

# Scottish Law Commission

(SCOT. LAW COM. No. 68)

## REPORT ON BANKRUPTCY AND RELATED ASPECTS OF INSOLVENCY AND LIQUIDATION

*Laid before Parliament  
by the Lord Advocate  
under section 3(2) of the Law Commissions Act 1965*

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The Scottish Law Commission was set up by section 2 of the Law Commissions Act 1965 for the purpose of promoting the reform of the law of Scotland. The Commissioners are:

The Honourable Lord Hunter, V.R.D., *Chairman*<sup>1</sup>

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## SCOTTISH LAW COMMISSION

(Scot. Law. Com. No. 68)

### REPORT ON BANKRUPTCY

AND

### RELATED ASPECTS OF INSOLVENCY

AND LIQUIDATION

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## CORRECTION

**Page 3: line 4: "indication" should read "liquidation".**

**Page 11: line 4: insert "to" before "those"**

**Page 78: line 1: insert "of" after "power"**

**Page 302: line 18: "to" after "awarded" should read "at"**

**Page 484: 3rd last line: "state" should read "date"**

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<sup>1</sup>Lord Hunter's term of office expires on 30 September 1981; his successor as Chairman of the Commission is the Hon. Lord Maxwell.

**SCOTTISH LAW COMMISSION**

*Item 6 of the Second Programme*

**REPORT ON BANKRUPTCY  
AND  
RELATED ASPECTS OF INSOLVENCY  
AND LIQUIDATION**

To: The Right Honourable the Lord Mackay of Clashfern, Q.C.,  
*Her Majesty's Advocate.*

We have the honour to submit our Report on Bankruptcy and related aspects of Insolvency and Liquidation.

(Signed) J. O. M. HUNTER, *Chairman*  
A. E. ANTON  
R. D. D. BERTRAM  
E. M. CLIVE  
JOHN MURRAY

R. EADIE, *Secretary*  
*11 August 1981*



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## TABLE OF ABBREVIATIONS

### *Statutes*

- 1621 Act The Bankruptcy Act 1621, cited in 12mo. edition as 1621, c. 18.  
1696 Act The Bankruptcy Act 1696, cited in 12mo. edition as 1696, c. 5.  
1839 Act The Bankruptcy (Scotland) Act 1839, c. 41.  
1856 Act The Bankruptcy (Scotland) Act 1856, c. 79.  
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# SCOTTISH LAW COMMISSION

## REPORT ON BANKRUPTCY AND RELATED ASPECTS OF INSOLVENCY AND LIQUIDATION

### CHAPTER 1

#### INTRODUCTION

1.1 "Insolvency, Bankruptcy and Liquidation" constitutes Item No. 6 of our Second Programme of Law Reform and was included in that Programme in response to representations concerning a variety of anomalies and defects in the present law. Following the approval of the Programme by Ministers, the Commission in November 1968 set up a Working Party under the chairmanship of Lord Kilbrandon to examine the subject.<sup>1</sup>

1.2 Our Working Party, in response to public invitations for comments on this branch of the law, received many helpful submissions, including Memoranda from the Institute of Chartered Accountants in Scotland and from the Law Society of Scotland. On the basis of these submissions the Working Party prepared and presented to us a valuable Report. We are indebted to the members of the Working Party for their contribution to the examination of Scots bankruptcy law.

1.3 We published the Working Party's Report in November 1971 as No. 16 in our series of Memoranda and invited comments on the Working Party's proposals. We received many useful comments on these proposals and our examination of them revealed that, to meet the more serious criticisms of the present law and at the same time to fulfil our duties systematically to develop, simplify and modernise the law, more radical changes were required than had been envisaged by the Working Party.

1.4 We noted that the system of summary sequestration, introduced by the 1913 Act, had largely proved a failure, and it seemed necessary to consider whether some other procedure could be devised to deal inexpensively with small assets cases. Apart from introducing summary sequestration, the Bankruptcy (Scotland) Act 1913 had done little more than re-enact the provisions of legislation devised in the early part of the nineteenth century. We felt bound to consider whether a substantive and procedural law developed in the light of the social and economic background of that period was suitable for the needs of the present time. Though the main framework of ordinary sequestration procedure appeared to have stood the test of time remarkably well, its detailed provisions called for

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<sup>1</sup>The members of this Working Party are listed in Appendix 1 to this Report.

reconsideration. There seemed to be an exaggerated emphasis on formal steps and judicial procedures which add considerably to the expense of sequestrations. Some of the provisions of the 1913 Act seemed out of keeping with current social attitudes and with the development of the law in other fields. The language, too, in which its provisions were expressed was often archaic and sometimes even misleading.

1.5 The importance of bankruptcy law during the economic difficulties of the 1970s led to its examination in other countries, and we considered reports issued by bodies concerned with the reform of that law elsewhere, notably in Canada,<sup>2</sup> the United States<sup>3</sup> and Ireland.<sup>4</sup> We also had regard to recent bankruptcy legislation in Australia<sup>5</sup> and New Zealand.<sup>6</sup> We noted that in these countries a state official was concerned in the administration of at least the earlier stages of bankruptcy law, an official with duties similar to those of the "Official Receiver" in English bankruptcy procedure. It was strongly represented to us by the Insolvency Department of the Department of Trade and Industry<sup>7</sup> that a similar system should be adopted in Scotland. Our Working Party, moreover, had criticised the existing system of voluntary trust deeds for creditors in Scotland and recommended that "the existing method of voluntary trust deeds by private arrangement should be replaced by a system of voluntary bankruptcy initiated at the instance of the insolvent party".<sup>8</sup> It seemed to us that further consideration of this far-reaching proposal was required. To obtain further advice, therefore, on both issues we circulated a Consultation Paper to the persons and representative bodies most directly concerned, including the Law Society of Scotland and the Institute of Chartered Accountants in Scotland. We are grateful to them for their advice.

1.6 It was approximately at this stage in our examination of the law that a Committee was appointed by the Department of Trade under the chairmanship of Sir Kenneth Cork *inter alia*:

"to review the law and practice relating to insolvency, bankruptcy, liquidation and receiverships in England and Wales and to consider what reforms are necessary or desirable."<sup>9</sup>

Professor R. B. Jack, then a member of this Commission, was given the status of an observer to that Committee and we have kept in touch with its

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<sup>2</sup>Report of the Study Committee on Bankruptcy and Insolvency Legislation (Ottawa, 1970): the Tassé Report.

<sup>3</sup>Report of the Commission on the Bankruptcy Laws of the United States, H.R. Doc. No. 93-137, 93rd Cong., 1st Sess. Parts I & II.

<sup>4</sup>Report of the Bankruptcy Law Committee (Dublin, 1973): the Budd Report.

<sup>5</sup>The (Australian) Bankruptcy Act 1966. We have referred to E. J. Hayek, *Principles of Bankruptcy Law in Australia*, 2nd ed. (Queensland, 1967).

<sup>6</sup>The (New Zealand) Insolvency Act 1967. We have referred to Spratt and McKenzie, *Law of Insolvency*, 2nd ed. (Wellington, 1972).

<sup>7</sup>As it then was styled.

<sup>8</sup>Memo. No. 16, para. 38.

<sup>9</sup>See H.C. Deb., (25 October 1976), Vol. 918, Written Answers, col. 20.

deliberations.<sup>10</sup> It seemed to us, following the appointment of this Committee, that it would be inappropriate for this Commission to examine for the present the administrative and procedural structure of the law relating to the indication of companies. The relevant legislation is to be found in the Companies Act 1948, a statute common to the legal systems of England and Wales and of Scotland and, though the Scottish rules are in certain respects materially different from those in England and Wales, it seemed right to await the publication of the views of the Cork Committee on that aspect of their remit before reaching concluded views on this subject. There are, however, certain areas in which substantially the same rules ought to apply in sequestrations and liquidations. This is at present recognised in the 1948 Act which at various points applies the rules of the 1913 Act to issues arising in the course of liquidations.<sup>11</sup> We have, therefore, wherever appropriate, considered the implications of our proposals for the law relating to the liquidation of companies. To that extent, we are making recommendations entailing the amendment of the law relating to the liquidation of companies in Scotland.

1.7 We are grateful to the many organisations and individuals who have assisted us with their expert advice and assistance. We have benefited from consultations with the Accountant of Court and members of his staff. We have received helpful guidance from many members of the legal profession including Mr. David G. Antonio, Mr. I. F. Fletcher, Dr. Enid Marshall, the Hon. Lord Maxwell and Mr. R. M. Williamson. We have constantly benefited also from the knowledge and practical experience of Mr. P. H. Armour, C.A. and Mr. D. G. Slidders, C.A. and, not least, of Professor J. M. Halliday, C.B.E., LL.D. To all we express our deep sense of obligation.

