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Introduction

Insolvency law is essential in regulating the economy, ensuring financial stability, and promoting economic growth. It provides a structured legal mechanism for financially distressed businesses to seek relief while balancing the interests of creditors and debtors and ensuring the efficient allocation of economic resources. As the world progresses towards globalisation, harmonising insolvency laws across nations becomes increasingly important. This is particularly significant in the European Union ('EU'), where cross-border commercial activities are common.

The EU Insolvency Directive is a recent legislative initiative that aims to simplify insolvency proceedings across EU member states. It primarily seeks to establish a consistent approach to dealing with cross-border insolvencies, which can be complicated by differing national insolvency laws. Although the Directive represents a shared vision for the EU, its implementation presents unique challenges for each member state, given their distinct legal traditions and heritage. Having left the EU after Brexit, Scotland is now facing a crucial moment. Due to its rich legal heritage and unique insolvency regulations, Scotland's position raises important questions. Among these is the dilemma of how a nation, deeply rooted in its legal principles, can adopt a Directive designed for Europe. Furthermore, contemplation is warranted on the ramifications of such an integration on Scottish enterprises, creditors, and insolvency professionals.

This article thoroughly examines the ramifications of the EU Insolvency Directive on Scottish insolvency laws. By juxtaposing the historical evolution of Scottish insolvency legislation with the tenets of the Directive, the article provides a reflective perspective on the assimilation process. It critically appraises the emergent opportunities and challenges, furnishing invaluable insights for legal practitioners and policymakers.

Historical context of Scottish insolvency law

Scotland's insolvency law, deeply rooted in the nation's unique legal traditions, has evolved over centuries in response to socio-economic transformations. While many global jurisdictions primarily emphasise creditor protection, Scotland has consistently sought a balanced approach, catering to both creditor protection and debtor rehabilitation.[1]

The origins of insolvency law in Scotland can be traced back to the early 17th century with the Bankruptcy Act of 1621, pivotal in establishing collective debt recovery principles. This legislation primarily aimed to protect creditor interests.[2] The 19th century, influenced by the industrial revolution and increasing cross-border trade, acknowledged the need for structured insolvency procedures. The Bankruptcy (Scotland) Act 1856 introduced sequestration, allowing creditors to realise assets of insolvent debtors.

A watershed moment in the historical trajectory of Scottish insolvency law was the enactment of the Insolvency Act 1986. This Act consolidated various insolvency regulations and distinguished between corporate and personal insolvency, proposing tailored solutions for each. Furthermore, it amplified the significance of debtor rehabilitation. The subsequent Insolvency (Scotland) (Company Voluntary Arrangements and Administration) Rules 2018 and the Insolvency (Scotland) (Receivership and Winding Up) Rules 2018, as influenced by devolution, further refined the procedural architecture for liquidations in Scotland. The proceedings cover voluntary liquidation, either by solvent company members (members' voluntary liquidation) or without a solvency declaration for creditor interests (creditors' voluntary liquidation), and compulsory liquidation, instigated through judicial channels for reasons like a company's inability to meet its debts.

Upon winding-up commencement, a liquidator oversees the dissolution, responsible for tasks such as asset collection, debt settlement, and surplus distribution to company members. In Scotland, unlike in England and Wales, there is no official receiver; instead, private insolvency practitioners must agree to participate in any corporate insolvency. This distinction means Scotland lacks a default liquidator, but it also avoids paying a portion of the realised assets to an official receiver.

Unique to Scottish insolvency law is the appointment of an interim liquidator, guiding the early winding-up stages, and the distinct walling of petitions for compulsory winding up, notifying banks and creditors through a primary order. Moreover, Scottish insolvency law designates an essential role to the trustee, central in managing the insolvent estate, ensuring asset distribution to creditors and supervising the debtor's discharge process. An interesting facet is the protected trust deed, akin to the individual voluntary arrangement in England but with notable differences. This voluntary agreement lets debtors transfer assets to a trustee for creditor benefit.

