the legitimate business interests of the undertaking to which it relates, or
> (b) information relating to the private affairs of an individual whose disclosure the authority thinks might significantly harm the individual's interests.
>
> (4) The third consideration is the extent to which the disclosure of the information mentioned in subsection (3)(a) or (b) is necessary for the purpose for which the authority is permitted to make the disclosure.

In certain circumstances, the disclosure of information, or the incorrect use of information, can constitute an offence. Under **clause 236(1)**:

> 236(1) A person commits an offence if he discloses information to which section 227 applies in contravention of section 227(2).
>
> (2) A person commits an offence if he discloses information in contravention of a direction given under section 233(4).
> (3) A person commits an offence if he uses information disclosed to him under this Part for a purpose which is not permitted under this Part.

[168] In the Bill's Explanatory Notes (Bill 115-EN), it is acknowledged that this provision is essentially unenforceable as there are no sanctions that could be taken against an overseas authority that contravenes these conditions. However, it is envisaged that should an overseas authority breach these provisions it is unlikely that a UK authority would disclose any further information.

In effect, an offence is committed if competition or consumer information is disclosed in circumstances to which none of the relevant exceptions set out in clauses 229-233 of Part 9 applies and whilst the individual who is the subject of the information is still alive or any undertakings to which the information relates continues to trade.

An offence is also committed if information is disclosed despite a direction from the Secretary of State that it should not be. Clause 236(3) extends the offence to include the use of information for a purpose not permitted under Part 9 of the Bill.

A person who commits an offence under clause 236 is liable on summary conviction to imprisonment for a term not exceeding three months and/or a fine not exceeding the statutory maximum. On conviction on indictment, a person may be liable to imprisonment for a term not exceeding two years and/or a fine.

To conclude, Part 9 of the *Enterprise Bill* creates a new 'gateway' that sets out general restrictions and conditions for the disclosure of competition and consumer information held by public authorities:

> It is part of the Government's strategy of widening and harmonising the gateways through which information can be disclosed in the UK and overseas and at the same time introduces appropriate safeguards in respect of permitted disclosure of information.[169]

IV Insolvency

The *Insolvency Act 1986* [IA 1986] as amended by the *Insolvency Act 2000* and the *Insolvency Rules 1986* sets out the regime for dealing with the affairs of insolvent companies in Great Britain. It also provides the principal statutory regime for dealing with bankruptcy in England and Wales. The corresponding bankruptcy provisions for Scotland are contained in the *Bankruptcy (Scotland) Act 1985 (as amended).*

The insolvency clauses of the *Enterprise Bill* fall into four main sections: corporate insolvency; the abolition of Crown preference; individual insolvency (bankruptcy and individual voluntary arrangements); and the financial arrangements relating to the functions performed by the Secretary of State in relation to insolvency.

This section of the Paper provides a general commentary on what the legislation seeks to achieve.

[169] Explanatory Notes to the *Enterprise Bill*, Bill 115-EN

A. Part 10: Corporate insolvency reforms

1. Background

In December 1998, the Government published *Our Competitive Future: Building the Knowledge Driven Economy.*[170] In this White Paper, the Government announced (amongst other things) its intention to review arrangements for business rescues and reassess the relative rights of creditors, including possible changes to the Crown's preferential status. The Government's aim being to encourage risk-taking and facilitate company rescue when things go wrong. It argued that when fundamentally viable businesses are lost there are consequences for creditors, employees and the wider economy.

A joint DTI and Treasury working party was set up in 1999 to review company rescue and business reconstruction mechanisms.[171] Its terms of reference were:

> To review aspects of company and insolvency law and practice in the United Kingdom and elsewhere relating to the opportunities for, and the means by which, businesses can resolve short to medium term financial difficulties, so as to preserve maximum economic value, and to make recommendations.[172]

This working party issued a consultation document in September 1999, *A Review of Company Rescue and Business Reconstruction Mechanisms*.[173] A principal theme of the document was whether there was a need to shift the balance of the UK insolvency regime from being creditor-friendly to being debtor-friendly. Evidence referred to in the consultation document suggested that the UK is significantly less debtor-friendly than the regimes of other major industrialised countries, France having the most debtor-friendly regime.

In its report, which was published for consultation in November 2000, the Working Party recommended an improvement in the approach of the Inland Revenue and HM Customs & Excise towards business rescue. It also recommended certain legislative changes.[174] These recommendations have been considered further in the light of consultation, and the proposals in the Government's White Paper, *Insolvency – A Second Chance*, published in July 2001, are the Government's response. [175]

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[170] Department of Trade and Industry, *Our Competitive Future: Building The Knowledge Driven Economy: Government's Competitiveness White Paper*, Cm 4176, 16 December 1998

[171] Ibid. paragraph 2.13

[172] HC Deb 2 February 1999 c580W

[173] The Insolvency Service, *A Review of Company Rescue and Business Reconstruction Mechanisms*, 1 September 1999

[174] For example, their proposal to subject landlords to the statutory moratorium in an administration has now been made law as part of the provisions of the *Insolvency Act 2000*

[175] Department of Trade and Industry White Paper, *Productivity and Enterprise, Insolvency – A Second Chance*, Cm 5234, July 2001

In the foreword to this insolvency White Paper, Patricia Hewitt, Secretary of State for Trade and Industry, explained the main aim of insolvency reform:

> Promoting enterprise will boost UK business and improve productivity. Our Enterprise Bill will strengthen competition and the power of consumers by radically reforming competition law, transforming our approach to bankruptcy and corporate rescue and promoting new safeguards for consumers. We believe that promoting enterprise will release the entrepreneurial skills of the British people.
>
> In this White Paper I am setting out my proposals for the reform of insolvency law. Companies in financial difficulties must not be allowed to go to the wall unnecessarily. Administrative receivership, which places effective control of the direction and outcome of the procedure in the hands of the secured creditor, is now seen by many as outdated. There are many other important interests involved in the fate of such a company, including unsecured creditors, shareholders and employees. We propose to create a streamlined administration procedure, which will ensure that all interest groups get a fair say and have an opportunity to influence the outcome.[176]

The main thrust of the White paper's proposals is to abolish the right of the holder of a floating charge to appoint an administrative receiver, save in connection with certain transactions. At the same time, the Paper outlines reforms to streamline the administration procedure, so that it becomes more accessible and effective. For example, by the introduction of non-court routes into administration. The reforms are intended to shift the existing balance of power between secured and unsecured creditors.

Existing provisions contained in Part II of the IA 1986 allow the court to make an administration order in respect of a company that is in financial difficulties. The effect of such an order is to give the company protection from its creditors whilst attempts are made to save the company or achieve a better result for creditors than would be achieved in a winding up. However, according to the Insolvency White Paper, in many cases where a company gets into financial difficulties, this leads not to administration but to the appointment of an administrative receiver by lenders (typically the company's bank) who have taken a floating charge over all the company's assets.[177] This is because the holder of a floating charge has an effective veto over the appointment of an administrator. The floating charge-holder must be given notice of any application for an administration

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[176] Ibid.

[177] A lender (usually a bank) can take as security for a loan either a fixed or floating charge. A fixed charge is a charge over a specified asset. A floating charge is a charge over assets (that will change in the ordinary course of business), it is contemplated that until some further step is taken by the lender (the charge-holder), the company may continue in its business and deal with those assets. If the company defaults on the loan, then the floating charge is said to 'crystallise' and the lender can appoint an administrative receiver to recover his debt.

order, and if he immediately appoints an administrative receiver, the court must dismiss the application for administration unless the appointor of the administrative receiver consents to the making of an administration order.[178]

The White Paper accepts that administrative receivership is popular with floating-charge holders as cases could be dealt with quickly, and it allows them to realise their own security easily. However, it is the Government's view, that there is a case for abolishing administrative receivers on the grounds of efficiency and fairness to all creditors:

> … on the grounds of both equity and efficiency, the time has come to make changes which will tip the balance firmly in favour of collective insolvency proceedings – proceedings in which all creditors participate, under which a duty is owed to all creditors and in which all creditors may look to an office holder for an account of his dealings with a company's assets It follows that we believe that administrative receivership should cease to be a major insolvency procedure. We therefore propose to restrict the right to appoint an administrative receiver to the holders of a floating charge granted in connection with transactions in the capital markets.[179]

Administrative receivership is regarded in the insolvency White Paper as

> …lacking in transparency: the unsecured creditors cannot challenge the receiver's costs even though the higher these are, the less the unsecured creditors will receive, and in practice creditors' committees are seldom appointed. It is also lacking in accountability to other stakeholders with an interest in a company's affairs, particularly unsecured creditors: the administrative receiver owes duties only to the person appointing him, and so if he receives an offer that will cover his costs and satisfy the appointing secured creditor's claim, then there is no incentive to wait for a higher offer that might provide a higher return for creditors.[180]

Part of the Government's criticism of administrative receiverships is that the receiver primarily owes a duty to his appointor to recover the debt, rather than to the company's creditors as a whole. An administrative receiver has no powers or duty to seek to put together a company rescue in the same way that an administrator has.[181]

The White Paper recognises that administration needs to be streamlined and many of the current formalities removed if it is to be effective as a major insolvency rescue procedure. Nevertheless, a revised administration procedure (subject to the supervision of the court)

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[178] Sections 9(2)(a) and 9(3) of the *Insolvency Act 1986*

[179] Department of Trade and Industry White Paper, *Productivity and Enterprise, Insolvency-A Second Chance*, Cm 5234, July 2001

[180] Ibid.

[181] For example, under Part I of the *Insolvency Act 1986*, an administrator may put proposals to creditors for a Company Voluntary Arrangement (CVA) or a scheme of arrangement pursuant to section 425 of the *Companies Act 1975*

is seen by the Government to be an important tool in providing companies in financial difficulty with the space needed to put together a rescue plan. If the company cannot be saved, administration will provide a better return to all creditors, not just floating charge holders. Although the reforms will affect secured creditors, the Government does not consider that the changes will be detrimental to them because their interests will be protected in the new administration procedure.[182]

The White Paper also proposes to abolish, in all insolvencies, the Crown's preferential right to recover certain unpaid taxes ahead of other creditors. Released assets will be ring-fenced in a corporate insolvency for unsecured creditors.

Under current insolvency legislation the Crown is able to claim preferential status in relation to part of its debt.[183] This is mainly in respect of debts owed in relation to VAT, Income Tax and National Insurance Contributions. The order of payment out of the insolvent estate is:

- the costs and expenses of the insolvency;
- preferential creditors;
- secured creditors;
- unsecured creditors.

The Government's reason for wanting to abolish the Crown's preference was outlined in the Insolvency White Paper:

> Preferential claims in insolvency originated in the late 19th century, but in recent years the trend in other jurisdictions has been towards restricting or abolishing Crown or state preference as, for instance, in Germany and Australia. We believe that this is more equitable. Where there is no floating charge-holder, the benefit of abolition will be available for the unsecured creditors. Where there is a floating charge-holder (in relation to a floating charge created after the coming into force of the legislation), we would ensure that the benefit of the abolition of preferential status goes to unsecured creditors. We will achieve this through a mechanism that ring fences a proportion of the funds generated by the floating charge.[184]

[182] Department of Trade and Industry White Paper, *Productivity and Enterprise, Insolvency-A Second Chance*, Cm 5234, July 2001
[183] Schedule 6 of the *Insolvency Act 1986*
[184] Department of Trade and Industry White Paper, *Productivity and Enterprise, Insolvency – A Second Chance*, Cm 5234, July 2001

The preferential status of certain claims by employees in insolvency proceedings, such as wages and holiday pay within certain limits, will remain, as will the rights of those subrogated to them.

2. The relevant clauses

a. The restrictive use of administrative receivership

Under current legislation a floating charge-holder, whose security covers the whole or substantially the whole of the company's property, may (if a company is in default) enforce their contractual right to realise their security by appointing an administrative receiver (or receiver in Scotland).

Clause 241 of the Bill inserts a new Chapter IV after Chapter III of Part III of the IA 1986. Schedule 18 introduces a new Schedule 2A into the IA 1986.