1.8. The large number of proposals which we make for changes in the law on matters both of principle and of detail, has made it impracticable to follow our usual course of signalling our recommendations typographically in the text of the Report and of listing them. Instead, after considering the principal issues of policy in Chapter 2, we set out a convenient summary of our principal conclusions and recommendations in Chapter 3. We hope that this summary will enable readers to familiarise themselves quickly with the scheme which we envisage. For their further assistance we have prepared a summary chart or time-table of the principal steps in the proposed new sequestration procedure. This forms Appendix 5 to this Report. Our recommendations in detail are embodied in the draft Bill which, with notes on clauses, is annexed as Appendix 6.

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<sup>10</sup>We have considered its Interim Report published in July 1980, Cmnd. 7968 (1980) in the light of the Green Paper published at the same time by the Department of Trade, Cmnd. 7967 (1980).

<sup>11</sup>*E.g.* 1948 Act, s. 245(5) (general powers), s. 318 (provisions relating to voting and ranking, calculating of majorities, and interruption of prescription), s. 320 (fraudulent preferences), and s. 344 (unclaimed dividends).

## CHAPTER 2

### PRINCIPAL QUESTIONS OF POLICY

#### Earlier proposals for reform

2.1 A major problem confronting the Commission in its review of the present bankruptcy law of Scotland has been the fact that many of its detailed provisions reflect the social and legal preoccupations of a bygone age. The framework of the present procedure for sequestration was set out almost a century and a half ago in the Bankruptcy (Scotland) Act 1839. Many of the provisions of the 1839 Act were carried over into the Bankruptcy (Scotland) Act 1856 which remains, apart from certain amendments, the basis of the present law.

2.2 While it was generally agreed that the 1856 Act had worked well,<sup>1</sup> certain features of it attracted criticism as long ago as the 1880s. There were some who argued that its structure was unsatisfactory. It was said that many trustees took a perfunctory view of their duty to the public to report on the conduct of the debtor "with the result that in many cases the report was little better than an empty formality".<sup>2</sup> There was a need, Wallace argued, for introducing into our procedure a public officer modelled upon the Official Receiver in English bankruptcy procedure with a duty to report on whether the bankruptcy had arisen from innocent misfortune or from culpable conduct. There were others who criticised private trust deeds for creditors on the ground that the absence of any requirement to advertise them excluded the public from knowledge of the debtor's financial position.<sup>3</sup> It was said that under private trust deeds the trustee might be the mere nominee of the debtor, that the trustee lacked effective power to control the bankrupt, and that fraudulent debtors were rarely prosecuted.

2.3 Further discussion of the reform of the law of bankruptcy culminated in the introduction in the House of Commons on 4th July 1907 of a Bill to reform the law. Notably, it proposed the introduction of a system of summary sequestration, and the regulation of private trust deeds by their inclusion within the system of sequestration. The Bill failed, but a Departmental Committee under the chairmanship of Lord Cullen was appointed on 15 October 1908 by the Secretary for Scotland to inquire into:

"the laws ... in relation to bankruptcy, compositions and arrangements by insolvent debtors with their creditors, and the prevention and punishment of frauds by debtors on their creditors."

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<sup>1</sup>See "Procedure in Bankruptcy in England and Scotland" 9 *Journal of Jurisprudence* (1865), 3, para. 1. A similar view was expressed by Lord President Inglis in *Phosphate Sewage Co. v. Molleson* (1874) 1 R. 840 at 846.

<sup>2</sup>See Wallace, 23 S.L.R. (1907), 248, 284, 311 and 344.

<sup>3</sup>See Anon, 2 S.L.R. (1886), 145; "The New Bankruptcy Consolidation Bill" 6 S.L.R. (1890), 151 and 172; Anon, 7 S.L.R. (1891), 325 and 360 and W.W., 23 S.L.R. (1907), 213 and 311.

2.4 For those who had been hoping for a fundamental review of the Scots law of bankruptcy, the Cullen Report<sup>4</sup> must have been disappointing. It did propose the introduction of a system of summary sequestration but otherwise its proposals were extremely cautious. In relation to private trust deeds, it examined suggestions *inter alia* for their compulsory registration, for a meeting of creditors to decide upon their adoption, for compelling the minority to accede, for the application of the ordinary statutory rules as to ranking, for the examination of the debtor, and for his discharge. The Committee rejected these proposals on the view that there were advantages in the current unregulated trust deeds which caused them to be utilised three or four times as frequently as formal sequestrations:

“The absence of any fixed machinery imparts a freedom and elasticity to the administration which is conducive to speed in the distribution and also permits of many estates being handled in a way more advantageous to the creditors’ interests than would be practicable under a sequestration. There is, further, the element of comparative privacy which creditors are usually willing to concede to an honest debtor, and which, in many cases, aids materially in the beneficial realisation of the estate.”<sup>5</sup>

2.5 In relation to ordinary sequestration procedure the Committee rejected proposals for the introduction of Official Receivers on the English model into Scots law. Those witnesses who had practical experience of the English system argued that the Scottish one was much to be preferred for reasons of expedition and economy.<sup>6</sup> The Committee concluded:

“It is an outstanding feature of the sequestration system that the intrusion of the official element is minimised as far as possible. Statutory provision is made for checking misconduct on the part of trustees or commissioners, but the ingathering, realisation, and distribution of the bankrupt estate is performed by the trustee with the assistance of the commissioners, and subject, generally, to the control of the creditors. This freedom from official machinery is a valuable feature of the system, and is conducive to expedition and economy.”<sup>7</sup>

The Cullen Committee confined itself, therefore, to making a few recommendations for improvements in detail. Apart from this, the Committee proposed that the provisions of the 1856 Act and subsequent legislation relating to bankruptcy in Scotland should be consolidated in a new statute.

2.6 The Cullen Committee’s recommendations were accepted by the Secretary for Scotland. In 1913 a Bill based largely<sup>8</sup> on its recommendations was introduced as the Bankruptcy (Scotland) Consolidation Bill. It was certified by the Speaker as relating to Scotland only and, piloted by the Lord

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<sup>4</sup>Cd. 5201 (1910).

<sup>5</sup>Para. 58.

<sup>6</sup>See *inter alia* the discussion reported in paras. 2927–29 and 4927–4931 of the evidence.

<sup>7</sup>Para. 6.

<sup>8</sup>Some changes were made, including modifications to the rules relating to the constitution of notour bankruptcy, and to the preference for wages and an entirely new rule in s. 102 relating to the sale of copyright interests.

Advocate through the Standing Committee on Scottish Bills,<sup>9</sup> it emerged as the Bankruptcy (Scotland) Act 1913. There was some criticism of this Act, but it was stilled by the outbreak of the First World War. Since 1913, only minor alterations have been made to the law.<sup>10</sup>

2.7 Though the Cullen Committee tackled the problem of small assets cases by proposing a system of summary sequestration and examined and rejected the proposals to introduce Official Receivers into Scots law and to regulate private trust deeds for creditors, its Report cannot be said to have reviewed in a systematic way the policies of Scottish bankruptcy law. Indeed, there has been no thorough examination of that law since the work of Commissioners (under the chairmanship of Professor G. J. Bell) appointed in 1833 with a view to reform the law of Scotland, whose reports on sequestration resulted in the passing of the 1839 Act.<sup>11</sup> This Commission, therefore, would not be carrying out its duties under section 3(1) of the Law Commissions Act 1965 if it failed to re-appraise in the light of present business needs and social attitudes the policies of bankruptcy law and the administrative structure required to give effect to those policies.

### Current issues

2.8 The sequestration of an insolvent debtor's estate is one of a number of possible solutions to the problem of securing the orderly payment of debts. Sequestration is primarily a coercive procedure initiated by a creditor by which the assets of a debtor who fails or refuses to pay his debts are made available to his creditors towards the satisfaction of their debts. The debtor, however, may petition the court for the sequestration of his own estate with the object of obtaining in due course a general discharge of his debts, a privilege not granted to debtors in several European legal systems unless they have paid their debts in full. It may be argued, however, that the primary purpose of sequestration is to secure the orderly transfer of the assets of an insolvent debtor—and in principle the whole of those assets—to his creditors generally. It is this transfer of assets for the benefit of creditors *generally* that distinguishes sequestration from other coercive measures for securing the payment of debts in Scots law, notably the ordinary diligences of arrestment and poinding. Sequestration is a coercive process, in relation both to the debtor and to his creditors, since, once the award of sequestration has been made, the transfer of the assets and their distribution take place irrespective of the wishes of the debtor and his creditors.<sup>12</sup>

2.9 It is, again, this element of coercion which distinguishes sequestration from other arrangements available in Scotland for the distribution of the

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<sup>9</sup>H.C. Deb., ser. 5 (1913), Vol. 51, col. 583; Vol. 55, col. 1849; and Vol. 56, col. 1177.