On the personal insolvency front, Scotland governs through the Bankruptcy (Scotland) Act 2016, introducing distinct terminologies and procedures. For instance, bankruptcy is referred to as sequestration. The Accountant in Bankruptcy ('AiB'), an executive agency of the Scottish Government, plays a supervisory role in personal insolvencies. Debtors can apply for self-sequestration with the AiB, but creditor applications necessitate court involvement.

Post-Brexit, Scotland faces a critical juncture. The EU's drive for insolvency regulation uniformity presents both challenges and opportunities. The EU Insolvency Directive, striving for cohesion among member states, could impact Scotland's insolvency practices, even though it is no longer an EU member. The impending challenge involves a careful balance between adhering to evolving European insolvency standards and safeguarding its esteemed legal traditions. In this context, the rich history and distinct characteristics of Scottish insolvency law gain prominence, particularly as it navigates its post-Brexit trajectory.

The EU Insolvency Directive

The EU, over the decades, has been steadfast in its commitment to creating a single market where goods, services, capital, and labour move freely across member states. Such integration, while beneficial, also presents challenges, especially when businesses operating across borders face financial difficulties. Recognising the need for a coordinated approach to cross-border insolvencies, the EU introduced the Insolvency Directive on 7 December 2022.[3]

The directive introduces six key proposals, each targeting a specific aspect of insolvency law. The first proposal sets regulations for avoidance actions during insolvency. These actions allow companies to recover assets lost in transactions that are undervalued, intentionally harmful, fraudulent, or demonstrate creditor preference. The proposal suggests varying hardening periods, ranging from three months to four years, based on the action's nature and intent. In some jurisdictions, like France, this could extend existing lookback periods, introducing potential legal complexities.

The second proposal focuses on strengthening asset tracing. It authorises insolvency practitioners to access beneficial ownership data and allows insolvency courts to obtain bank account information. This enhancement in international asset tracing and recovery is vital for insolvency practitioners, who bear personal liability for the insolvent estate and depend on an indemnity from these assets. Access to this information is crucial, especially when the insolvent estate is insufficient.

The directive also introduces a new framework for pre-pack proceedings. This involves negotiating the sale of a debtor's business before starting insolvency proceedings and executing the sale soon after these proceedings commence. This process is essential for trustees to understand, as it influences their responsibilities and strategies during insolvency proceedings.

A notable change requires company directors to initiate insolvency proceedings within three months of recognising the company's insolvency. Insolvency can be determined through a balance sheet test (where liabilities exceed assets) or a cash flow test (inability to pay debts as they become due). This change is particularly significant for trust-held companies with substantial soft borrowings that cannot be repaid, as directors could face personal liability for non-compliance.

The final two proposals involve simplifying winding-up proceedings for micro-enterprises and establishing creditors' committees. The latter aims to enhance transparency and provide a structured forum for creditors to voice their concerns and interests.

Implications for Scotland

The EU Insolvency Directive, with its comprehensive objectives and clauses, holds significant implications, not only for EU member states but also for regions like Scotland that have exited the EU. Despite Brexit, Scotland's legal traditions in insolvency, developed over centuries alongside socio-economic shifts, necessitate that Scottish legal stakeholders stay informed about the Directive's developments.

Scottish insolvency law, historically aimed at balancing creditor rights and debtor rehabilitation, highlights the need to comprehend the Directive's impact. This balance presents both potential challenges and opportunities for Scotland. For

example, while the Directive's emphasis on mutual recognition of insolvency procedures among member states might not directly affect Scotland post-Brexit, it remains crucial for the Scottish judiciary and legal professionals to stay abreast of insolvency judgments from EU territories. This awareness ensures consistency and uniformity in legal approaches.