The purpose of section 72A within new Chapter IV to the IA 1986 is to prohibit the holder of a qualifying floating charge from appointing an administrative receiver (or receiver in Scotland).[185] Secured lenders will still be entitled to take fixed and floating charges but the enforcement of the floating charge will be through the administration procedure.

The general prohibition introduced by section 72A applies to any floating charge created on or after the date that it comes into force. On 9 November 2001, Patricia Hewitt confirmed that secured lenders, who have entered into a loan agreement and taken floating charge security before the Bill is enacted, would still be able to appoint an administrative receiver pursuant to the existing insolvency legislation.[186] In effect, existing security arrangements will not be affected by the proposed reforms. In practice, this means that there will be separate and parallel regimes for security granted prior to and after the date on which the Bill comes into force.

There are important exceptions to section 72A and these are outlined in sections 72B-72F. Section 72B provides that an administrative receiver can be appointed in pursuance of an arrangement that is, or forms part of, a capital market arrangement.[187] For example:

- it involves security that has been granted to a person holding a capital market investment issued by a party to the arrangement; or
- at least one party to the arrangement guarantees the performance of the obligations of another party; or

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[185] A qualifying floating charge is defined by paragraph 12 of new Schedule B1

[186] Department of Trade and Industry press notice P/2001/629, *Administrative receivership to stay for existing corporate lending agreements*, 9 November 2001

[187] A capital market arrangement is defined by paragraph 1 of Schedule 2A of the *Insolvency Act 1986*

- at least one party provides security in respect of the performance of the obligations of another party; or

- the arrangement involves the issue of options, futures or contracts for differences.

This only applies if the debt, or expected debt, is at least £50 million and involves the issue of capital market investments as defined by paragraphs 2 and 3 of new Schedule 2A to the IA 1986.[188]

The Bill also provides for three particular sorts of companies in respect of which an administrative receiver may still be appointed after the Bill comes into force:

- project companies of projects which are public-private partnerships which include 'step-in' rights;[189]

- project companies of projects which are utility projects and which include 'step-in' rights;[190]

- project companies of projects which are financial projects where the project creditor has 'step-in' rights in respect of the project company.[191]

A project has 'step-in' rights if a person who provides finance for a project has a conditional contractual entitlement to assume sole or principal contractual responsibility for carrying out all or part of the project.

There is a fifth exceptional circumstance where under section 72F an administrative receiver may still be appointed in respect of companies which are party to certain types of financial market contracts.

b. Streamlining the administration procedure

In order to provide for the streamlining of administration, clause 239 of the Bill replaces Part II of the IA 1986 with a new Schedule B1 – as set out in Schedule 16 of the Bill. This will be inserted after Schedule A1 to the IA 1986.

New Schedule B1 is arranged with 113 paragraphs concerning, among other things, the appointment of an administrator, the process and effect of administration and the ending of administration.

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[188] Clause 241 and Schedule 16 and paragraph 1(1) of Schedule 18
[189] Section 72C
[190] Section 72D
[191] Section 72E

Nature of administration: paragraphs 1 to 7 of Schedule B1

Under **clause 239** and **Schedule B1**, an administrator (whether or not appointed by the court) is an officer of the court and must be a qualified insolvency practitioner. An administrator may not be appointed if the company is already in administration. A company cannot go into administration if:

- a resolution for voluntary winding-up has been passed (paragraph 7(1)(a) in new Schedule B1) or
- a winding – up order has been made (subject to an application by the liquidator or a floating charge-holder) (paragraph 7(1)(b) in new Schedule B1).

Currently, under section 8(3) of the IA 1986, administration has four statutory purposes. However, in order to clarify the purpose of administration and to place greater emphasis on company rescue, **paragraph 3** creates a single overarching purpose, which will apply to all cases of administration. The administrator will be required to carry out his functions with the objective of rescuing the company where it is *reasonably practicable:*

> 3(1) The administrator of a company must perform his functions-
>
> (a) with the objective of rescuing the company, or
>
> (b) where it is not reasonably practicable to rescue the company, with the objective of achieving a better result for the company's creditors as a whole than would be likely if the company were wound up (without first being in administration), or
>
> (c) where it is not reasonably practicable to rescue the company or achieve the result mentioned in paragraph (b), with the objective of realising property in order to make a distribution to one or more secured or preferential creditors.
>
> (2) The administrator of a company must exercise his functions -
>
> (a) in the interests of the creditors of the company as a whole, or
>
> (b) in a case to which sub-paragraph 1(c) applies, without unnecessarily harming the interests of the creditors of the company as a whole.

It is clear that company rescue means the company continuing as a going concern, with all or a significant part of its business. It may involve the creditors agreeing to the company entering a Company Voluntary Arrangement (CVA) or a scheme of arrangement under section 425 of the *Companies Act 1985*. However, a proposal that would result in just a 'shell' company remaining would not be considered a rescue for the purposes of clause 239.

If the administrator considers that a company rescue is not reasonably practicable, his task is to seek a better result for creditors from administration than on a winding-up. This might involve breaking-up and selling-off the company's individual businesses as 'going concerns'. If a company is simply not viable and has no business that can be sold as a going concern, then under the Bill, the company's remaining assets must be sold in order to make a distribution to one or more secured or preferential creditors.

Whether a company rescue is a *reasonably practicable* option is a matter of commercial judgment. It is envisaged that the courts will not seek to criticise the exercise of such judgment, except in cases where bad faith can be established or the decision taken was one that no reasonable administrator would have taken. However, an administrator must have regard to the interests of all creditors. In situations where there are insufficient assets to pay the unsecured creditors, the administrator must not harm their interests.

Currently, under section 8 of the IA 1986, only the court can appoint an administrator. The Bill retains this court-route into administration but also introduces a much faster out-of-court route.

Appointment of administrator by the court: paragraphs 8 to 11 of new schedule B1

Paragraphs 8-11 to Schedule B1 of the Bill set out the court route into administration. A floating charge-holder, a company or its directors, or one or more creditors of a company can apply to court for an administration order. The court will only make an order if it is satisfied that the company is, or is likely to become, unable to pay its debts and that the order is reasonably likely to achieve the purpose of administration.[192]

Paragraph 10(2) provides that, once an administration application has been made, the applicant must notify, amongst others, anyone who has appointed, or is entitled to appoint, either an administrative receiver or an administrator. However, the application for administration cannot be withdrawn without the permission of the court.[193]

On hearing an application for an administration order, the court may either make the order, dismiss the application or make any other order it deems appropriate, including treating the application as a winding up petition or making an interim order.[194]

It may be helpful to point out here, that under **paragraph 33**, a floating charge-holder can apply to the court for an administration order without the need to show that a company is or is likely to become unable to pay its debts. However, the court must be satisfied that the applicant would be entitled to appoint an administrator under provisions of paragraph 12 (concerning an out of court appointment by the holder of the floating charge).

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[192] Paragraph 9
[193] Paragraph 10(3)
[194] Paragraph 11

It should also be pointed out that if there is already a winding up order in relation to the company that would prevent an out-of-court appointment, the floating charge holder can still apply for administration through the court.[195] If the court makes an administration order, the court will then discharge the winding-up order.[196]

Paragraph 37 provides that if an administrative receiver is already in office (at the time the Bill becomes law), the court must dismiss an application for an administration unless:

- the appointor of the administrative receiver consents to the administration order; or
- the court thinks that the appointee's security may be set aside or challenged under sections 238-240, 245 or 242 of the IA 1986 if an administration order was made.

Out-of-court appointment of an administrator by floating charge-holder: paragraphs 12 to 19 of new Schedule B1

Paragraphs 12 to 19 of new Schedule B1 to the Bill provide an out-of-court route into administration for holders of a floating charge. Floating charge holders will be able to appoint the administrator of their choice, provided that:

- the floating charge on which the appointment relies is enforceable (for the purposes of paragraph 14, enforceable means that the floating charge holder is entitled to call in their security);
- he has given notice to the holder of any floating charge that has priority over his own floating charge; [197]
- the company is not in liquidation nor has a provisional liquidator been appointed;[198]
- neither an administrative receiver nor administrator is already in office.[199]

Before the administrator can take office, a notice of appointment must be filed with the court together with a statutory declaration made by the floating charge-holder. This declaration should state that he has a qualifying floating charge (which may be one or more floating charges together with other security) over the whole or substantially the whole of the company's assets and this is or was enforceable on the date of the appointment.

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[195] In fact, under Paragraph 36 the liquidator may also present an application for administration
[196] Paragraph 33
[197] Paragraph 13
[198] Paragraphs 7(1)(a) and (b) and 15(a)
[199] Paragraph 6

Out-of court appointment of administrator by company/director: paragraphs 20-32

Paragraphs 20-32 of Schedule B1 to the Bill set out the out-of-court entry route into administration for a company or its directors. A company or its directors will only be able to appoint an administrator if:

- the company has not been in administration (instigated by the company or its directors) nor subject to a moratorium in respect of a failed CVA under Schedule A1 of the IA 1986 in the previous 12 months;[200]

- the company is or is likely to become unable to pay its debts;[201]

- there is no outstanding winding-up petition in respect of the company;[202]

- the company is not in liquidation; [203]and

- there is no administrator or administrative receiver in office.[204]

The company or its directors must send a 'notice of intention to appoint' to all parties and also file a copy at court. Attached to this notice should be a statutory declaration, stating that the application meets the criteria set out in **paragraph 25**. Once these formalities have been observed, an interim moratorium commences.[205] The notice period must last at least five working days, during which time, a floating charge-holder entitled to appoint an administrator, may either agree to the proposed appointment or appoint their own choice of administrator.[206]

If the floating charge-holder consents to the company's or directors' nominee or does not respond to the notice within five working days, the company/directors must make the appointment no more than ten working days after filing their 'notice of intention to appoint'. If the 'notice of appointment' is not filed within this ten-day period, the interim moratorium will cease to have effect and an administrator cannot be appointed.

If there is no floating charge-holder, the company/directors are required to file the 'notice of appointment' at court together with a statutory declaration stating that the application meets the criteria set out in paragraph 25.

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200 Paragraph 22(3)
201 Paragraph 25(2)(a)
202 Paragraph 23(a)
203 Paragraph 7(1)(a) and (b)
204 Paragraphs 6 and 23(c)
205 Paragraph 42(2)
206 Paragraph 12

In both cases, the 'notice of appointment' must be accompanied by a statement from the administrator consenting to act and stating that, in his opinion, the administration is likely to be achieved.

The effect of administration: paragraphs 38 to 43 of new Schedule B1

Paragraph 38 of Schedule B1 states that, if the court makes an administration order, it shall dismiss any outstanding winding-up petitions that have not already been dealt with. However, if a company goes into administration as a result of a floating charge-holder's appointment of an administrator, then any winding-up petition that has not been dealt with shall be suspended.

Paragraph 37 provides that if an administrative receiver is already in office, the court must dismiss an application for administration unless the appointor of the administrative receiver consents to the administration order, or the court thinks that the appointee's security may be set aside if an administration order were made.

Paragraph 39 provides that, on the making of an administration order, an administrative receiver will vacate office. It also secures the administrative receiver's right to remuneration and any entitlement to an indemnity that he may have had, ahead of the claims of the floating charge-holder who appointed him.[207]

Once a company has passed into administration (whether by a court or out-of-court route) a moratorium takes effect. This moratorium will apply from the date that the application for the administration, or the notice of intention to appoint, is filed at court. Under **paragraphs 40** and **41** a moratorium means that a resolution cannot be passed, or an order made, to wind up the company except in certain limited circumstances.[208] Similarly, no steps can be taken by the creditors to enforce their rights without the consent of the administrator or the permission of the court. A moratorium therefore gives the administrator a breathing space in which to assess, and if possible, rescue the company.

While a company is in administration, every business document issued by, or on behalf of, the company or the administrator must identify the administrator and state that the administrator is managing the affairs, business and property of the company.[209] Again, this is a measure to protect the public interest.