<sup>10</sup>Examples can be found in the following enactments: Married Women's Property (Scotland) Act 1920 (c. 64), s. 5; Conveyancing (Scotland) Act 1924 (c. 27), s. 44 (4); Moneylenders Act 1927 (c. 21), ss. 9, 18; Third Parties (Rights against Insurers) Act 1930 (c. 25); Prescription and Limitation (Scotland) Act 1973 (c. 52), s. 9; Insolvency Act 1976 (c. 60), ss. 1, 5, Sched. 1; Law Reform (Miscellaneous Provisions) (Scotland) Act 1980 (c. 55), s. 12.

<sup>11</sup>G. J. Bell, *Commentaries on Recent Statutes* (Edinburgh, 1840), pp. 38–41.

<sup>12</sup>See Max Radin, "The Nature of Bankruptcy" 89 *Univ. of Pennsylvania Law Review* (1940), 1.

estates of insolvent debtors, notably private composition contracts<sup>13</sup> and private trust deeds for creditors. These are in essence voluntary systems. The position is different under English law. In the Cork Interim Report it is stated that:

“There is no procedure for the insolvent debtor to adopt equivalent to the voluntary liquidation machinery which is available to an insolvent company and its creditors and in which, judging by the extent to which it is used, there appears to be general public confidence.”<sup>14</sup>

### *Non-coercive systems*

2.10 The private composition contract is essentially an agreement between the debtor and his creditors by which the latter agree to forego further diligence and to discharge their debts in consideration of the debtor paying, usually by instalments, an agreed proportion thereof. A private composition contract, as Lord Gifford stressed in *Miller v. Downie*,<sup>15</sup> is adapted essentially to the rehabilitation of the trading debtor, and the principle is that the debtor should not be divested of his whole estate but carry on his business under the supervision of his creditors. Recourse to composition contracts is infrequent today. Creditors may not be interested in a system in which the bankrupt's estate remains under his control and which does not prevent non-acceding creditors from doing separate diligence to recover their debts. Despite the rarity of recourse to composition contracts, we are advised that in appropriate cases they may be extremely useful. Non-acceding creditors are well protected, because the estate remains vested in the debtor. It would, in our view, be an unwarranted interference with freedom of contract to ban recourse to them or even to regulate in detail their operation. We make no recommendations, therefore, for statutory intervention in relation to private composition contracts.

2.11 In the voluntary trust deed for creditors, as distinct from the composition contract, there is a conveyance by the debtor to the trustee of his assets, usually all his assets, for the benefit of his creditors as a whole. Since there is this conveyance, it will effectively preclude diligence by an individual creditor, but only after the trustee completes his title to the estate. While no accurate statistics are available to indicate the extent of their use, we understand that recourse to voluntary trust deeds may be more frequent than recourse to sequestration. Though, as we point out in Chapter 24, certain disadvantages attach to trust deeds (notably the fact that under the present law they bind only acceding creditors), their simplicity, informality and flexibility make them useful instruments for both creditors and debtors. They achieve the main objects of a sequestration largely without the involvement of the courts or expense to the State. We agree with the conclusion of the Cullen Committee that the statutory regulation of the administration of an insolvent estate under a trust deed would deprive the

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<sup>13</sup>They are occasionally referred to as “extra-judicial composition contracts”.

<sup>14</sup>p. 4, para. 7.

<sup>15</sup>(1876) 3 R. 548 at 553.

system of its main advantages.<sup>16</sup> Accordingly, we propose to reduce to a minimum mandatory rules regulating the operation of trust deeds. We envisage rather that, where a trust deed fulfils certain straightforward conditions designed to protect creditors, it should enjoy a measure of protection against being superseded by sequestration and that the trustee should be empowered, whether or not representing prior creditors, to challenge gratuitous alienations and unfair preferences.<sup>17</sup> He should also be empowered to apply the rules for the equalisation of diligence applicable where the debtor's estate has been sequestrated.<sup>18</sup>

2.12 We have made in Memorandum No. 50 detailed proposals for the introduction into Scots law of a new procedure enabling insolvent wage-earners with multiple debts to ask the court to confirm a scheme (called a "debt arrangement scheme") for the orderly and regular payment of their debts out of their future earnings or other income. Sequestration is often an inappropriate procedure for resolving the indebtedness of such persons because they may not have assets which justify its application. The resale value of such assets as they may possess is likely to be a fraction of their use-value to the debtor and to his family.

2.13 A debt arrangement scheme, as we envisage it, would operate primarily as a sequestration of a determinate part of the debtor's income, and he would not necessarily be divested of his assets. An administrator would be appointed by the sheriff to collect the payments due by the debtor and to pay proportionate sums to the creditors. The scheme envisages either the payment of the debts in full or the payment of a stipulated composition by instalments over a period of years. Diligence would be sisted pending the approval of the scheme and further diligence by creditors or an application by a creditor for sequestration would become incompetent while the scheme was in operation. Though we envisage that a creditor would be entitled to apply for a debt arrangement scheme without the concurrence of the debtor, the willingness of the debtor to co-operate in its administration appears to us, as at present advised, to be essential to such a scheme. We regard this procedure, therefore, as being essentially a voluntary system for the repayment of multiple debts.

2.14 It is not at present clear whether our proposals for debt arrangement schemes will meet with favour on consultation or whether, assuming that our proposals attract favourable comment, they would result in implementing legislation. They would require some public expenditure; but debt arrangement schemes are not designed simply to facilitate the recovery of debts. They are also intended to protect debtors against pressures which may have become intolerable. Their introduction would provide an alternative to sequestration for wage-earners and others in respect of whose estates sequestration may not be an appropriate remedy.

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<sup>16</sup>These arguments are developed in Chapter 24.

<sup>17</sup>Para. 24.31.

<sup>18</sup>Para. 24.33.

## **Coercive systems**

2.15 Private composition contracts, trust deeds for creditors and debt arrangement schemes are all voluntary systems for the winding-up of insolvent estates and imply the co-operation of the debtor. There will remain cases where there is no such co-operation and where a coercive system, such as sequestration, is necessary. As we have explained above,<sup>19</sup> the essence of a sequestration is that it is a collective diligence, and it is necessary for the same reasons that other diligences are necessary: business and consumer credit play a valuable economic and social role and, without the availability of coercive systems for the recovery of unpaid debts, credit would become more expensive and less widely available. Moreover, there will always be, as the Crowther Committee pointed out:<sup>20</sup>

“... the minority who undertake commitments with every intention of defrauding the lender at the outset or during the course of the contract. It is in the interest of all borrowers that the lenders should have the full backing of the law and the enforcement agencies in preventing such people from benefiting from their frauds, since their activities inevitably raise the cost of borrowing for all.”

2.16 The diligence of sequestration is required because the other processes of diligence available in Scots law are less well-adapted to cases of insolvency and of multiple indebtedness. Another creditor may intervene in a poinding process and claim a share in the proceeds of sale, but this can happen only if he is aware of the poinding. This procedure is cumbersome and expensive, and it makes available only the assets attached and not the debtor's whole estate. From the debtor's standpoint he remains vulnerable to further diligence and he will not obtain a discharge of debts other than those of the poinding creditors.

2.17 The interests of all concerned, that is the creditors, the debtor and the public in general, suggest that, in cases where a debtor cannot pay his debts as they fall due and cannot come to informal arrangements with his creditors, an orderly coercive procedure should be available to any creditor, and indeed to the debtor himself, in which his whole assets may be recovered and administered by one person for the benefit of all the creditors. From the standpoint of the creditors such a procedure avoids the expense of separate diligences, conduces to economies of administration and makes possible the orderly distribution of the estate among the creditors. But the system may also serve to protect the debtor against the over-zealous attentions of individual creditors, and can permit of his ultimately receiving a discharge in respect of all his debts if (as is likely) the debts have not been paid in full.