In light of the Directive's focus on subsidiary proceedings, Scotland may consider mechanisms to address cases where the main proceedings are in an EU country. The connection between Scottish legal traditions and the Directive provides a unique perspective, enhancing both creditor protection and debtor rehabilitation.

The nexus between Scottish legal paradigms and the Directive offers a distinct perspective, reinforcing both creditor safeguards and debtor recovery. Even though the Directive's aspirations of standardisation and affording debtors a fresh start align with Scottish legal ethos, potential incongruities could emerge. For example, the trustee's central function in Scottish insolvency law, especially concerning the administration of the insolvent estate and overseeing the debtor's discharge process, might require adaptations to be in sync with the Directive's mandates. The protected trust deeds ('PTDs') in Scotland, mechanisms facilitating asset transfer from debtors to trustees for creditor benefit, might need re-examination vis-à-vis the Directive.[4] Balancing compliance with the Directive while upholding PTDs' core principles will be intricate. Furthermore, the Directive's emphasis on transparency and advocating a consolidated electronic registry might prompt a reconsideration of specific Scottish customs, like the 'walling' of petitions for mandatory dissolution.

To understand the impact of the EU Insolvency Directive, envision two hypothetical scenarios.

In the first scenario, a Scottish retail conglomerate with extensive operations across the EU faces insolvency. Traditionally, such a company would initiate insolvency proceedings in Scotland. However, under the new EU Insolvency Directive, these proceedings might instead take place in another EU member state where the company has substantial business activities. This change, influenced by the Directive's focus on the debtor's main interests and streamlined cross-border insolvency processes, introduces significant challenges for Scottish creditors. They might have to contend with different legal systems and varied hardening periods for avoidance actions across EU states, affecting asset recovery and their rights as creditors.

The second scenario involves a European manufacturing company with significant operations in Scotland becoming insolvent. Under the Directive, the primary insolvency proceedings would likely begin in the company's home EU country, but auxiliary proceedings could also be initiated in Scotland to manage its local assets. These subsidiary proceedings, in line with the Directive's emphasis on enhanced asset tracing and recovery, would necessitate Scottish insolvency practitioners accessing ownership data and bank information to effectively trace and reclaim assets. Furthermore, the Directive imposes a requirement on company directors to promptly initiate insolvency proceedings, either through a balance sheet or a cash flow test. A delay in this initiation by the company's directors could notably influence the course of the insolvency proceedings.

The EU Insolvency Directive poses distinct challenges for Scotland in the post-Brexit context but also offers an opportunity for introspection and evolution in its insolvency jurisprudence. Integrating Scotland's esteemed legal traditions with the evolving European standards will undoubtedly shape the future of insolvency practices in Scotland.

Challenges and opportunities

While Scotland has exited the EU in the wake of Brexit, the potential incorporation of the EU Directive into the broader European legal framework carries significant ramifications for Scotland. Given Scotland's attentiveness to European benchmarks, it is poised to scrutinise and possibly refine aspects of its insolvency practices in reflection of the Directive.

For Scottish legal practitioners, the Directive poses several considerations. A primary concern is the need to be well-versed in both domestic insolvency laws and the stipulations of the Directive, particularly for cross-border issues. This dual familiarity may lead to challenges, especially when there are disparities between local laws and the principles of the Directive. Additionally, the Directive's focus on cross-border insolvencies suggests that Scottish professionals might occasionally handle insolvency cases spanning multiple jurisdictions. This requires navigating through various legal systems, particularly in ancillary proceedings.

The Directive's provisions could also determine where key insolvency proceedings for Scottish businesses take place, sometimes outside Scotland, impacting domestic creditors and the involvement of Scottish courts in these proceedings. Moreover, professionals with frequent dealings in Europe must remain updated on evolving European insolvency practices, necessitating ongoing professional development, especially for those accustomed to the traditional Scottish approach.