Process of administration: paragraphs 44-56 of new Schedule B1

Paragraphs 44-46 provides that once the administrator has been appointed certain formalities must be observed in all cases. The administrator must send notice of his

[207] The right to payment is subject to the moratorium under paragraph 41

[208] For example, compulsory winding up orders made on public interest petitions

[209] Paragraph 43

appointment to the company and its creditors as soon as is reasonably practicable and send notice to the Registrar of Companies within 7 days of the appointment. He must also receive (within 10 days of serving a notice asking for it) a written statement of the company's affairs. This statement must give full particulars of the company's property, debts and liabilities and the details of each creditor and their security.

Paragraph 47 provides that, within 28 days from the beginning of the administration, the administrator is required to make a statement setting out proposals for achieving the purpose of administration. Under paragraphs 105 and 106, this 28-days period can be extended but only with the permission of the court or with the creditors' agreement.

A copy of the proposals should be sent to the Registrar of Companies, the company's creditors and every member of the company. Each copy must be accompanied by an invitation to an initial creditor's meeting, which must be held within 6 weeks from the start of the administration, and on a prescribed period of notice as set out in **paragraphs 48** and **49**.

If, at the initial creditors' meeting, the administrator concludes that the company can be rescued as a going concern, the creditors must decide whether to accept an arrangement under which they will agree to accept less than full payment of their debts. This will usually be through a CVA or a scheme of arrangement under section 425 of the *Companies Act 1985*. The creditors could decide to accept, modify or reject the proposal.[210]

If rescuing the company is deemed impracticable by the administrator, he must explain why this is the case. He must then make a proposal to the creditors setting out how he plans to achieve a better result for the company's creditors as a whole than if the company were wound-up. Again, the creditors will vote on whether to accept, modify or reject the proposal.

Where it is anticipated that there will be no funds available from the insolvent estate for unsecured creditors (apart from those flowing from the abolition of Crown preference), the administrator will not be required to call a meeting of the creditors. However, paragraph 50 provides that within the prescribed period such a meeting may be called by creditors whose debts amount to at least 10% of the total debts of the company.

Paragraph 72 stipulates that the administrator's statement of proposals may not include any proposal that affects the right of a secured creditor to enforce his security without his consent. Also, the statement of proposals may not include any action that would result in a preferential debt being paid otherwise than in priority to non-preferential debt.

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[210] Under paragraphs 51-52, a creditors' meeting can only modify the administrator's proposal with his consent. Similarly, the administrator cannot subsequently make any substantial changes to the proposals without first obtaining the agreement of the creditors.

After this creditors' meeting, the administrator will report any decision to the court and the Registrar of Companies. If the creditors fail to approve his proposals, the court may order that the administrator's appointment shall cease, adjourn the hearing conditionally or unconditionally, make an interim order, or any other order deemed to be appropriate in the circumstances.

Functions of the administrator - paragraphs 57-71 of new Schedule B1

On his appointment the administrator of a company must take custody or control of all company property.[211]

Under current legislation, Schedule 1 to the IA 1986, sets out the powers of the administrator. Schedule B1 to the Bill further clarifies the position.

Paragraph 57 states:

> 57 (1) The administrator of a company may do anything necessary or expedient for the management of the affairs, business and property of the company.

To this end, **paragraph 59**, provides that the administration may remove or appoint a company director. Under **paragraph 63** he can also make payments to secured creditors and preferential creditors without the permission of the court. He can make payments to unsecured creditors with the permission of the court or payments from the ring-fenced fund without leave of the court.

Paragraph 69 provides that the administrator may dispose of property, subject to a floating charge, without the consent of the floating charge-holder. However, the floating charge holder has first call on the proceeds of sale.

Paragraph 70 provides that the court may give the administrator the power to override the rights of the holder of a fixed security over the company's property and the power to dispose of the property in question. However, again, the holder of the fixed security has first call on the proceeds of sale.

Paragraph 71 provides that the court may give the administrator the power to sell property subject to a hire-purchase agreement. However, the hire-purchase creditor has first call on the proceeds of sale.

Given the powers available to a company administrator, **paragraph 73** is important. It states that any creditor or member of a company in administration may apply to the court if he thinks that the administrator has acted, or proposes to act, in a way that could

[211] Paragraph 66

unfairly harm his interests. On such an application, the court may grant relief, adjourn the hearing conditionally or unconditionally or make an interim order or other order deemed appropriate.[212] An interested party would have a similar right to apply to the court if he considers that the administrator has not properly accounted for all company assets.[213]

Ending of administration: paragraphs 72-85 of new Schedule B1

Paragraphs 72-85 deal with the formalities of ending an administration.

An administrator will automatically vacate office 3 months after the date the administration commenced. With the consent of the creditors this term may be extended for an additional period of up to three months. Alternatively, on an application from the administrator, the court can grant an extension for as long as it deems it necessary.[214] However, an extension of time cannot be made once the administrator's term of office has ended.[215]

The administrator is required to apply to the court to end his appointment if he thinks that the purpose of the administration cannot be achieved, that the company should not have entered into administration or if required to do so by a creditors' meeting. [216]

If the administrator concludes that the purpose of the company administration has been achieved he will file a notice with the court and the Registrar of Companies and send copies to all the company's creditors. The administrator's appointment will end when the notice is filed.[217] If a creditor has reason to believe that the appointment of an administrator was made under an improper motive, he can apply to the court to have the administration stopped.[218]

Paragraph 82 is important, it permits the administrator to end the administration and convert the proceedings into a voluntary winding-up. This will occur if the preferential and secured creditors have been paid, and there is money available for the unsecured creditors. The administrator will file a notice with the Registrar of Companies and send a copy to each creditor. Once the notice has been filed, the administrator's appointment ends, the company proceeds to undergo a creditors' voluntary winding-up and the administrator becomes the liquidator of the company, unless the creditors decide (as they are entitled) to appoint an alternative liquidator.

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[212] An order may not be made if it would impede or prevent the implementation of an approved voluntary arrangement sanctioned under Section 425 *Companies Act 1985*
[213] Paragraph 74
[214] Paragraphs 75-77
[215] Paragraph 76
[216] Paragraph 78
[217] Paragraph 79
[218] Paragraph 80

If, after making distributions to the secured and preferential creditors, there are insufficient assets to make a distribution to the company's unsecured creditors, the administrator may file a notice with the Registrar of Companies and send a copy to each of the creditors. The company is dissolved three months after the filing of the notice. However, on an application by the administrator or other interested party, the court may defer the dissolution of the company; any such court order should also be filed with the Registrar of Companies.

c. Abolition of the Crown's preference

The Crown's preferential debts are set out in sections 386 and 387 of, and Schedule 6 to, the IA 1986. They include arrears of Income Tax (PAYE), National Insurance Contributions (NIC) and Value Added Tax (VAT).

Clause 242(1) of the Bill will abolish the Crown's preferential status in the following areas:

- debts due to the Inland Revenue for 12 months prior to the relevant date (category 1 of Schedule 6);
- debts due to Customs and Excise for the 6 to 12 months prior to the relevant date (category 2 of Schedule 6);
- social security contributions for the 12 months prior to the relevant date (category 3 of Schedule 6).

However, the Crown's preferential status will be retained for:

- contributions to occupational pension schemes (category 4);
- remuneration of employees for the relevant period (category 5); and
- levies on coal and steel production under the European Coal and Steel Community (ECSC) Treaty.

Clause 243 inserts a new section 176A after the present section 176 of the IA 1986. This new section 176A is concerned with the share of assets for unsecured creditors. It provides for a percentage share of the company's assets to go to unsecured creditors, although the actual percentage will be set by Statutory Instrument and will be subject to consultation.[219]

[219] New Section 176A(5) –(6)

The intention is that where a company has gone into liquidation, administration, provisional liquidation or receivership, the office-holder will make part of the company's net property available to unsecured creditors. 'Net property' is company property that is left after taking into account any preferential debts, any liability subject to a fixed charge and the costs of realising the company's property. However, the Bill makes it clear that it will not be necessary for the office-holder to distribute funds to unsecured creditors if they are less than the prescribed minimum, and he thinks that the cost of making a distribution would be disproportionate to the benefits.

3. Views of the business community

There have been a number of responses to the corporate insolvency reforms proposed in the Insolvency White Paper.[220] Unsurprisingly, the proposal to abolish the use of administrative receiverships and to reform the administration process provoked most comment.

a. Abolition of administrative receiverships

The British Bankers' Association (BBA) is unconvinced that the proposed corporate insolvency reforms will promote an enterprise culture. In particular, it has criticised the proposal to restrict the use of administrative receiverships to the capital markets:

> In our responses to the previous consultation papers on this subject, we went to some trouble to explain how successful administrative receivership had been an engine for reconstruction and enterprise in the UK and the role of banks in contributing to this. Fundamental to this has been the ability of secured creditors to appoint somebody who is able to act quickly and manage the restructuring process in a way which has saved jobs in a cost-effective way. The word 'business' is important. The whole thrust of any insolvency legislation should be focussed, as are banks' actions, on saving more businesses, not companies as legal entities. There is no evidence in the White Paper that its proposals would save more businesses and so enhance the rescue culture.
>
> Instead, the proposals represent a significant alteration in the substantive rights of secured creditors. If there is a material shift in the balance of risk for financiers, or uncertainty as to the outcome of attempted rescues, this will lead to an environment in which finance for the vast majority of businesses which do not get into difficulty may become less flexible, more expensive and probably less available. Depending on the detail of the legislation and resulting regulations, and of court practice, it is quite likely that businesses will have to turn to much more (and more expensive) asset-based finance and to far more requests for additional personal security. In addition, the new regime, based as it is on court application, can only increase time and costs significantly for creditors in seeking to protect

[220] Department of Trade and Industry White Paper, *Productivity an Enterprise-Insolvency a Second Chance*, Cm 5234, 31 July 2001

> their position. These costs will inevitably be passed on to current and future debtors. The proposals are therefore likely to work against the enterprise culture, completely contrary to the Government's objectives. [221]

The law firm, Freshfields Bruckhaus Deringer, has also said that this proposal does not take into account the important role administrative receivers have played in the rescue culture in recent years:

> It is not receivership in itself, which creates a hierarchy of creditors – it is the underlying policy which, quite rightly, allows those providing debt finance to take security. Receivership is the only way in which secured creditors' valid rights are enforced.
>
> To promote the rescue culture it is our view that wherever possible, viable businesses should survive. It may be that the only way of ensuring this is to extract a viable business from, for example, an over-indebted corporate vehicle. This has traditionally been the role of the receiver. Administration now provides an alternative mechanism. This is not to say that company rescues cannot or should not be achieved. It must, however, be acknowledged that in many cases a rescue of a company in its entirety is technically more difficult and expensive (particularly if it requires a scheme of arrangement).
>
> While any insolvency process is obviously undesirable, receivership can, wherever there is a viable business, enable it to be hived off into new ownership or management. Receivership can therefore be a positive factor for that business and its employees and can have a successful outcome. Statistics on company failure are therefore misleading because there will be many cases where the corporate shell has been lost but the business has been saved.
>
> The white paper also contains fundamental misconceptions as to the duties owed by administrative receivers to all creditors. We do not consider that a receiver can, as a matter of law, ignore the interests of unsecured creditors. [222]

The law firm queries why administrative receivership should remain as an option only for the capital markets:

> It would appear that the government has concluded as a matter of policy that the administrative receivership procedure is to be discouraged and that secured creditors should use administration to enforce their rights. If this is the government's position, it seems hard to understand why the government believes that a different regime should apply where the rights potentially arise by virtue of transactions, which are legally identical, but happen to be conducted in a different manner (i.e. by use in the capital markets).