### **Problems of substantive law**

2.18 The main question, therefore, is not whether the process of sequestration should be available to creditors and to the debtor. It is rather that of balancing within the process the interests of debtors and their

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<sup>19</sup>Para. 2.8.

<sup>20</sup>*Report of the Committee on Consumer Credit*, Cmnd. 4596 (1971), para. 3.9.8.

creditors on the one hand and, on the other, of the creditors *inter se*. The appropriate balance between the claims of debtors and those of their creditors is not easy to attain. Our present system is in most respects a humane one. In particular, it envisages that the debtor should ultimately obtain a discharge from his debts though they may not have been met in full. This principle should be retained. We propose, indeed, in this Report to go further, making discharge more accessible to bankrupts and ensuring that they will not remain indefinitely subject to the disqualifications of a bankrupt.

2.19 The present law adopts what might be thought to be a less humane approach to the question: What assets vest in the bankrupt's trustee? In principle, all the bankrupt's assets vest, other than those exempted from attachment for debt.<sup>21</sup> In some systems a wide range of exemptions is admitted. In the United States, the Federal Bankruptcy Act excludes (up to certain values only) the bankrupt's home, his household goods and clothes, the articles he requires for the exercise of his trade or profession, and even a car.<sup>22</sup> The attractiveness of these exemptions has been cited as the main reason why, in 1980, there was an 82% increase in personal bankruptcies, bringing the total to 381,000.<sup>23</sup> We conclude that the precise scope of exemptions for bankrupts requires careful consideration. There must be no temptation to debtors to have recourse to sequestration to obtain a discharge from debts which they could reasonably pay. We propose, therefore, only limited extensions to the class of assets which will not vest in the trustee. We have, however, thought it desirable to exclude from the vesting in the trustee the future earnings of the bankrupt.<sup>24</sup> This exclusion is justified on the ground that a bankrupt should have no disincentive to take up employment. Creditors, however, will be protected by a provision allowing the trustee to claim any income exceeding a suitable aliment for the debtor and his family.

2.20 The securing of distributive justice among the creditors also presents problems. At present the State and local authorities enjoy wide preferences in a sequestration, with the result that the payment of any substantial dividend to the ordinary creditors is the exception rather than the rule. We have examined with care arguments adduced for the preservation of these preferences, but have not been persuaded that they justify the consequential disparity of treatment between the claims of the preferred creditors and those of the ordinary creditors. Such disparity of treatment requires the strongest justification and it has not been adduced in relation to the present

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<sup>21</sup>1913 Act, s. 97(1). The common law excluded the necessary wearing apparel of the bankrupt. The Law Reform (Diligence) (Scotland) Act 1973 exempts from diligence and, therefore, inferentially from the estate falling to the debtor's trustee in bankruptcy certain household furniture and effects. In our Memo. No. 48, paras. 4.13-4.41 we discuss the existing exemptions and make proposals for their extension. We deal with the exemptions in sequestration in para. 11.3.

<sup>22</sup>Chapter VII.

<sup>23</sup>*The Sunday Times*, 29th March 1981. See also Martin I. Klein, "Chapters XI of the Bankruptcy Act", 1979 *Anglo-American Law Review*, 36.

<sup>24</sup>Paras. 11.3 and 11.33-11.35.

preferences accorded to the claims of Government departments and local authorities. It does seem to us, on the other hand, that there are good reasons for retaining the preferential rankings at present accorded to the claims of employees to unpaid earnings and extending them those who have made advances to secure the payment of such earnings. We recommend their retention in Chapter 15.

### **Problems of procedure**

2.21 Any compulsory procedure involving the sequestration by the court of the assets of an insolvent debtor and their distribution among the creditors is necessarily complicated. It will involve discovering the debtor's estate, winding-up his business (if any), selling his assets, assessing the claims of creditors, and distributing the realised estate among the creditors. This in turn involves interfering with the property rights of the debtor and, in some cases at least, with the property rights of third parties. Adequate provision will be required for the protection of a variety of interests, including those of the debtor, of different classes of creditors, and of third parties.

2.22 Because the procedure is necessarily complicated, it involves the intensive use of professional persons and is bound to be expensive. Since the debtor *ex hypothesi* is insolvent, the expense must be borne, or largely borne, by the creditors themselves, and especially by the ordinary creditors.<sup>25</sup> In our view every effort should be made to diminish their losses. But expense is also occasioned to the public by reason of the involvement of the judges, particularly of the sheriffs, and of court staff in the course of the judicial proceedings in sequestrations. From the outset, therefore, of our examination of the law we have endeavoured to simplify the system of bankruptcy administration, particularly by eliminating certain judicial procedures or substituting for them procedures of an administrative character, with a view to reducing the losses of the ordinary creditors and the expense of the procedure to the public as a whole.

2.23 To set out in detail the procedural simplifications which we propose would take us far away from the subject-matter of this Chapter. Examples, however, include simplifying the rules for submitting and valuing of claims, assimilating the rules for voting and ranking, simplifying the rules relating to the vesting of heritable property and to the vesting of property acquired by the bankrupt after the date of the sequestration, reducing the number of compulsory meetings of creditors, abandoning the mandatory public examination of the bankrupt, simplifying the law relating to the reduction of gratuitous alienations and unfair preferences, providing for the discharge of the bankrupt by operation of law after a specified period and permitting the trustee to obtain a discharge without a formal petition to the court. We have proposed the introduction of an inexpensive system for curing procedural

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<sup>25</sup>It is apparent from the Civil Judicial Statistics (Scotland), that the expenses incurred in the administration of all sequestrations concluded by final division (including extraordinary payments such as wages and other charges connected with the completion of contracts, the carrying on of businesses until sold, etc.) are generally higher in total year by year than the payments made to unsecured creditors.

defects in the course of a sequestration. These proposals should materially reduce the expense of sequestration procedure.

2.24 In considering possible simplifications in the law we have had regard to the process of summary sequestration introduced by the 1913 Act<sup>26</sup> and applicable to cases where the estimated value of the debtor's assets did not exceed £300, a figure increased to £4,000 by the Insolvency Act 1976.<sup>27</sup> The process has certain defects which make its adoption as a whole impracticable; but its detailed provisions are simpler in some respects than those applicable in ordinary sequestrations. We have, therefore, proposed the introduction into our general procedure of certain provisions modelled upon those at present applicable only in summary procedure. These and other simplifications should reduce the overall expense of ordinary sequestration procedure and enable us to propose that the system of summary sequestration in small assets cases should be discarded. It is confusing to have on the statute book two procedures for sequestration, varying slightly in their details. We propose, therefore, the adoption of a single, simplified procedure applicable in principle to all sequestrations. To deal with small assets cases<sup>28</sup> we propose certain modifications to the ordinary sequestration procedure designed to ensure that it is so conducted that expense will be kept to a minimum. These modifications are described briefly in this Chapter<sup>29</sup> and more fully in Chapter 7.<sup>30</sup>

### ***Official Receivers***

2.25 The Scottish system of sequestration has tended to be less costly to all concerned, including the State, than bankruptcy procedures in England<sup>31</sup> and we have endeavoured, so far as practicable, to retain those features of the Scots law of sequestration which conduce to the avoidance of expense. In this respect the distinctive feature of the Scottish system is that it is in principle creditor-controlled. Bankruptcy administration has been left to the creditors subject to a minimum of intervention by the State. To allow the creditors to pursue their own interests was thought to secure coincidentally the public interest in the law of bankruptcy and economy in its administration. The philosophy underlying Scottish bankruptcy law and procedure has been summarised as follows:

“The principle in Scotland is, that the estate of the bankrupt belongs to the creditors, and that they shall have the means of managing it as they see fit—subject to this proviso that all their actings must be in accordance with law, and that the officers acting under the creditors, as well as the bankrupt, must observe certain statutory proceedings which

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<sup>26</sup>ss. 174–176.

<sup>27</sup>s. 1, and Sched. 1.

<sup>28</sup>We use the expression “small assets cases” to denote those cases where the debtor's assets are so small that there is unlikely to be any dividend for the creditors, whether preferred or ordinary.

<sup>29</sup>See para. 2.42.

<sup>30</sup>Paras. 7.29–7.36.

<sup>31</sup>See “Procedure in Bankruptcy in England and Scotland”, 9 *Journal of Jurisprudence* (1865), 15–17.

the Legislature has established as those most likely to provide checks on dishonesty and mismanagement.”<sup>32</sup>

2.26 The English approach to bankruptcy administration, on the other hand, has involved more frequent recourse to judicial procedures and greater intervention by Government agencies. Explaining the introduction of the present system of Official Receivers, Joseph Chamberlain, as President of the Board of Trade, said that it was a main object of a satisfactory system of bankruptcy law:

“following the idea that prevention was better than cure, to do something to improve the general tone of commercial morality, to promote honest trading, and to lessen the number of failures .... There was only one way by which [these objects] could be secured and that was by securing an independent and impartial examination in the circumstances of each case; and that was the cardinal principle of this Bill ....