However, analysing the Directive also reveals significant insights for Scotland. Its emphasis on harmonization and consistency among member states offers a certain level of protection for creditors' rights. Scottish creditors working with EU-based firms

may find more predictability due to the Directive's regulations. By aligning certain aspects of its insolvency framework with the Directive, Scotland could enhance its attractiveness as a business destination. The clarity provided by the Directive could increase investor confidence in Scotland. Moreover, the Directive's support for giving insolvent debtors a second chance resonates with Scottish values, potentially encouraging entrepreneurship and innovation. Additionally, the Directive fosters collaboration among insolvency practitioners across the EU, offering opportunities for Scottish professionals to engage in knowledge exchange and best practice sharing.

Conclusion

In conclusion, with its comprehensive framework and harmonisation agenda, the EU Insolvency Directive presents a pivotal moment for Scottish insolvency law. As Scotland navigates its post-Brexit landscape, the Directive's influence, although indirect, cannot be understated. The challenges and opportunities emerging from this new legislative environment call for a nuanced understanding and strategic adaptation by Scottish legal practitioners and stakeholders.

The Directive's emphasis on consistency and streamlined cross-border insolvency proceedings poses significant implications for Scotland's historically distinct insolvency framework. The need for Scottish legal professionals to stay abreast of both domestic laws and the Directive's stipulations, particularly regarding cross-border insolvencies, is more pressing than ever. This dual awareness may lead to complexities, given the potential disparities between Scottish insolvency laws and the principles espoused by the Directive. Furthermore, Scottish businesses and their creditors may find themselves navigating unfamiliar legal terrains as insolvency proceedings could take place outside Scotland under the Directive's guidelines.

However, these challenges are accompanied by unique opportunities. The Directive's focus on creditor rights protection and debtor rehabilitation aligns well with Scotland's balanced approach to insolvency. By closely examining and potentially integrating certain aspects of the Directive, Scotland could enhance the predictability and fairness of its insolvency processes, thereby bolstering its attractiveness as a business and investment hub. The Directive also opens avenues for Scottish insolvency practitioners to participate in broader European discussions, fostering knowledge exchange and collaboration. This could lead to the development of best practices that are beneficial both within and beyond Scotland.

Ultimately, the EU Insolvency Directive serves as a catalyst for Scotland to reassess and potentially refine its insolvency laws. This period of introspection and adaptation is crucial for ensuring that Scotland's esteemed legal traditions coexist with, and are enriched by, contemporary European insolvency standards. As Scottish insolvency law evolves in this new era, it is incumbent upon legal professionals, policymakers, and stakeholders to strike a delicate balance: preserving the unique aspects of Scottish law while embracing the constructive aspects of European harmonisation. This balance will not only uphold Scotland's legal heritage but also ensure its robust participation in the dynamic landscape of European insolvency law.

Footnotes

1 Donna McKenzie Skene, 'Plus Ça Change, Plus C'est La Même Chose? The Reform of Bankruptcy Law in Scotland' (2015) 3 (15) Nottingham Insolvency and Business Law e-Journal 292–293.

2 Ibid 287–288.

3 European Commission, 'Proposal for a Directive of the European Parliament and of the Council on harmonising certain aspects of insolvency law' (COM (2022) 702 final, 7 December 2022). For the discussion of the challenges and progress of harmonizing insolvency law in the EU, particularly in light of the COVID-19 pandemic, see Emilie Ghio, Gert-Jan Boon, David Ehmke, Jennifer Gant, Line Langkjaer, and Eugenio Vaccari, 'Harmonising insolvency law in the EU: New thoughts on old ideas in the wake of the COVID-19 pandemic' (2021) 30 (3) International Insolvency Review 427.

4 For more discussion regarding the implications of the EU Directive for trustees, see Charles Ho Wang Mak, 'Trusts Across Borders: Steering through the European Union's Insolvency Directive and Its Implications for Trustees' (2023) 38 (10) Journal of International Banking Law and Regulation 387.