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[221] British Bankers' Association, *Response of the British Bankers' Association to the Insolvency White Paper: Insolvency – a second chance*, October 2001

[222] Freshfields Bruckhaus Deringer, *Insolvency – a second chance*, November 2001

> Indeed, we would take issue with the thrust of paragraph 2.18 of the White Paper, which talks of the 'important role' of the floating charge and the right to appoint an administrative receiver. On what basis does the government believe that this important role is limited to the capital markets? Quite apart from the apparent discrimination against banks lending their own funds, which this implies, we doubt whether a workable definition of a capital market transaction can be drawn up, particularly in evolving and innovative markets.[223]

The law firm concludes that:

> …we believe that by abolishing administrative receivership and muddling the objectives of an administration, a cost-effective and successful rescue tool will be lost, and a more complex and consequentially more expensive administration regime will be introduced. [224]

Conversely, the Institute of Chartered Accountants in England and Wales (ICAEW) broadly supports the proposal to restrict the appointment of administrative receivers, on the grounds that it would give the 'appearance' of fairness to all creditors:

> On balance, we do not oppose the restriction of the right of floating charge holders to appoint administrative receivers. While recent academic research has not revealed any significant disadvantage to creditors accruing from the appointment of administrative receivers, we agree that their abolition will give the appearance of more equitable treatment of unsecured creditors, and will probably result in better incentives to maximise the economic return.
>
> However, it must be recognised that there will be costs arising from the administrator's accountability to unsecured creditors, that would not accrue to an administrative receiver. The administrator should not be obliged to undertake lengthy procedures in relation to unsecured creditors, such as the proving of their claims, if funds are unlikely to be sufficient to give them a return.[225]

b. Streamlining the administration procedure

The BBA broadly welcomes the proposal for an urgent administration process, but argues that for the proposals to work the courts must have adequate resources:

> To make the proposals work, it is vital that the courts are adequately resourced to deal with this new dynamic and the substantially increased workload they will encounter, whatever the state of the economy. The latest figures from the Government Review Group suggest that there are approximately four times the

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[223] Ibid.
[224] Ibid.
[225] Institute of Chartered Accountants in England and Wales, *Memorandum of Comment in response to the White Paper issued by the Insolvency service of the Department of Trade and Industry in July 2001,* TECH 16/01, October 2001

> number of administrative receivership appointments as administrations. These figures date from a more benign economic environment than today. If courts are not adequately resourced, the outcome of administrations will become even more uncertain and detrimental to creditors, especially secured creditors, with the result that business finance will be restricted and not encouraged as the engine for enterprise. Lack of resource will also lead to fewer, not more, business rescues.[226]

The ICAEW feels the proposals as outlined in the insolvency White Paper do not go far enough:

> …Our overall impression of the proposals on corporate insolvency is that they should be more radical. The Enterprise Bill, when it is presented to Parliament, would benefit from clarification that administrators will be free to carry out a wide range of procedures, in the interest of creditors and other stakeholders, within the overall safeguard of the sanction of the Court. The ability of administrators to act in an entrepreneurial manner, for the continuation of businesses which can be saved, should not be needlessly impeded by restrictions drafted into the legislation, which are not needed for the protection of creditors or other stakeholders.[227]

According to the Association of Business Recovery Professionals (R3), the move away from administrative receivership and the renewed emphasis on administration is not as radical as it first appears:

> The proposed move away from administrative receivership is not as radical as the government would like us to think: banks will continue to have the right to petition for an administration – if necessary, without notice. The banks are also likely to be able to put in their preferred choice of individual as administrator and the purpose of the administration will probably be able to be defined as realising the bank's security. It would appear that the banks have little to fear from these proposals.[228]

c. Abolition of the Crown preference

The ICAEW supports the abolition of Crown preference and also the determination of the Government that at least a proportion of the proceeds resulting from the abolition should go to unsecured creditors. However, it points out that in some cases the ring fencing of the funds generated will result in complex calculations and procedures:

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[226] British Bankers' Association, *Response of the British Bankers' Association to the Insolvency White Paper: 'Insolvency – a second chance*, October 2001

[227] Institute of Chartered Accountants in England and Wales, *Memorandum of Comment in response to the White Paper issued by the Insolvency service of the Department of Trade and Industry in July 2001,* TECH 16/01, October 2001

[228] The Association of Business Recovery Professionals (R3), *Recovery*, quarterly journal, September 2001

> Unless a significant return to unsecured creditors is likely, there is a strong danger of a disproportionate amount of the proceeds being absorbed by costs.[229]

According to the ICAEW, a further unintentional effect of the removal of Crown preference is that the Inland Revenue and other Government creditors could be motivated to enforce methods of recovering their debt at an even earlier stage than they have been accustomed. This could have the effect of leading to more insolvencies rather than fewer.

This point was also made by the BBA. The BBA argues that the sum of funds released will have little or no material impact on the recovery rates of other creditors:

> The most important thing the Crown could do to support the further development of enterprise, would be to behave in a 'commercial' way when considering CVAs or other instances of distress. Businesses could be saved if the Crown were prepared to forego part of its 100p in the pound.[230]

R3 greatly supports the removal of the Crown preference:

> Removing Crown preference status is terrific news. The change will cost the taxpayer money, but not very much. In return, unsecured creditors should get higher returns and the revenue departments should take a more positive attitude to business rescues.[231]

The proposal was also welcomed by the Institute of Directors on the basis that it should help to improve returns to corporate creditors.[232]

The Federation of Small Businesses (FSB) also welcomed the abolition of the Crown preference:

> We are particularly pleased with moves to abolish the Crown's preferential right to recover unpaid taxes ahead of unsecured small businesses. Whilst this will cost the Treasury around £90 million, it means that the small firms sector will benefit by the same amount, thus giving small businesses more chance to survive and prosper.[233]

However, the law firm, Allen & Overy, commented that secured lenders will be disappointed by the reform:

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[229] Institute of Chartered Accountants in England & Wales, *Memorandum of Comment, in response to the White Paper issued by the Insolvency Service of the Department of Trade and Industry in July 2001*, TECH 16/01, October 2001

[230] British Bankers' Association, *Response of the British Bankers' Association to the Insolvency White Paper: 'Insolvency – a second chance'*, October 2001

[231] The Association of Business Recovery Professionals (R3), *Recovery*, quarterly journal, September 2001

[232] "Business welcomes plans for insolvency reform", *Financial Times*, 1 August 2001

[233] http://www.dti.gov.ukenterprisebill/otherpeople.htm

> Lenders who were hoping that the announcements regarding the abolition of the Crown's preferential status would lessen the effect of the Privy Council's decision in Brumark Investments (concerning fixed and floating charges over book debts) will be disappointed. Although the Government confirmed its intention to abolish the Crown's preferential status, its appears that the benefit of the abolition will go to the unsecured creditors rather than the floating charge-holder. [234]

d. (d) Statutory fees

The ICAEW strongly supports the reforms proposed to the financial regime for the Insolvency Service, and describes as anachronistic the current obligation for funds from voluntary liquidations to be placed in the Insolvency Services Account.

B. Part 10: Individual insolvency reforms

1. Background

At present, insolvency legislation subjects all bankrupts to substantially the same process. Statutory restrictions automatically attach to all bankrupts on the making of the bankruptcy order irrespective of the facts of their individual case or whether they are in any way culpable. This regime is seen by the Government as acting as a real barrier to enterprise by discouraging business start-ups and restarts.[235]

At the same time it is the Government's view that Individual Voluntary Arrangements (IVAs) have been an ineffective alternative to bankruptcy. Briefly, an IVA is an arrangement between an individual debtor and his creditors whereby the creditors agree to accept something less than 100p in the pound on their debts. Alternatively, the creditors might agree to some deferment of the time for payment of their debts and also agree not to force the debtor into bankruptcy. An IVA agreement is overseen by a supervisor, who must be an insolvency practitioner, and it is binding on those creditors who had notice of and were entitled to vote at a creditors' meeting. In effect, an IVA is a less formal procedure open to insolvent individuals.[236]

The Government has said:

> Individual Voluntary Arrangements (IVA), which are intended as an alternative to bankruptcy, are subject to some criticism by both creditors and debtors due to the level of fees charged by insolvency practitioners and the poor returns to

[234] "Bulletin", Allen & Overy, August 2001

[235] Department of Trade and Industry White Paper, *Productivity and Enterprise, Insolvency – A Second Chance*, July 2001, Cm 5234

[236] An IVA cannot affect the rights of secured or preferential creditors except with their agreement

> unsecured creditors. The numbers of IVAs commenced over the last 5 years are as follows:
>
> 1996 3,983
> 1997 4,211
> 1998 4,620
> 1999 7,086
> 2000 7,909.[237]

As a result of these failings the Government has been consulting interested parties on its proposals to revamp bankruptcy laws.

A review of bankruptcy law and practice was announced in the Competitive White Paper, *Our Competitive Future – Building the Knowledge Driven Economy*, published in December 1998.[238] In this White Paper the Government announced its intention to reassess the relative rights of creditors, including possible changes to the Crown's preferential status. It would also review whether bankruptcy law needed to be changed to ensure that it supported enterprise, including whether any of the current restrictions on bankrupts could be eased.

Subsequently, a working party (whose members were compiled from the Insolvency Service) was established to carry out an internal review of bankruptcy law. Officials from this working party reported to Ministers on 30 April 1999. In its recommendations the working party differentiated between 'responsible risk takers' and 'culpable' bankrupts. It identified a range of options including measures to allow responsible risk takers who become bankrupt to be discharged after only six months and to keep enough money to cover a deposit for a new home. But for so-called 'rogue bankrupts', disqualification could be extended to 15 years.[239]

Speaking at a joint US Embassy, DTI and Treasury conference on '*Fostering Enterprise – the American Experience*, Stephen Byers, former Secretary of State for Trade and Industry, said:

> For too many people the fear of failure stifles innovation and enterprise. No wonder if failure means losing everything including the family home. We need to take a fresh look at out attitude to business failures, balancing the needs of the bankrupt with the rights of their creditors.

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[237] Department of Trade and Industry White Paper, *Productivity and Enterprise, Insolvency – A Second Chance*, July 2001, Cm 5234

[238] *Our Competitive Future – Building the Knowledge Driven Economy*, White Paper Cm 4176, December 1998

[239] In the DTI White Paper, *Productivity and Enterprise, Insolvency – A Second Chance*, Cm 5234, July 2001, the Government states that its proposal for financial counselling for bankrupts and the proposal that certain non-culpable bankrupts who had capitalised their business might be allowed to retain a proportion of any equity of redemption in their home, received little support and are not being taken forward at this time.

> We must come down hard on the estimated 7-12% of bankrupts who are culpable, that is those who deliberately set out to mislead and deceive. But for those who fail for reasons beyond their control and despite their best efforts to save their business we need a new attitude.[240]

On 7 April 2000, a consultation document entitled *Bankruptcy – A Fresh Start* was published.[241] Again, a distinction was made between those who fail for reasons beyond their control despite their best efforts to save their business and those who fail deliberately in order to deceive creditors. The main thrust of the proposals outlined in the consultation document is to counter the stigma of failure, to avoid excluding entrepreneurs from business life and to ensure higher returns to creditors.

Announcing the publication of *Bankruptcy – A Fresh Start* and a period of consultation, Stephen Byers said:

> We must remove the stigma surrounding bankruptcy. Too many people are unwilling to set up their own business because they are worried about the consequences of failure.
>
> We must change attitudes. Most businesses fail because of bad luck or a lack of cash. But for too long such people have been tarred with the same brush as the reckless minority whose company collapses because of fraudulent activity.[242]

On 20 June 2000, Dr Kim Howells provided written answers to two questions about the recommendations of the Insolvency Working Party:

> **Mr Mitchell**: To ask the Secretary of State for trade and Industry how he defines the difference between responsible risk takers and culpable bankrupts for the purpose of implementing the recommendations of the Insolvency Working Party; and if he will estimate the proportion of each.
>
> **Dr Howells**: I am satisfied that there is a clear distinction to be drawn between individuals who are dishonest or whose conduct with regard to their creditors is irresponsible and those whose use of credit and treatment of their creditors is conscientious and above board. Examples of irresponsible conduct would be an individual continuing to trade and incur credit at a time when he or she knew themselves to be insolvent; or an individual consumer obtaining credit without any regard to his ability to repay the debts incurred. Information available from Official Receivers indicates that the very great majority of individuals subject to bankruptcy are neither dishonest nor irresponsible.