Now, it would be seen that the provision which he had described (a description of duties and responsibilities of the official receiver, the office of which was first created by this Bill) constituted a system which he thought they might fairly call a system of official inquiry, and which went on all fours with a similar system in the matters of accident to which he had referred. He did not think that without some such limited officialism as this any satisfactory inquiry was even possible. No investigation could be worth anything unless it was conducted by an independent and impartial officer.”<sup>33</sup>

2.27 The Bankruptcy Act 1883, accordingly, established a system of Official Receivers with territorial responsibilities subject to the directions of the Insolvency Service of the Board (now Department) of Trade. The first step in a bankruptcy petition is the making of a receiving order which makes an Official Receiver the interim manager of the estate with a variety of responsibilities. He sends notice of the receiving order to a number of public bodies and to those private persons with whom the debtor has business connections. He inspects and takes possession of the debtor’s property and business books, papers and documents, removing (if necessary) the property and papers to a safe place. He obtains from the debtor a full statement of his assets and liabilities, and the names of the creditors. He receives claims from creditors and summons the first meeting of creditors, where he normally takes the chair. Most importantly, where no trustee is appointed, or where there is a vacancy in the office of trustee, the Official Receiver becomes the trustee in bankruptcy.<sup>34</sup>

2.28 The Official Receiver has various duties in relation to the investigation of the bankrupt’s conduct. He participates in the public

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<sup>32</sup>*Idem* 11.

<sup>33</sup>Parl. Deb., ser. 3 (1883) Vol. 277, cols. 817–823.

<sup>34</sup>1914 Act, ss. 53(1), 74(1)(g), and 78(4). For this reason s. 72(3) of the 1914 Act provides that references to the trustee in bankruptcy will normally include the Official Receiver when acting as trustee.

examination of the bankrupt, unless on his application the court has dispensed with such examination. He is required to file with the court what is termed "a prosecution report" in every case where he is of opinion that any offence has been committed<sup>35</sup> and he has the duty to make such other reports on the conduct of the debtor as the Department of Trade may require.<sup>36</sup> To permit the Official Receiver to carry out these duties, the trustee in bankruptcy is required to supply the Official Receiver with information, give him access to the bankrupt's books and documents, and generally to give him such aid as he may require.<sup>37</sup>

2.29 At an early stage of our review of bankruptcy law, it was suggested to us by the Department of Trade that the Scottish system of bankruptcy administration was defective. It was argued that the mechanisms for the interim protection of the bankrupt's estate pending the appointment of a trustee were inadequate. It was suggested that, since there was no timeous investigation into the debtor's business affairs in the public interest, the causes of the debtor's insolvency and his possible commission of offences under the criminal law were not brought to light. It was also pointed out that there were no adequate methods for securing the administration of the estate where (as often occurs in small assets cases) no trustee was appointed. The Department accordingly suggested that the Scottish system of bankruptcy administration would be improved if the English system of Official Receivers were introduced into Scots law.

2.30 We largely accepted the force of these criticisms of the procedures of the 1914 Act. It is certainly unsatisfactory that less than one-third of sequestrations are concluded by final division of the estate. It seemed to us, however, as it did to those whom we consulted on this matter, that the crucial issue was whether the tasks at present performed by Official Receivers in England should be undertaken by officials, or whether they could not be adequately performed by private professional persons. An official system seemed indispensable only if it were thought desirable to conduct in every case a detailed investigation into the bankrupt's conduct of his affairs with a view to ascertaining whether he had committed breaches of the criminal law. The Crown Office and the police advised us that criminal offences were often associated with bankruptcy and stated that they would find it useful if the possibility of the bankrupt having committed an offence were brought to their notice at an early stage in bankruptcy administration. They pointed out that few bankruptcy offences were reported in Scotland and that the number of persons proceeded against was extremely small.<sup>38</sup> They argued, therefore, that it would assist in the detection of bankruptcy offences and their

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<sup>35</sup> 1914 Act, s. 73(a).

<sup>36</sup> 1914 Act, s. 73(b), (d).

<sup>37</sup> 1914 Act, s. 72(4).

<sup>38</sup> From 1973 to 1977 an average of less than one case per annum was tried on indictment in Scotland. The number of summary trials was only slightly higher. In England, over the same period, the number of prosecutions of bankrupts for offences against the Bankruptcy Acts 1914 and 1926 (c. 7), and the Deeds of Arrangement Act 1914 (c. 47), ranged between 114 and 239 per annum.

prosecution if an official were appointed with a positive duty to investigate the conduct of the debtor and to report suspected offences to the prosecuting authorities.

2.31 We are not persuaded that the statistics for bankruptcy offences in England and Wales on the one hand and for Scotland on the other lend themselves to useful comparison. The characterisation of offences differs in the two countries and the existence in Scotland of stricter rules of corroboration may have an influence on the number of acquittals. While we accept the view of the prosecuting authorities that greater emphasis should be placed upon the investigation of the bankrupt's conduct in the public interest, we are convinced that the detection and investigation of fraud with a view to the possible prosecution of the bankrupt are not primarily matters for bankruptcy administration. The majority of bankruptcies are likely to be caused by misfortune, misjudgment or incompetence rather than by criminal actings: the need, therefore, is not for a detailed investigation of the conduct of every bankrupt but rather for an effective system for detecting and reporting those cases that deserve to be investigated.

2.32 We also considered the possible cost to public funds of introducing Official Receivers on the English model into Scotland. In the absence, however, in the published statistics relating to insolvency in England and Wales of any breakdown of the expenditure as between personal bankruptcy cases and company insolvencies, we found it impracticable to quantify these costs with any precision. The element of uncertainty was increased by the fact that the incidence of personal insolvency in Scotland has consistently been lower than that in England and Wales<sup>39</sup> largely, it is thought, because of the frequent recourse in Scotland to private trust deeds for creditors but also, to some extent, because the absence of a system of Official Receivers makes sequestration less attractive to creditors. On the other hand, if Official Receivers were introduced into Scotland, the geography of the country would seem to make it necessary to establish offices in places with a relatively low case-load. Tackling the problem in different ways, nevertheless, we invariably concluded that the introduction into Scotland of a system of Official Receivers would entail additional public expenditure in 1980 terms of some £100,000 to £150,000 per annum. We felt bound to question whether such expenditure could be justified if the main purpose of introducing Official Receivers is to deal more effectively with the relatively few cases where personal bankrupts have acted fraudulently. We concluded that the possible advantages accruing from a system of Official Receivers on the English model would not be commensurate with its cost. This view had already been taken by our Working Party and was amply endorsed on consultation. We have since been confirmed in this view by the Green Paper on Bankruptcy published in 1980 by the Department of Trade. This argues that fraud is not sufficiently common in personal bankruptcy cases in England and Wales to justify the continued intervention of Official Receivers in such cases, from which, the Green Paper proposes, they should be completely withdrawn.

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<sup>39</sup>See para. 4.42.

### *Interim trustees and small assets cases*

2.33 Our conclusion, however, requires us to consider whether there are not other, and less expensive, ways of meeting the criticisms of the Scottish system to which we referred in paragraph 2.29.

2.34 Perhaps the most difficult problem concerns the administration of bankruptcy where there are no assets or few assets. In the eyes of the Commission's Working Party<sup>40</sup> and of those who commented on its Report, the most important defect in the present system is its frequent failure to deal with "small assets" cases. The same phenomenon was noted in the McKechnie Report where it is stated:<sup>41</sup>

"As the law stands at present it may be to a debtor's advantage to petition for summary sequestration. Where there are no assets creditors are reluctant to incur expenses in the sequestration and so the debtor's wages are protected from arrestment... The Accountant of Court told us that in the six years from 1950 to 1955 an average of twenty-six summary sequestrations were awarded each year and that the number of cases in which no trustee was appointed averaged ten a year. The effect is that in about 2 out of 5 cases of summary sequestration the debtor, although subject to the various statutory disabilities and disqualifications imposed by the Bankruptcy Act, has not been penalised thereby and yet has been immune from arrestment of wages and other forms of diligence by creditors."

In fact, as we are informed, the problem is not confined to cases of summary sequestration but applies wherever there are insufficient assets to meet the expense of the sequestration. The following figures speak for themselves—

	1974	1975	1976	1977	1978	1979	1980
No. of awards—							
ordinary and summary	104	148	128	132	130	105	151
No. of cases where no							
trustee appointed	42	59	46	52	46	35	38

The problem is by no means a new one and an attempt was made by an Act of Sederunt of 25 May 1937<sup>42</sup> to deal with it by providing that, where no trustee or commissioners have been elected at the first meeting of creditors, or where that meeting for any reason has not been held, any creditor may apply to the sheriff for an order appointing a special meeting of creditors for the purpose of making such elections. Such a procedure, as the McKechnie Report pointed out, involves expense and, perhaps for this reason and because it does not guarantee that a trustee will be appointed at the special meeting, little or no use is made of it.

2.35 The solution proposed in the McKechnie Report was that a sequestration should lapse where after 60 days no trustee had been appointed. The Committee added:

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<sup>40</sup>Memo. No. 16, para. 30.

<sup>41</sup>At para. 304.

<sup>42</sup>53 S.L.R. (1937), 201.

“Presumably it would be necessary to provide that a lapsed sequestration is of no effect whatsoever, the former bankrupt being re-invested in his whole estate and his wages being available for diligence in respect of debts contracted prior to the sequestration proceedings.”<sup>43</sup>

The disadvantage of this proposal is that a debtor whose assets are insufficient to justify the appointment of a trustee would not be in a position to obtain a discharge of his prior debts and start afresh. This is one of the main objectives of a civilised system of bankruptcy law and we consider that it would be morally indefensible and politically unacceptable to recommend policies which do not, at least after the lapse of time, admit of an insolvent debtor's discharge.

2.36 Our Working Party suggested an alternative approach. Referring to small assets cases they commented:<sup>44</sup>

“The relative frequency of this type of case suggests to us that it is desirable to introduce a system whereby a trustee is always appointed, regardless of whether the assets of the debtor are sufficient to provide for his adequate remuneration. Another aspect of this same problem is that there are cases, the number of which cannot by their very nature be ascertained, where frustrated creditors fail even to petition for sequestration because they know that it would be impossible to obtain, under the present law, the services of a trustee. In some instances, where a debtor has had all his apparent goods pointed there are preferential claims for rates outstanding; the consequence is that no person is willing to undertake the office of trustee and no action is taken under the bankruptcy law although this is the very type of case where its sanctions and procedures are most needed.”

2.37 Our Working Party examined, and rejected on the ground of its likely expense, the possibility of meeting this problem by introducing Official Receivers into Scotland.<sup>45</sup> They suggested rather that the work should be done by qualified accountants or solicitors whose name appeared on a register kept in each sheriffdom. They went on to say:

“Each of the persons whose name appears on this register would be prepared to act as interim trustee, and as trustee where no trustee was appointed, or the nominated trustee was not accepted by the court, or the nominated person did not accept office. These interim trustees would have the full powers given to trustees under the system of voluntary bankruptcy and creditors' bankruptcy. In most cases the costs and remuneration of the trustee would be provided for out of the bankrupt's estate, but where the assets were not sufficient to meet these, then we recommend that such costs and remuneration should be met out of a fund set up by the state. The cost to the state of such a scheme would, we consider, be much less than the cost of setting up a system of Official Receivers.”

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<sup>43</sup>p. 79, para. 306.

<sup>44</sup>Memo. No. 16, para. 30.

<sup>45</sup>Memo. No. 16, para. 35.

2.38 This scheme envisages the continuation of normal sequestration procedures even where the available assets are unlikely to result in any substantial dividend to the creditors. It could, we agree, be argued that the following-out of those procedures to their proper conclusion is desirable in any event. The need for the investigation of the debtor's affairs is related more to the amount of the debtor's liabilities than to that of his assets and, even in small assets cases, the debtor's total liabilities may be large. While we have much sympathy with this argument, we came to the conclusion that we could not justify the expense of maintaining normal sequestration procedures without modifications appropriate to small assets cases.

### *The proposals in the Green Paper on Bankruptcy*

2.39 We carefully considered, therefore, an alternative scheme, modelled on that in the Green Paper on Bankruptcy, under which proceedings for sequestration, whether at the instance of the debtor or of the creditor may be commenced only when a qualified person is willing to accept appointment as a receiver. This scheme would entail, as the Green Paper on Bankruptcy points out,<sup>46</sup> that a debtor would be unable to secure protection from his creditors unless he applies for sequestration while he has assets available to meet the costs of the receiver or unless he can persuade a third party to meet or to guarantee those costs. In cases, moreover, where it is unclear whether there are sufficient assets in the debtor's estate to cover the receiver's outlays and remuneration, the petitioning creditor would require to guarantee these.<sup>47</sup>

2.40 We consider that these proposals are open to serious objections. Creditors will seldom be fully aware of the state of the bankrupt's affairs and cannot know in advance the extent of the liability which they are likely to incur in guaranteeing the costs of a private receiver. Creditors other than preferred creditors have little enough incentive at present to apply for their debtor's sequestration. If they were required to underwrite the outlays and remuneration of a receiver, that incentive would diminish to vanishing point. Indeed, it is a matter for speculation whether even preferred creditors would be prepared to incur the risk of underwriting the costs of the debtor's sequestration. It is not satisfactory to argue either that "Creditors could ... be expected to be more discriminating in the choice of debtors they pursued into bankruptcy" or that they "will reach acceptable compromises with them within the limits of the law".<sup>48</sup> The former proposition is simply a way of saying that creditors in practice will not find it worthwhile to initiate sequestration proceedings against a large proportion of debtors. This is contrary to the conception of bankruptcy in Scots law as a collective diligence available for the protection of any creditor. The latter proposition ignores the fact that an insolvent debtor is likely to be subject to diligence at the instance of several creditors, a situation which may put it outwith the power of the debtor to achieve a satisfactory compromise with any individual creditor.

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<sup>46</sup>Para. 14.

<sup>47</sup>Para. 13.

<sup>48</sup>*Idem.*

2.41 But the proposals of the Insolvency Department are equally open to objection from the standpoint of the debtor. The debtor who plans to evade his obligations to his creditors is more likely to retain assets sufficient to meet the expenses of a private receiver than the honest debtor who is attempting to pay his debts as they fall due. Whether, moreover, a debtor exposed to diligence can retain assets to meet the outlays and remuneration of a private receiver may depend more upon the course of action adopted by his creditors than upon his own volition. It seems unrealistic either to suppose that the debtor will retain funds or to suppose that other persons will often be prepared to underwrite the costs of the receiver. In consequence, as under the scheme proposed by the McKechnie Committee,<sup>49</sup> many insolvent debtors would remain exposed to diligence in relation to their unprotected assets and would be unable to obtain a general discharge of their anterior debts. This is quite alien to the conception of Scots law that sequestration, as well as being a collective diligence available to creditors, is a means of protecting debtors from individual diligences and, in exchange for the surrender of their assets to their creditors, is a means of securing their discharge. For these reasons, we do not favour a scheme modelled on the proposals in the Green Paper but prefer (though with modifications in small assets cases) the scheme proposed by our Working Party.

### *Our proposals*

2.42 One important advantage of the system of interim trustees proposed by our Working Party lies in the fact that the appointment early in a sequestration of an interim trustee would enable him to investigate the financial situation of the bankrupt, the state of his present assets and liabilities, and the prospects of recovering any estate which the debtor has alienated prior to his "apparent insolvency".<sup>50</sup> Where, therefore, the assets appear to the interim trustee to be unlikely to be sufficient to pay any dividend to the preferred or ordinary creditors and he remains of this view after hearing the representations (if any) of the creditors at their first meeting, the interim trustee should automatically become the permanent trustee. He would then ingather, realise and distribute the estate in accordance with a simplified procedure appropriate to a "small assets case". His own outlays and remuneration should become a first charge upon the assets. In those cases where the assets of the bankrupt estate were insufficient, the State should undertake to meet the balance of his remuneration as interim and as permanent trustee. For this reason, the auditing of the trustee's accounts and the fixing of his remuneration should in small assets cases become the sole responsibility of the Accountant. Under these proposals the debtor would be freed from diligence in respect of his past debts. He would, however, be subject to the usual disabilities of a bankrupt until he received (under our proposals<sup>51</sup>) a discharge on his own application or a discharge by operation of the law normally after five years from the date of the sequestration.

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<sup>49</sup>See para. 2.35.