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[240] DTI press notice, *Byers outlines details of bankruptcy study*, 2 July 1999
[241] The consultation document is available on the Insolvency Service website at www.insolvency.gov.uk
[242] DTI press notice P/2000/257, *Radical new approach to bankruptcy law planned*, 7 April 2000

> **Mr Mitchell**: To ask the Secretary of State for Trade and Industry on what basis he estimates that seven to 12 per cent of bankrupts are culpable; and what relationship these percentages have to the findings of the Insolvency Service's Study of Business Failures in January and February 1999.
>
> **Dr Howells**: An estimate of the number of bankrupts who may have been guilty of misconduct in relation to their creditors can be made by reference to the number of bankrupts reported by Official Receivers as having, prima facie, committed criminal offences; the number of bankrupts identified by Official Receivers as having committed criminal offences but in respect of whose affairs further investigation or prosecution would not, in the public interest, be warranted; and information obtained from Official Receivers as in their survey of Business Failures.[243]

In February 2001, a joint DTI/DfEE White Paper, *Opportunity for all in a world of change*, was published.[244] This White Paper expanded on the theme of the previous consultation paper, of the need to move away from the 'one size fits all' approach that characterises the current insolvency regime. It emphasised the importance of reducing the impact of financial failure on individuals and encouraging a second chance.[245]

According to the DTI, responses to the consultation showed strong support from both the public and the business community for measures to liberalise the bankruptcy regime:

> There was broad support for the proposal to make a distinction between bankrupts on the basis of their culpability, provided that the reasons for a bankrupt's failure were tested with appropriate rigour. The proposed 'Bankruptcy Restriction Order' was seen by most as offering real and effective protection for the public and the business community against the financially irresponsible or downright dishonest.[246]

In June 2001, the Government's intention to introduce an *Enterprise Bill* was announced in the Queen's Speech. This was followed by the publication in July 2001 of a White Paper, *Productivity and Enterprise: Insolvency – A Second Chance.*[247] In the introduction to this White Paper, Patricia Hewitt, explained the main aim of the bankruptcy proposals as follows:

> In order to ensure that we enjoy the benefits of an increasingly dynamic and successful economy, the framework – legal, economic and social – within which individuals are prepared to risk their capital, their energies and their time, has to

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[243] HC Deb 20 June 2000 c138W

[244] DTI/Dfee White Paper, *Opportunity for all in a world of change: A White Paper on enterprise skills and innovation*, Cm 5052, 13 February 2001

[245] Ibid.

[246] Department of Trade & Industry White Paper, *Productivity and Enterprise, Insolvency – A Second Chance,* Cm 5234, July 2001

[247] Ibid.

> be thoroughly modern. The Government can improve the incentives and rewards for people to succeed but we have to recognise that in a dynamic market economy some risk taking will inevitably end in failure. Fear of failure can act as a powerful disincentive to potential entrepreneurs and the actual cost of failure can deter many whose first failure was honest from trying again. Therefore, the Government intends to legislate for a major package of reforms to personal bankruptcy, to modernise the framework and to encourage entrepreneurship and responsible risk taking, which will contribute to the creation of wealth and employment. These reforms will streamline the process and reduce the stigma for the vast majority of individuals, and encourage those who have failed, through no fault of their own, to try again. At the same time, the Government will legislate to provide for robust and effective remedies against the small minority who have acted recklessly, irresponsibly or dishonestly.[248]

A summary of responses to the insolvency White Paper was published in November 2001.[249]

The reforms outlined in the Bill are driven by the Government's view that a fear of failure can act as a powerful disincentive to potential entrepreneurs. The stated intention is to encourage enterprise by reducing the stigma of failure in 'honest' cases whilst providing for a robust and effective remedies against the small minority of bankrupts who act recklessly or dishonestly.

2. The relevant clauses

a. The duration of bankruptcy: clauses 245 and 257 & schedules 19 and 23

Under current legislation, the bankrupt is generally automatically discharged from bankruptcy three years after the making of the bankruptcy order.[250]

The Official Receiver has a statutory duty to investigate the cause of failure in most bankruptcy cases.[251] However, according to Government appraisals, the majority of bankruptcy cases investigated by the Official Receiver lead to no further action being taken against the bankrupt and little administrative activity beyond the first few months:

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[248] Ibid.

[249] The Insolvency Service, *Summary of responses to the White Paper, Productivity and Enterprise-Insolvency a Second Chance*, 28 November 2001

[250] There are exceptions to this general rule. For example, in cases where the bankrupt does not comply with his obligations, the court can order suspension of the operation of the automatic discharge provisions for such period or on such terms as it sees fit. In cases where the debtor has previously been made bankrupt in the 15 years preceding his further bankruptcy or remains subject to a criminal order (a procedure which in fact ceased to be available in 1989) his discharge can only be ordered by the court. In cases where the court has made an order for summary administration, the bankrupt is discharged after two years.

[251] Approximately, 21,000 a year according to the insolvency White Paper

> Most bankrupts are discharged three years after the bankruptcy order. Thus, in addition to the continuing cost of The Insolvency Service administering these cases, most bankrupts are denied the opportunity of prompt rehabilitation in relation to their financial affairs.[252]

Under clause 245 of the Bill, bankrupts who are not reckless, irresponsible or dishonest will be eligible for an automatic discharge from their debts and released from bankruptcy restrictions after a maximum period of 12 months from the date of the bankruptcy order.

Clause 245 of the Bill replaces the existing section 279 of the IA 1986 on duration of bankruptcy. It states:

> **245** (1) The following shall be substituted for section 279 of the Insolvency Act 1986 (duration of bankruptcy) –
>
> "279 Duration
>
> (1) A bankrupt is discharged from bankruptcy at the end of the period of one year beginning with the date on which the bankruptcy commences.
>
> (2) If before the end of that period the official receiver files with the court a notice stating that investigation of the conduct and affairs of the bankrupt under section 289 is unnecessary or concluded, the bankrupt is discharged when the notice is filed.
>
> (3) On the application of the official receiver or the trustee of a bankrupt's estate, the court may order that the period specified in subsection (1) shall cease to run until –
>
> (a) the end of a specified period, or
>
> (b) the fulfilment of a specified condition.
>
> (4) The court may make an order under subsection (3) only if satisfied that the bankrupt has failed or is failing to comply with an obligation under this Part.
>
> (5) In subsection (3)(b) 'condition' includes a condition requiring that the court be satisfied of something.

It provides for bankrupts to be automatically discharged one year after the bankruptcy order was made. The period of bankruptcy may be reduced to less than a year if the Official Receiver files a notice stating that further investigation into the bankrupt's conduct or affairs is unnecessary. In effect, this 12 months bankruptcy period is taken as a maximum; an 'honest' and compliant bankrupt may obtain his discharge even earlier.

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[252] Department of Trade & Industry White Paper, *Productivity and Enterprise, Insolvency – A Second Chance*, Cm 5234, July 2001

However, under clause 245(3) the ability to suspend discharge where the bankrupt fails to co-operate with the Official Receiver remains.

A number of other amendments to the IA 1986 stem from reducing the automatic discharge period to one year. These can be summarised as follows.

Under current legislation, the court can issue a certificate of summary administration where the following conditions are satisfied:

- a bankruptcy order is made by the court as a result of the debtor's own petition;
- at the time of the debtor's petition, the level of debt is less than the small bankruptcies level, and
- in the preceding five years the debtor has not been bankrupt or entered into an individual voluntary arrangement.

One of the effects of the certificate of summary administration is to reduce the discharge period from three to two years.

Consequently, in order to reduce the automatic discharge period to one year, it is necessary to repeal those provisions in the IA 1986 dealing with summary administration of a bankrupt's affairs. These amendments are made in Schedule 23 to the Bill, which is given effect by **clause 257**.

In reducing the discharge period to one year, transitional provision needs to be made to deal with individuals who have already been made bankrupt on commencement (assuming the Bill is enacted) but have not yet been discharged. This is achieved by **Schedule 19** to the Bill. Schedule 19 provides that the date of discharge will be one year from the date of commencement of clause 245 or earlier if the three-year discharge period is due to end before that date.

However, the position will be different for those individuals who have been an undischarged bankrupt more than once in the previous fifteen years and who are still undischarged at the time clause 245 is commenced. In this case, the bankrupt is discharged five years from the date of commencement or earlier if an order under section 280(2) of the IA 1986 is made or comes into effect. Very briefly, an order under section 280(2) of the IA 1986 allows the court to refuse to discharge, conditionally discharge or absolutely discharge a bankrupt on the application of the bankrupt. An application can be made any time after five years from the date of bankruptcy.

The following example may help to illustrate the position. If (within a fifteen years period) a person is made bankrupt for the second time one year before the commencement of clause 245 he would, under section 280 of the IA 1986, be entitled to apply for

discharge four years after commencement of that clause. If he is successful in this application and the court discharges him, he is discharged from that date. If he makes no such application, he is discharged automatically five years after clause 245 is commenced.

If a person is made bankrupt under section 264(1)(d) of the IA 1986 (criminal bankruptcy) before commencement of clause 245 of the Bill, he can only be discharged by order of the court under section 280 of the IA 1986.

Finally, it should be noted that reducing the bankruptcy discharge period to one year does not affect the Official Receiver's ability to claim any assets that the bankrupt had at the time of the bankruptcy order. Discharge does not return ownership or control of bankruptcy assets to the bankrupt or prevent the official receiver from carrying out any of his remaining functions in relation to the bankrupt's estate. The bankrupt also has a continuing obligation to attend on and provide information to the Official Receiver if required.

b. Post-discharge restrictions: clauses 246 and 251 & Schedules 20 and 21

Whilst bankrupt, an individual is subject to a wide range of automatic restrictions irrespective of the level of their assets and liabilities, or culpability. The most significant are prohibitions on:

- acting as a director of, or in the management of a limited company without the court's permission;
- obtaining credit above a prescribed limit (currently £250) without disclosing the bankruptcy;
- carrying on business in a different name from that in which they were made bankrupt without revealing their earlier name.

Generally these restrictions are in place for the duration of the bankruptcy (currently three years in most cases). Breach of the restrictions is a criminal offence and exposes the bankrupt to the risk of imprisonment for up to two years and/or a fine.

The aim of such restrictions is to protect the public and the business community. However, it is the Government's view that while in some cases these restrictions can be justified in the public interest, there is little justification for others. In line with the Government's view that bankrupts who have failed through no fault of their own should not face undue restrictions, the Bill removes some of the more 'outdated' restrictions that automatically apply as a result of bankruptcy.

For example, **Clause 253** will remove the automatic disqualification on a bankrupt acting as a justice of the peace. The removal of bankrupt justices of the peace will be left to the Lord Chancellor's general power to appoint and remove justices of the peace where it is

thought appropriate. The automatic restriction on bankrupts serving as a member of a Local Authority will be replaced by **clause 255** with one disqualifying those subject to a Bankruptcy Restriction Order.

Clause 254 deals with the disqualification from Parliament, the Scottish Parliament, the Northern Ireland Assembly or the National Assembly for Wales where a Bankruptcy Restriction Order is made against a member of any of these bodies.

Under **clause 256** Government Departments are able to review the restrictions in legislation for which they have responsibility to see whether they should be removed or retained on public interest grounds.[253]

c. Introduction of Bankruptcy Restriction Orders (BROs)

Whilst removing some statutory restrictions on bankrupts, **clause 246** and **Schedules 20** and **21** of the Bill introduce Bankruptcy Restriction Orders (BROs). BROs are a major part of the Government's reform of bankruptcy law. The aim of BROs is to protect the public and the commercial community from the minority of bankrupts who abuse the system, do not co-operate with the Official Receiver or whose conduct has been dishonest or otherwise culpable. The imposition of a BRO (or an interim BRO) would be a matter for the court to determine.

According to the Government's insolvency White Paper, BROs would offer greater protection to the public:

> The only sanctions currently available to address misconduct or dishonesty by bankrupts are criminal ones. The high evidential requirements of the current criminal sanctions mean that very few bankrupts have action taken against them (about 3% of cases in the last year). The civil BRO regime, with its lower standard of proof (i.e. the balance of probabilities rather than beyond reasonable doubt), will allow for greater protection of the public and business. The protection will not be present if the proposals are not brought into force. The BRO regime will require additional resource from the courts by way of court time, but this should be balanced against a reduction in case numbers taken through the criminal system.[254]

Schedule 20 to the Bill inserts a new **Schedule 4A** into the IA 1986 that sets out the details regarding BROs and Bankruptcy Restrictions Undertakings (BRUs). Paragraph 1 of new Schedule 4A, states that BROs are made by the court on the application of the Secretary of State.

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[253] The Insolvency Service notice, *An update on the Bankruptcy proposals*, 21 March 2002

[254] Department of Trade & Industry White Paper, *Productivity and Enterprise, Insolvency – A Second Chance*, Cm 5234, July 2001

Under paragraphs 7 – 9 of new Schedule 4A, any reference to a person against whom a BRO has been made includes a reference to a person who is the subject of a BRU (paragraph 8). This allows a bankrupt to agree to be bound by such restrictions without the need for an application to court.

Paragraph 2 of new Schedule 4A sets out the kinds of conduct to which the court will have particular regard in making a BRO. It states:

> 2(1) the court shall grant an application for a bankruptcy restrictions order if it thinks it is appropriate having regard to the conduct of the bankrupt (whether before or after the making of the bankruptcy order).
>
> (2) The court shall, in particular, take into account any of the following kinds of behaviour on the part of the bankrupt-
>
> (a) failing to keep records which account for a loss of property by the bankrupt, or by a business carried on by him, where the loss occurred in the period beginning 2 years before petition and ending with the date of the application;
>
> (b) failing to produce records of that kind on demand by the official receiver or the trustee;
>
> (c) entering into a transaction at an undervalue;
>
> (d) giving a preference;
>
> (e) making an excessive pension contribution;
>
> (f) a failure to supply goods or services which were wholly or partly paid for which gave rise to a claim provable in the bankruptcy;
>
> (g) trading at a time before commencement of the bankruptcy when the bankrupt knew himself to be unable to pay his debts;
>
> (h) incurring, before commencement of the bankruptcy, a debt which the bankrupt had no reasonable expectation of being able to pay;
>
> (i) failing to account satisfactorily to the court, the official receiver or the trustee for a loss of property or for an insufficiency of property to meet bankruptcy debts;
>
> (j) carrying on any gambling, rash and hazardous speculation or unreasonable extravagance which may have materially contributed to or increased the extent of the bankruptcy or which took place between presentation of the petition and commencement of the bankruptcy;
>
> (k) neglect of business affairs of a kind which may have materially contributed to or increased the extent of the bankruptcy;

(l) fraud or fraudulent breach of trust;

(m) failing to cooperate with the official receiver or the trustee.

Failure to keep proper accounting records, gambling and rash and hazardous speculation are types of conduct already covered by criminal offences in sections 361 and 362 of the IA 1986. **Clause 251** of the Bill repeals those two criminal offences. Matters that would have been dealt with under those two offences will in the future be dealt with under the Bill's new bankruptcy restriction regime.[255]

Paragraph 3 of Schedule 4A to the Bill is important. It stipulates that an application for a BRO must be made within 1 year of the making of the bankruptcy order. After a year, proceedings may still be brought but only with the permission of the court.

Paragraph 4 of Schedule 4A provides that a BRO will come into force on the day the order is made by the court and will last until the date specified in the order, which could be for a minimum period of 2 years or a maximum of 15 years. (The minimum and maximum duration period of a BRU will be the same as a BRO). These restrictions mirror those that are currently applied automatically under the IA 1986 on the making of a bankruptcy order.

It is envisaged that in many cases, it is unlikely that the court will reach a substantive decision in relation to an application for a BRO before the defendant's discharge from bankruptcy (after 12 months). Consequently, in cases where a BRO is being sought from the court there is likely to be a gap in time between the discharge of the bankrupt and the making of the BRO.

Paragraphs 5 and 6 of new Schedule 4A provides for the court to make an interim order when proceedings for an BRO are issued and where the Official Receiver or Secretary of State has made out a prima facie case and the court is of the view that the misconduct is so serious that it is in the public interest to make such an order.

Paragraph 5(4) of new Schedule 4A provides that restrictions will apply on the making of the interim order pending a substantive hearing of the application.

The purpose of paragraphs 10 and 11 of Schedule 4A is to set out the effects of annulment of the bankruptcy order on any BRO. Under section 282(1)(a) of the IA 1986, a bankruptcy order can be annulled on the grounds that it should never have been made, if this happens, any BRO (either substantive or interim) that is in force will be annulled.

Under current law, sections 261 and 263D of the IA 1986, a bankruptcy order may be annulled because the creditors have approved an IVA or because the bankruptcy debts

[255] Provided the misconduct is material having regard to the circumstances of the case

and expenses have been paid in full. However, the annulment of a bankruptcy order in these circumstances will not affect whether a BRO (or interim order) remains in force. Where an application for a BRO has been initiated, then those proceedings can be continued notwithstanding the annulment of the bankruptcy. In effect, BROs can still be made against culpable bankrupts who have managed to have their bankruptcy order annulled solely because they are now able, for whatever reason, to pay off their debts in full or partially to the satisfaction of creditors in an IVA. Similarly, where a BRU has been offered in place of a BRO, the undertaking can be finalised and implemented irrespective of any annulment of the bankruptcy order under sections 261 and 263D of the IA 1986.

Paragraph 12 of new Schedule 4A requires the Secretary of State to maintain a public record of all BROs, interim BROs and BRUs. Paragraph 16 of Schedule 23 inserts a new paragraph 29A into Schedule 9 of the IA 1986. This permits rules to be made about the inspection of the public register.

Schedule 21 to the Bill is important because it deals with the effect of BROs, interim BROs and BRUs on the bankrupt (whether or not discharged). In essence, the Schedule amends certain provisions that make particular conduct an offence while an undischarged bankrupt and extends them to cover individuals subject to BROs, interim BROs and BRUs.[256] Under Schedule 21 to the Bill, it is an offence for a person who is an undischarged bankrupt or subject to a BRO to:

- Act as a receiver or manager of the property of a company on behalf of debenture holders.

- Obtain credit and do business without first disclosing he is a discharged bankrupt but subject to a BRO.

- Act as an insolvency practitioner while subject to a BRO.

- To act as director of a company or directly or indirectly to take part in or be concerned in the promotion, formation or management of a company, without the leave of the court.

Finally, under the IA 1986 bankruptcy restrictions are only triggered by the existence of a bankruptcy order. By reducing the automatic discharge period to 12 months for most cases, these statutory restrictions will fall away for non-culpable bankrupts after one year. However, new Schedule 21 to the Bill, amends those provisions of the IA 1986 that contain restrictions to add in references to Bankruptcy Restriction Orders (BROs) and interim BROs. The effect is that such restrictions will continue to apply to persons whose bankruptcy has been discharged but who remain subject to a BRO (or interim BRO).

[256] Incorporated by Paragraph 5(4) and 8 of new Schedule 4A of the *Insolvency Act 1986* respectively

It might be helpful to point out here that the Secretary of State for Trade and Industry considered the provisions of the Bill relating to the imposition of BROs were compatible with Articles 6 and 8 of the European Convention on Human Rights.[257]

d. Income Payments Order and Income Payments Agreement: clauses 248-249

Under current legislation, Income Payments Orders (IPOs) are designed to ensure that a bankrupt makes an affordable contribution towards his debts from income. IPOs are made by the Courts on the application of an Insolvency Receiver (or more probably the trustee in bankruptcy) and are usually uncontested. IPOs cease on discharge (i.e the life of an IPO is currently three years). The court on an application by the trustee or the bankrupt IPOs can be varied by the court on an application by the trustee or the bankrupt.

The purpose of clauses 248 and 249 of the Bill is to change the arrangements for Income Payments Orders (IPOs) and to introduce Income Payments Agreements (IPAs). This is to ensure that mechanisms are in place to require bankrupts to pay their creditors from income if they are able to do so.

Clause 248 of the Bill inserts new section 310(6) into the IA 1986. This new section ensures that the continuation of an IPO for a term of 3 years from the date of the IPO, irrespective of the fact that the period of bankruptcy is to be reduced by this Bill to just one year (or less) for non-culpable bankrupts. This clause was considered necessary in order to protect the position of creditors.

Assuming the Bill is enacted, paragraph 7 of Schedule 19 sets out the transitional provisions as they relate to IPOs in existence at the time of commencement.

Clause 249 inserts a new section 310A into the IA 1986. In so doing, it removes the need to involve the court in non-contentious cases by introducing Income Payments Agreements (IPAs). IPAs are a new administrative alternative to court-based IPOs. IPAs will provide a legally binding written agreement between the bankrupt and his trustee in bankruptcy (or Official Receiver) that requires the bankrupt (or a third party) to make specified payments to his trustee for a specified period. An IPA will carry the same conditions as IPOs and will be enforced as if it were an IPO made by the court.

Another similarity an IPA shares with an IPO is that it can be varied by the court on an application by the bankrupt, trustee or official receiver. Alternatively, an IPA could be varied simply by agreement between the parties. That said, the court may not vary an IPA

[257] Article 6 is the right to a fair trial and Article 8 is respect for private and family life

to include a provision that could not be included in an IPO. The court must grant a variation of the IPA if it considers it necessary to enable the bankrupt to retain sufficient funds to meet the reasonable domestic needs of the bankrupt and his family.

An IPA must specify the period in which it is to have effect. Under the Bill, an IPA can apply after a bankrupt has been discharged from bankruptcy but cannot extend to a date more than 3 years after the date of the IPA.

e. Individual Voluntary Arrangement: clause 252 and Schedule 22

As previously mentioned, an Individual Voluntary Arrangement (IVAs) is a rescue mechanism built into the IA 1986. It is an alternative to bankruptcy, without the same automatic restrictions, where the debtor comes to an arrangement with his creditors about the repayment of his debts. IVAs generally result in a better return for creditors. However, according to the DTI, very few IVAs are entered into after a bankruptcy order has been made, despite the fact that they allow bankruptcy to be annulled and provide an alternative to IPOs. In this Bill, it is the Government's intention to increase the number of straightforward IVAs.

Under current legislation, a debtor can make a proposal for an IVA.[258] The proposal will also put forward a person to supervise the implementation of that arrangement (known as the nominee) and on approval of the arrangement the nominee becomes the supervisor of the IVA. However, to act as a nominee and supervisor of an IVA, the person is required to be qualified as an insolvency practitioner.

In practice, the debtor will usually send the nominee a copy of the proposal and a statement of his affairs. He can then apply for an interim order that, if granted, would create a moratorium (i.e. a stay) of any actions against him or his property.[259] The nominee reports to the court stating whether a meeting of creditors should be called to consider the proposal. If a meeting is called and the creditors approve the IVA, the interim order can be discharged and any bankruptcy order may be annulled. Modifications can then be made to the proposals if the debtor so consents.

The *Enterprise Bill* includes provisions to allow the Official Receiver to act as the nominee and supervisor in post-bankruptcy IVAs. The Official receiver will have most, if not all, the information needed to draw up a simple IVA proposal. The Official Receiver will act as nominee for a flat fee and the supervisor's fee will be a percentage of realisations.