<sup>50</sup>We use this concept in the Report to refer to the occurrence of certain facts not dissimilar to those which, under the present law, would constitute the debtor's notour bankruptcy.

<sup>51</sup>See Chapter 19.

2.43 But there are several subsidiary advantages which cumulatively make the introduction of a system of interim trustees highly desirable. In the first place, in Scots law there is an interval of some 21 days (and often more) in the case of a debtor's petition and of some 27 days (and often more) in the case of a creditor's petition between the date of the presentation of the petition and the date when the trustee is confirmed in office and the debtor divested of his estate. Our Working Party pointed out that during this interval there is a risk that the debtor's estate may suffer damage, and referred to cases where the assets include stocks for sale and contracts for completion. The critical period, they suggested, was during the first two or three weeks of the sequestration.<sup>52</sup> It is true that, under section 14 of the 1913 Act, it is competent for the court to which a petition for sequestration is presented to appoint a judicial factor to take immediate measures for the preservation of the debtor's estate. But such appointments are rare,<sup>53</sup> because the initiative lies with the individual creditor, because justification for the appointment must be demonstrated,<sup>54</sup> and because a professional man may not wish to accept an interim appointment as judicial factor where the availability of assets to meet his expenses is not clear. In many bankruptcies, speed is of the essence if the bankrupt's assets are not to be further dissipated. These problems are serious, and to meet them it would be highly desirable to provide for the appointment of interim trustees whose outlays and remuneration, in so far as the assets of the bankrupt estate do not suffice, would be met by the State. The burden, of course, would fall on the State in practice only in small assets cases.

2.44 In the second place, when the trustee in the course of his duties finds reasonable grounds to suspect that the debtor has been guilty of an offence under the 1913 Act, he has a duty to report the facts to the Lord Advocate. But he has no positive duty to investigate the conduct of the debtor. We understand that such reports are rare, partly because in many cases no trustee is appointed, partly (it seems likely) because the trustee's duty is to report directly to the Lord Advocate, and partly because no comments on the debtor's statement of affairs are sent to the Accountant of Court, who would seem to be the appropriate person to make further inquiries and to report to the Lord Advocate. We propose, therefore, that the debtor should deliver to the interim trustee soon after his appointment a statement of affairs and that the interim trustee should comment on it to the Accountant,<sup>55</sup> who, where he suspects that the debtor may have committed an offence, should report the matter to the Lord Advocate.<sup>56</sup> These proposals should go some way to meet the concerns, referred to in paragraph 2.30 above, of the Crown Office and of the police.

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<sup>52</sup>Memo. No. 16, para. 32.

<sup>53</sup>No statistics are available, but we are advised that applications for such appointments are extremely rare.

<sup>54</sup>*Cuthbertson v. Gibson* (1887) 14 R. 736.

<sup>55</sup>See paras. 7.21, 7.22, and 7.26.

<sup>56</sup>Para. 23.9.

2.45 In the third place, the adoption of a system of interim trustees would enable us to recommend that, where the creditors fail to nominate a trustee (as occurs not infrequently in present practice) even in cases where the debtor possesses assets, the interim trustee should become the permanent trustee. This should assist to secure the orderly winding-up of all insolvent estates.

2.46 The introduction of a system of interim trustees on the model described above would go far to meet the principal criticisms of the present scheme of bankruptcy administration in Scotland. It is an essential feature, however, of our proposals that, in cases where the assets of the bankrupt estate are insufficient to meet the outlays and remuneration of the interim trustee, whether as interim trustee or, in default of another appointment, as permanent trustee, the State should meet these outlays and remuneration. Some additional expenditure, moreover, would be occasioned by a small increase in the staff of the Accountant of Court. Against these costs to the State must be set savings in the use of expensive judicial resources. The net cost, therefore, of our proposals to the State is likely to be marginal.<sup>57</sup>

2.47 It may be asked, however, why the State should assume any additional burdens, however small they may be. It is normally left to a creditor himself to meet the irrecoverable costs of ordinary diligences. Why should the same principle not apply in insolvency situations? The answer to this question is necessarily complex. One point of departure, however, is that in small assets cases neither an individual creditor of an individual debtor nor even his creditors as a class can have sufficient financial interest in the sequestration of the debtor to underwrite the costs of a trustee, yet the community as a whole has an interest in ensuring that sequestration procedures are carried out. Unless the debtor's estate is sequestrated it will be and continue to be vulnerable to the diligence of his creditors and the debtor will not obtain a general discharge of his debts. By reason of the risk of bankruptcies in fraud of creditors' rights, it would be inappropriate either to protect insolvent debtors from such diligence or to allow such a discharge to be granted without the antecedent sequestration of the debtor's estate. More importantly, the threat of sequestration is the residual compulsitor upon a debtor to meet his debts, and the threat of sequestration should remain a real one. Society is concerned to ensure that the cost of borrowing is not unnecessarily high. Any failure to pay is a lending cost which in the long run will be borne by other borrowers and by the revenue authorities. The latter are involved because bad debts are a business cost which diminishes the income of the creditor assessable for taxation. It is, therefore, not financial institutions as a class, but rather borrowers and the public as a whole who in the end pay the cost of bad debts. Sequestration is the ultimate sanction upon the defaulting debtor, so that society has the strongest interest in securing that its procedures are duly carried out.

2.48 In the system which we propose the trustee in sequestration, whom we may refer to as the permanent trustee, would retain his present central

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<sup>57</sup>We examine the question in paras. 4.40-4.49.

role in bankruptcy administration. Nothing would constrain the creditors to elect the interim trustee as permanent trustee, but nothing would preclude this and the creditors would no doubt often elect him. The administrative duties and co-ordinating functions connected with our proposals for a system of interim trustees, together with certain other duties referred to in this Report, would be discharged by the Accountant of Court who, in the exercise of his new functions, will be referred to as the Accountant in Bankruptcy. His duties are described in Chapter 4 but are not substantially different from those exercised by the Accountant of Court at present in the context of sequestrations. He will, however, have certain additional responsibilities, often of a permissive rather than of a mandatory nature. This will require some addition to the present small staff but consequential expenditure should be small.

### **Our objectives**

2.49 After the preceding discussion of the principal policy questions which arise in this Report, it may be helpful to summarise briefly the objectives which we have sought to keep in mind while preparing our recommendations. We reached a consensus on the nature of these objectives only after external consultation on the issues of policy considered above. Our objectives may be summarised as follows—

1. To preserve the rights of creditors to come to voluntary arrangements with insolvent debtors for resolving their indebtedness.
2. To preserve, where voluntary arrangements are not made, and so far as consistent with the humane treatment of the debtor, the effectiveness of sequestration as a support for the system of commercial credit.
3. To ensure that, in so far as the law does not otherwise direct, sequestration should be available in all cases of insolvency.
4. To protect creditors by ensuring that the bankrupt makes a full disclosure of his estate, wherever situated, and by providing procedures by which the extent of that estate may be verified.
5. To ensure that that estate may be rapidly recovered and distributed among the creditors.
6. To protect creditors, also, by retaining those rules of bankruptcy law designed to ensure that disposals of property made by the debtor before the sequestration and likely to have been made in contemplation of it may be reduced for the benefit of the creditors.
7. To promote equality among the creditors as a class by reducing the categories of preferential creditors, by retaining provision for cutting down unfair preferences to individual creditors, by ensuring that diligences effected within a short period prior to the sequestration are cut down, and by providing appropriate rules for the valuation of debts and appropriate machinery for adjudicating upon them.
8. To protect the interests of the debtor so far as the fulfilment of the preceding objectives allows. In particular, the law should not discourage the bankrupt from earning his living during the sequestration or prevent him retaining sufficient income to alimnt himself and his family.

9. To facilitate the discharge of the bankrupt and to ensure that bankrupt debtors do not remain indefinitely subject to the disqualifications of a bankrupt.
10. To strengthen the law relating to bankruptcy offences, but to ensure, also, that the civil law of bankruptcy is not used as an instrument of penal policy.
11. To provide an efficient and expeditious machinery for attaining the preceding objects; to ensure, also, that this machinery is adaptable to the circumstances of particular cases.
12. To provide a clear and comprehensive statement of the relevant law.