Clause 252 of the Bill makes two important changes to the current IVA regime:

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[258] Part VIII of the *Insolvency Act 1986*
[259] Sections 252-255 *Insolvency Act 1986*

1. It allows the Official Receiver to act as nominee and supervisor for post bankruptcy IVAs.[260] In effect, this provides debtors and creditors with a choice of who should administer the IVA: either a private sector insolvency practitioner or an Official Receiver. There is also an order-making power to extend the ability for the Official Receiver to act as nominee and supervisor to all cases.[261]

2. Clause 252 introduces a new fast-track scheme for post-bankruptcy IVAs where the Official Receiver is the proposed nominee.[262] Under this regime, the proposal will be agreed with the Official Receiver and filed with the court. No meeting of the creditors will be called and it will not be possible to modify the proposal. The Official Receiver will send out the proposal to all creditors on a 'take it or leave it' basis and the creditors will either agree to or disagree with the proposal by correspondence. If the IVA is approved, the Official Receiver will notify the court and the court can then annul the bankruptcy order. It is proposed that the majority required for approval will remain unchanged. [263]

f. Investigations by the Official Receiver: clause 247

Currently, under section 289 of the IA 1986, the Official Receiver has a statutory duty to investigate the conduct and affairs of every bankrupt and to make any report to the court that he thinks fit. Summary cases (i.e. those cases with unsecured liabilities of less than £20,000) are an exception to this general rule.[264] In addition to the debt threshold of £20,000, the bankrupt must not have been bankrupt or registered a formal agreement with creditors in the preceding 5 years). The Official Receiver will only investigate summary cases if he deems it necessary. This distinction is made on the basis that cases with relatively small unsecured liabilities do not require an extensive use of the Official Receiver's resources as those involving large debts with a greater number of creditors.

However, according to the Insolvency White Paper, this distinction is misleading because there are cases where the bankrupt debts are large (for example, where the liabilities of a limited company are guaranteed) in which no investigation is required. Similarly, there are some small, yet complex, cases that require extensive investigation.

Clause 247 of the Bill inserts a new section 289 into the IA 1986. This new section removes an automatic obligation on the Official Receiver to investigate every case and provides that the Official Receiver is only required to investigate the conduct and affairs of any bankruptcy where he thinks it necessary.

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[260] Paragraph 3 of Schedule 22

[261] Paragraph 3 of Schedule 22 which inserts new section 389 (b) into the *Insolvency Act 1986*

[262] Paragraph 2 of Schedule 22, which inserts a new section 263A-263G into the IA 1986

[263] The provision on majority is set out in Rule 5.18 of the *Insolvency Rules 1986* (SI 1986/1925)

[264] Summary cases are often consumer bankruptcies.

It is intended that under this new regime, all bankrupts will continue to be interviewed and the facts of all cases will be considered. However, the Official Receiver will have greater discretion concerning the degree of investigation required. In giving the Official Receiver this discretion, the intention is that resources will be targeted more efficiently.

g. Modernisation of the financial regime of The Insolvency Service

According to the Insolvency White Paper, there are two fundamental problems with the current financial regime of The Insolvency Service:

> First, the regime comprises numerous fees covering case administration and a Secretary of State Fee, none of which achieves full cost recovery of those activities undertaken by The Insolvency Service.
>
> Second, bankruptcy estate balances invested in the Insolvency Service's Investment Account are set at a low rate, consequently, the amount returned to estates is considerably less than the level of investment income received by the account. This excess income is currently paid into the 'Consolidated Fund' and apparently amounted to some £43 million in the period 2000-01.[265]

In the White Paper, the Government announced its intention to reform the regime to make it simpler, more transparent and fairer to creditors (for example, by returning to insolvent estates those investment returns that currently flow into the Consolidated Fund.)

According to the DTI, the majority of these changes can be achieved by using existing powers and changes to secondary legislation and rules. But there are two specific areas that require primary legislation, and provisions for these are included in the Bill.

First, clause 258(1) inserts a new section 415A into the IA 1986. This new section will enable the Secretary of State to charge a fee to bodies recognised under section 391 of the IA 1986 as a professional body for the purposes of licensing insolvency practitioners (IPs).[266] It is intended that the fees imposed under this new section cover the cost of recognition and also the cost of monitoring the bodies' activities, such as overseeing their procedures and ensuring that licensing is carried out properly. The fee will also cover the cost of more general regulatory functions carried out by The Insolvency Service, such as representation on the Joint Insolvency Council and keeping insolvency practitioners (IPs) informed of developments.[267]

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[265] Explanatory Notes to the *Enterprise Bill*, Bill1115-EN

[266] Authorisation to act as an IP may be granted either by the Secretary of State under Section 392 of the *Insolvency Act 1986* or by a professional body recognised by the Secretary of State under section 391. Bodies currently recognised by the *Insolvency Practitioners (Recognised Professional Bodies) Order 1986* include: The Institute of Chartered Accountants in England & Wales, The Association of Chartered Certified Accountants and The Law Society

[267] The cost of these regulatory functions are currently met by the DTI, but the new policy is that they should fall to the profession

According to the Bill's Explanatory Notes, the fee will be set out in secondary legislation, and will be charged to each body based on the number of IPs licensed by them (i.e. on a head count basis).

Second, new section 415A(2) also provides for a fee to be charged to those IPs licensed by the Secretary of State (rather than an authorised body) under section 392 of the IA 1986. This cost will be based on the cost of monitoring the IP and the general regulatory functions undertaking by The Insolvency Service. The fee for IPs licensed by the Secretary of State will also be set through secondary legislation.

New Section 415(3) provides for payment of fees that relate to the operation of the Insolvency Services Account by The Insolvency Service and money paid into or out of the Account. The intention is for The Insolvency Service to separate out the costs that relate to its operation of the Insolvency Service Account so that these costs are met by insolvent estates.

Under current legislation, section 405 of the IA 1986 requires that any excess in investment income from the Insolvency Service Investment Account after payments to insolvent estates and tax should be paid into the Consolidated Fund. Paragraph 16 of Schedule 8 and Paragraph 21 of schedule 9 of the IA 1986 enables the interest rate for the return of investment income to insolvent estates to be set through secondary legislation. According to the DTI, the current interest rate of 3.5% has applied to companies since before the implementation of the IA 1986.

Clause 259 of the Bill introduces additions to Schedules 8 and 9 to the IA 1986 to allow the interest rate to be set through secondary legislation. The intention is to enable the rate to be reviewed at regular intervals and allow changes in investment returns to the Account to pass through to the insolvent estates without having to make regular amendments through statutory instruments.

Clause 260(1) removes the requirement under section 405 of the IA 1986 for excess income from the Insolvency Services Investment Account to be paid into the Consolidated Fund.

Under current legislation, section 408 of the IA 1986 provides for recourse to the Consolidated Fund where, after payments received from the Investment Account, the Insolvency Service Account has insufficient funds to meet its liabilities. Clause 260(2) replaces the current section 408 with a new section that incorporates the circumstances covered by the current section 408 and section 405 but provides wider powers. These wider powers allow for adjustments to be made between the Insolvency Services Account or the Insolvency Services Investment Account and the Consolidated Fund.

3. Views of the business community

a. Distinction between honest and culpable bankrupts

With regard to the distinction between 'honest' and 'culpable' bankrupts, many organisations have expressed concern as to what is to be the test of honesty. For instance, the British Bankers' Association (BBA) has said:

> The distinction into two classes is only valid if those who are irresponsible or incompetent are included in those who are deemed to be 'culpable'. The tone of both the consultation paper and the White Paper suggests that this is not the Government's view.
>
> Unless drafted appropriately, there could well be a significant rise in the incidence of irresponsible risk-taking, with inevitable problems for individual and small business creditors, who would almost certainly be the hardest hit.
>
> If the issue of incompetence and irresponsibility is not recognised, there is a real likelihood that there will be a significant increase in the number of bankrupts. If the US experience (where a similar regime operates to that envisaged by the White Paper) is extrapolated to the UK population, there could be a ten-fold increase in the numbers of bankrupts.[268]

The law firm, Freshfields Bruckhaus Deringer, has similarly argued that the lack of resources available to official receivers may increase the difficulty of determining honest bankrupts from those 'culpable' for their own failure:

> Currently, the official receiver must investigate the conduct of every bankrupt. If the proposals go ahead, the official receiver will be able to pick and choose which bankrupts to investigate and, invariably, due to a lack of resources within the official receiver's department, some 'culpable' bankrupts will slip through the net. This seems to be confusing two separate points – the criteria for being considered an honest bankrupt and the process by which such determination is made.
>
> In any event, once a bankrupt has been selected for investigation, the test of whether a bankrupt is honest or dishonest will require more work by the official receiver if it is to work properly and fairly. Due to the heavy sanctions of being found a 'culpable' bankrupt, there is greater scope for judicial review of decisions made and challenges under the Human Rights Act by aggrieved bankrupts. It is therefore possible that this will discourage effective enforcement of the distinction between honest and culpable bankrupts.[269]

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[268] British Bankers' Association, *Response of the British Bankers' Association to the Insolvency White Paper: Insolvency – A second chance*, October 2001

[269] Freshfields Bruckhaus Deringer, *Insolvency – a second chance*, November 2001

b. Early discharge from bankruptcy

A number of organisations have responded to the proposal outlined in the White Paper to reduce the period of bankruptcy to a maximum period of 12 months. For instance, the Confederation of British Industry (CBI) said that the changes should help end the needless punishment of failure.[270] The British Chambers of Commerce (BCC) also thought that the proposals struck the right balance between the needs of bankrupts and their creditors. [271]

The Association of Business Recovery Professionals (known as 'R3') supports the bankruptcy proposals but argued that second chances for bankrupts would only be a reality when the issue of post rescue finance is addressed:

> I think we should welcome the reduced social cost of bankruptcy that comes from removing outmoded restrictions. But when it comes to helping a business bankrupt to start-up again having learnt the lessons of failure, the one change that might make a difference is absent: financial institutions and credit reference agencies will not be forced to expunge bankruptcy records from their files. Without this, can an ex-bankrupt realistically expect access to more start-up funds at normal rates? [272]

John McQueen, Chief Executive of the Bankruptcy Association, also made this point:

> One of the main provisions of the earlier consultations that remain in the White Paper is the proposal to bring about earlier discharges for most bankruptcies. The vast majority of bankrupts will get an automatic discharge and release from bankruptcy restrictions after twelve months. People going through a second bankruptcy will be automatically discharged after five years.
>
> These changes are welcome but today they are largely meaningless side issues. In today's credit-driven society it is the long-term effect on a person's credit status that really matters, as there are no legally-defined time-limits on penalising someone based on his credit history. The banks have introduced a system that effectively penalises debtors for life. In the real world, it is on this point that legislation is desperately needed. Even criminal records are at some time classified as 'spent'.[273]

In principle, the BBA supports a reduction in the duration of bankruptcy for honest debtors, but has stressed the need to protect creditors:

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[270] CBI press notice, 31 July 2001
[271] British Chambers of Commerce (BCC) press notice, 31 July 2001
[272] The Association of Business Recovery Professionals (R3), *Recovery*, quarterly journal, September 2001
[273] "Insolvency Law Reform – A Second Chance?", *Small Business Tax & Finance*, September 2001

> In principle, we support reduction in the discharge period for those who become bankrupt through no fault of their own. We take particular comfort from the sub-heading to the paper, a second chance.
>
> Bankruptcy is not a victimless crime. Other individuals and, very often, small businesses, suffer from the failure of a debtor to fulfil their obligations. It is important that the legislation should be written and implemented in a way which protects creditors as far as possible and, in particular, does not create a climate where the stigma of bankruptcy is so removed that debtors seek bankruptcy with impunity. This would run counter to the Government's work on over indebtedness and threatens its overall drive to more responsible borrowing.[274]

In its *Memorandum of Comment,* the Institute of Chartered Accountants in England and Wales (ICAEW) points out that the incidence of bankruptcy arising from consumer debt (as opposed to failed entrepreneurship) is rising. It argues that to reduce the bankruptcy period to twelve months will encourage consumers to embark upon reckless financial behaviour:

> Our overall impression of the proposals on bankruptcy is that they appear too radical. Bankruptcy will become increasingly easy, to the extent that potential bankrupts will have little incentive to come to an agreement with their creditors, or avoid a repeat of their problems. Figures quoted in the White Paper confirm that at present more than half of personal bankruptcies, a proportion that is rising fast, are caused by consumer, not business debts. Entrepreneurial attitudes will not be promoted by encouraging irresponsible consumerism. For these reasons, we do not believe that discharges from bankruptcy should be granted in under twelve months unless in very exceptional circumstances and additional controls should be introduced to ensure that Bankruptcy Restriction Orders (BROs) are imposed wherever needed. [275]

The ICAEW argues that to reduce the period of bankruptcy to a maximum of twelve months for 'honest' bankrupts would increase the number of bankruptcies. As the stigma and disadvantages of bankruptcy are reduced, there will be less incentive for debtors to reach an arrangement with their creditors and so they will be more likely to opt for full bankruptcy. There will be no incentive for a debtor to enter into an Individual Voluntary Arrangement (IVA) either after or instead of bankruptcy.

A link between the duration of bankruptcy and the use of IVAs was also highlighted by the BBA:

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[274] British Bankers' Association, *Response of the British Bankers' Association to the Insolvency Service White Paper: Insolvency – a second chance*, October 2001

[275] Institute of Chartered Accountants in England and Wales, *Memorandum of Comment in response to the White Paper issued by the Insolvency Service of the Department of Trade and Industry in July 2001,* TECH 16/01, October 2001

> In our previous response, we also emphasised the importance of Individual Voluntary Arrangements as a way in which debtors were asked to face their responsibilities to their creditors and seek to pay back whatever they reasonably could. Reduction in the discharge period will almost certainly see the demise of IVAs, other than in cases where debtors wish or need to avoid the negative impact of bankruptcy on their livelihood. This is to be regretted. [276]

R3 has also expressed concern about the future of IVAs and disagrees with the DTI's appraisal of their importance in the insolvency White Paper:

> The Paper hardly mentions individual voluntary arrangements. The government has virtually ignored this successful, no stigma, personal insolvency procedure…
>
> …The government appears to be preparing to damage IVA severely. After all, why should someone work hard over a number of years to repay several times more to their creditors than they need to repay in bankruptcy – especially when they can be out of that bankruptcy in 12 months or less?
>
> There is one perplexing reference to IVAs. It is proposed that the official receiver be able to undertake post-bankruptcy IVAs. Why, we wonder, would anyone want to put themselves into such an arrangement having been declared bankrupt and been discharged within a few months? It seems to be unnecessary pain for no gain.
>
> When it comes to private individuals, the proposals could be genuinely damaging. Hey do nothing to make second chances a reality by removing the financial disabilities of bankruptcy. And they may wreck a procedure, the IVA, which is doing very well for both creditors and debtors.[277]

R3 went on to make its own recommendations for reform:

> But what would make a difference to Britain's rescue culture?
>
> Firstly, we should encourage rescues and reconstructions to take place long before we get to the need to invoke any insolvency procedure. Secondly, we should not regard the statutory framework for business rescue as something that only needs changing every once in a while. A standing committee should be established to ensure rescue rules keep pace with the changes in the nature of the economy. Thirdly, a nettle that must be grasped is post-rescue finance. This subject is, possibly, the most intractable problem in company rescue: it must be addressed again and soon. [278]

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[276] British Bankers' Association, *Response of the British Bankers' Association to the Insolvency White Paper: Insolvency – a second chance*, October 2001

[277] The Association of Business Recovery Professionals (R3), *Recovery*, quarterly journal, September 2001

[278] Ibid.

The ICAEW also predicts that except in exceptional circumstances investigations by the official receiver will be uncommon, as the desires to minimise the stigma on bankrupts, to minimise the costs of the official receiver and to keep matters simple, all conspire to reduce the incidence of investigations. It anticipates that the typical period of bankruptcy will tend to reduce to the minimum period of three months where no obvious fraud has occurred.

As an alternative, the ICAEW suggests that all bankruptcies should last for one year except in special circumstances where an application could be made to the court for an earlier discharge (with the support of the trustee and possibly major creditors). Failing this, the ICAEW recommends that a minimum period of six months before discharge but after the appointment of the trustee should be allowed. The reasoning behind this proposal was outlined in its Memorandum as follows:

> It is our experience that many findings in bankruptcy investigations, as well as the discovery of concealed assets, voidable transactions and other matters in the interests of creditors, are in fact identified by trustees in bankruptcy rather than the official receiver. Trustees must be given sufficient time within reason, to carry out their work before the debtors are discharged as it is notoriously difficult to obtain co-operation afterwards.[279]

The BBA puts the case more strongly by arguing that the discharge period should be a minimum of twelve months in order to avoid the impression of a 'rogues charter':

> Reducing the period of discharge from 3 years to 12 months.
>
> We do not have a problem with this in principle, provided the discharge period is a minimum of 12 months. The White Paper implies that this should be the maximum period for discharge. There is real concern that there would be serious inconsistency across the country, depending both on the efficiency or policies of individual Ors, and on the circumstances of individual cases. This would be unfair. A fixed period is therefore preferable and we would recommend its being fixed at 12 months. This would allow time for the OR to complete investigations and respond to any objections raised by creditors.
>
> There is also a public policy issue, in that whereas the public may find a 12 month discharge period as acceptable, they would almost certainly see an effective discharge period of, say, 3/4 months as little more than a rogues' charter, however deserving an individual case might be.

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[279] Institute of Chartered Accountants in England and Wales, *Memorandum of Comment in response to the White Paper issued by the Insolvency service of the Department of Trade and Industry in July 2001,* TECH 16/01, October 2001

> Removing the stigma to this extent would be counter-productive and lead to many more creditors, predominantly individuals and small businesses, suffering loss. [280]

The law firm, Freshfields Bruckhaus and Deringer, has argued that instead of reducing the bankruptcy period a better approach to encouraging entrepreneurial behaviour would be to promote IVAs:

> Not only does the IVA procedure have little or no stigma attached, but many creditors would receive a far greater percentage of their debt than if the debtor ad gone into bankruptcy. It seems much more sensible for bankrupts to work and pay off their debts, over a period of years, rather than have all their debt written off so they are free to incur fresh debt within less than 12 months from the date on which they were declared bankrupt in the first instance. Reducing the discharge period to less than twelve months does not provide any incentive for individuals to propose IVAs.[281]

c. Removal of statutory restrictions

The removal of unnecessary statutory restrictions on undischarged bankrupts is generally welcomed by a number of organisations. Commenting on this proposal, John McQueen, Chief Executive of the Bankruptcy Association said:

> The white Paper also proposes to remove outmoded restrictions, which mean for example that a bankrupt cannot be a member of the National Patient Safety Agency Care Standards Commission or carry on business as an estate agent, amongst many other ludicrous limitations. This is one of the few proposals that I welcome as it seems to represent a change in attitude. It seems that the Government has at least come to its senses about many of the outright ridiculous notions held about bankrupts that these restrictions represent.[282]

However, the ICAEW does not agree that the restrictions on a bankrupt from managing a company, obtaining credit above a limit, or carrying on business in a different name should be removed. According to the ICAEW, these restrictions provide significant protection for potential future creditors in the period before investigations have been completed.[283]

The BBA acknowledges that in an environment in which attempts are being made to remove the stigma of bankruptcy, it is reasonable that many statutory restrictions on

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[280] British Bankers' Association, *Response of the British Bankers' Association to the Insolvency White Paper: Insolvency – a second chance*, October 2001

[281] Freshfields Bruckhaus Deringer, *Insolvency – a second chance*, November 2001

[282] "Insolvency Law Reform – A Second Chance?", *Small Business Tax & Finance*, September 2001

[283] Institute of Chartered Accountants in England and Wales, *Memorandum of Comment in response to the White Paper issued by the Insolvency service of the Department of Trade and Industry in July 2001,* TECH 16/01, October 2001

bankrupts should be lifted. However, it believes that public interest demand that certain statutory restrictions should remain:

> …we believe the public interest demands that those in a position of public trust or responsibility should continue to be debarred. This would certainly include Members of Parliament and JPs. In the case of those responsible, even collectively, for significant amounts of public funds, such as school governors, it might be acceptable for the appropriate department to issue guidance for inclusion in the constitution of the relevant body.
>
> Those subject to a BRO should continue to be subject to the more significant of the current restrictions, including those relating to positions of trust, such as charitable trustees.[284]

d. Bankruptcy Restriction Order (BRO) regime

The proposal to introduce BROs was generally welcomed by the ICAEW. However, in the absence of a longer period of bankruptcy or other controls, the ICAEW sees the success of BROs in protecting actual and potential creditors as being dependent on the vigorous application of the regime. It argues that in addition to 'culpable neglect' of a business, 'incompetence' and 'negligence' should be additional grounds for the imposition of a BRO. It argues that bankrupts should not be encouraged to repeat business failures where they are not capable of running a business, no matter how well meaning they are.[285]

Deliberate failure to abide by the terms of an Income Payment Order (IPO) or IVA or lack of co-operation in the arrangement of one, should, in the opinion of the ICAEW, also represent grounds for the imposition of a BRO. It argues that the trustee must have a way of requiring the co-operation of the bankrupt in ensuring these arrangements are maintained.[286]

The BBA supports the proposals for BROs, but argues that penalties stemming from the order should be more severe:

> We welcome, in the context of the White Paper reforms, the proposals for BROs. As indicated above, we believe that those who have acted in an irresponsible or incompetent manner should be subject to a BRO. We agree, therefore, with the inclusion of those who incurred a bankruptcy debt without reasonable expectation of being able to pay it. Importantly, we recommend that clear guidance should be

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[284] British Bankers' Association, *Response of the British Bankers' Association to the Insolvency Service White Paper: Insolvency – a second chance*, October 2001

[285] Institute of Chartered Accountants in England and Wales, *Memorandum of Comment in response to the White Paper issued by the Insolvency service of the Department of Trade and Industry in July 2001,* TECH 16/01, October 2001

[286] Ibid.

> given to ORs [official receivers] of the type of conduct which should warrant a BRO, and that a previous bankruptcy should automatically lead to a BRO. We support the sub-title to the White Paper, Insolvency – a second chance. A second chance, yes, but not a third or fourth or more.
>
> We note that the minimum period for a BRO is proposed at 2 years. We see no reason why bankrupts who have demonstrated culpability should be subject to a shorter discharge period than the current period for all bankrupts. We strongly recommend that the minimum discharge period for debtors subject to a BRO should be 3 years.
>
> If somebody who had been automatically discharged subsequently misappropriates funds or abuses their position, they should be subject to an automatic BRO term of at least 5 years.
>
> We also support the intention to extend restrictions to the management of a limited company. We believe that as far as practical this restriction should apply to the management of a business, whether incorporated or unincorporated, and so would recommend that the restriction should be extended at the Secretary of State's or Court's discretion, to other forms of business, such as management of a partnership or limited partnership. [287]

Conversely, John McQueen, Chief Executive of the Bankruptcy Association, thought BROs might act as a deterrent to enterprise:

> There is little of real significance in this White Paper that will encourage entrepreneurs – and this was its claimed intention. If anything, the fear of being caught up in long-lasting 'Bankruptcy Restriction Orders' may act as a deterrent at having a second go in business.
>
> The failure to offer any protection whatsoever for the family home of bankrupts indicates a shallow disregard for the pain and hardship its exclusion will cause to innocent family members of bankrupts. This is the main lost opportunity for real change.[288]

e. Proposal that the Official Receiver should also act as nominee and supervisor

The ICAEW see a number of practical problems with the proposal that the Official Receiver be able to act as nominee and supervisor in post bankruptcy IVAs. For example, will he be under a duty to act regardless of whether the creditors try to impose an uneconomically low fee? If the Official Receiver is to act in respect of complex cases it

[287] British Bankers' Association, *Response of the British Bankers' Association to the Insolvency Service White Paper: Insolvency – a second chance*, October 2001

[288] "Insolvency Law Reform – A Second Chance?", *Small Business Tax & Finance*, September 2001

may be found that his resources are being stretched and diverted from his principal duty of dealing with bankruptcies.[289]

[289] Institute of Chartered Accountants in England and Wales, *Memorandum of Comment in response to the White Paper issued by the Insolvency service of the Department of Trade and Industry in July 2001,* TECH 16/01, October 2001

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