## CHAPTER 3

### SUMMARY OF CONCLUSIONS AND RECOMMENDATIONS

#### Introduction

3.1 This Chapter is intended to provide, not an exhaustive list of our conclusions and recommendations, but a convenient summary of them. It is designed to permit the reader, before proceeding to the matters of principle and detail which are discussed in the following Chapters, to obtain a picture, inevitably an over-simplified picture, of our recommendations as a whole. We have endeavoured in this summary to be selective and reasonably succinct. Readers who wish further explanations can turn to the relevant passages in the Report and to the clauses of the Bill. Since it might confuse, rather than assist, readers to incorporate in this summary exhaustive references, particularly to the provisions of the Bill, reference is made only to the more important paragraphs of the Report and to especially relevant provisions of the Bill.

#### Summary of conclusions

3.2 Recourse to voluntary arrangements between an insolvent debtor and his creditors should not be discouraged. In particular, private trust deeds for creditors should be allowed to operate with minimal statutory intervention.

Paras. 2.10–2.11  
24.11–24.15

Sched. 4

3.3 A coercive system, however, must be retained to adjust the liabilities of insolvent debtors in cases where the law, expressly or by implication, does not preclude recourse to sequestration. It is proposed that a system of general application modelled on present sequestration procedure should be available. The facility for terminating a sequestration by a deed of arrangement should be withdrawn. The existing provisions for summary sequestration should be repealed and “small assets” cases dealt with by modifications of the ordinary procedure. The procedure under section 163 of the 1913 Act for the appointment of a judicial factor on the estate of a deceased person should be retained.

Paras. 2.15–2.17, 2.24  
4.39  
8.27  
21.7–21.8, 21.20–21.21

Clause 23(4)  
Sched. 2

3.4 In addition to the estates of individual debtors, the estates of deceased debtors and partnerships (including limited partnerships), estates belonging to or held for trusts and incorporated or unincorporated bodies should be liable to sequestration. In relation, however, to incorporated or unincorporated bodies, sequestration would not be competent where it appears expressly or by implication from the terms of any enactment that in

relation to those bodies, sequestration should not be available.

Paras. 5.1-5.13

Clauses 5

6

3.5 Sequestration should remain essentially a sheriff court process but the Court of Session should continue to have the power to award sequestration and should continue to have the exclusive power to recall an award of sequestration. When an award has been made by the Court of Session, it should remit the sequestration to the sheriff court.

Paras. 5.35

Clauses 9

8.4

15(1)

16

3.6 The general supervision of the administration of insolvency law, other than the law relating to the liquidation of companies, should remain the concern of the Accountant of Court.

Paras. 2.48

Clause 1

4.1-4.7

3.7 The principles underlying the present law of bankruptcy should be retained and, in some cases, strengthened. These include the principles that the bankrupt should obtain a discharge as a counterpart for making his whole estate available to his creditors, that the interests of creditors in the administration of the sequestration procedure should be recognised and that, so far as is practicable, equality between the creditors in the division of the estate should be promoted.

Paras. 2.18, 2.25

*E.g.* clauses 3

15.5

4

19.1

48

51-55

3.8 The interests of the debtor, the creditors and the general public require that, once the estate of a debtor has been sequestrated, sequestration procedure should be followed out to its conclusion. Though the introduction of a supervisory system, that is, a system based upon official receivers on the English model, would secure this end, the expense of setting up such a system in Scotland could not be justified. Instead similar tasks should be undertaken by interim trustees drawn from the private sector.

Paras. 2.32, 2.42, 2.45

Clauses 2

4.8-4.16

18-23

24(4)

3.9 The sequestration process should be simplified, wherever practicable, to reduce expense. Unnecessary recourse to judicial procedures should be avoided and in all cases the emphasis should be upon simplicity and the

avoiding of unnecessary expense.

Paras. 2.22–2.24	Clauses 42
	51
	56
	61

## Summary of recommendations

### *Accountant in Bankruptcy*

3.10 The Accountant of Court, when exercising his functions relating to bankruptcy, should be known as “the Accountant in Bankruptcy”. Our proposals, however, would involve certain extensions to the present duties of the Accountant. In addition to duties similar to those which fall upon him under the present law, he would have the duties of maintaining a list of qualified persons willing to be appointed to the office of interim trustee, of supervising the conduct of interim trustees in the performance of their functions in the sequestration process, of taking over the more important duties of commissioners where none have been or may be appointed, and of intervening in certain specified cases to ensure the protection of the public interest in the course of sequestration procedure.

Paras. 4.2–4.7	Clauses 1
	38(1)
	50

### *Interim trustee*

3.11 In every sequestration a qualified person should be appointed by the court as interim trustee—

- (a) to safeguard the estate until the appointment of a permanent trustee;
- (b) to ascertain the state of the debtor’s liabilities and assets and the causes of the debtor’s insolvency, and to report thereon to the Accountant in Bankruptcy and to the creditors;
- (c) to call a meeting of creditors for the election of a permanent trustee and commissioners and to undertake certain duties at this meeting;
- (d) to be available for appointment as permanent trustee where the creditors do not or may not elect anyone to that office (i.e. in a small assets case).

Paras. 4.8–4.10	Clauses 2
7.18–7.28	18
	21–26
	Sched. 2

3.12 The interim trustee would be appointed from persons whose names appear on the list maintained by the Accountant in Bankruptcy. To be qualified for inclusion in this list, a person would require to reside within the jurisdiction of the Court of Session and to possess such qualifications and fulfil such conditions as may be prescribed for permanent trustees. Interim trustees would require to find caution, and the Secretary of State should be empowered to make rules for the finding of caution by interim trustees.

Rules are proposed for the exclusion of persons' names from the list of interim trustees and for appeals against exclusion

Paras. 4.11 and 4.13

Clauses 1(1)(b)  
2(2)-(5)

3.13 The interim trustee would generally be appointed upon the award of sequestration or as soon as may be thereafter. In a petition by a debtor, an award immediately follows the presentation of the petition. In creditors' petitions, an interval will normally elapse before the award is made but the interim trustee may be appointed earlier with the consent of the debtor or on cause shown.

Paras. 4.12  
7.18

Clause 13(1)

3.14 A person whose name appears on the list of interim trustees should not be entitled to refuse appointment as interim trustee. He should not be entitled to resign office unless authorised by the court. In such a case the court would appoint to the office another person whose name appears on the list. If for any reason the interim trustee is not acting, or is incapacitated from acting, the bankrupt, any creditor, or the Accountant in Bankruptcy should be entitled to apply to the court for the filling of the vacancy.

Paras. 4.12 and 4.14

Clause 13

3.15 The outlays and remuneration of the interim trustee, whether acting as interim trustee or subsequently as permanent trustee in default of any election to that office, should enjoy in relation to the free funds of the bankrupt's estate a preference over all other claims in a sequestration. Where the sequestrated estate is insufficient to meet those outlays and that remuneration, the deficiency should be met out of public funds by the Accountant in Bankruptcy.

Paras. 4.15  
18.5 and 18.6

Clauses 26(3)(b)  
48(1)(a) and (b)  
50(3)  
Sched. 2, para. 5

### *The permanent trustee*

3.16 In every sequestration a qualified person should be appointed to the office of permanent trustee. His role would be similar to the present role of the trustee in a sequestration—that of recovering, managing and realising the debtor's estate, whether situated in Scotland or elsewhere. He would, however, no longer be subject to the general directions of the creditors but to the advice of the commissioners (if any) and to the directions (in matters relating to the recovery, management and realisation of the estate) of the commissioners, if there are any, or, if there are none, to the directions of the Accountant in Bankruptcy. In certain specified cases the trustee would require the consent of commissioners. In general, however, the trustee's

freedom to act on his own initiative would be enhanced.

Paras. 4.17 and 4.18  
10.9

Clauses 3  
37-39

3.17 The present disqualifications for appointment as trustee in a sequestration should be applied to permanent trustees. In addition, it is envisaged that they should possess appropriate professional or other qualifications, which would be prescribed. They would continue to require to find caution.

Paras. 4.20-4.23

Clauses 24(2)  
25(6)

3.18 The permanent trustee would be elected by the creditors at their statutory meeting. He would be elected by a majority in number and value (rather than a majority in value only) of the creditors then present or represented and entitled to vote. Where the creditors fail to elect a permanent trustee or may not competently elect a permanent trustee (i.e. in a small assets case), the interim trustee would become permanent trustee. The present procedure for the hearing of objections to the trustee's election and for the confirmation by the sheriff of a trustee would remain substantially unaltered.

Paras. 4.19  
7.33  
9.12-9.17

Clauses 24  
25  
Scheds. 5, para. 12  
2, para. 1(2)

3.19 The present law should be widened to permit a permanent trustee to resign office with the consent of the court. The substance of the present law relating to the removal of trustees would be retained, though it should be competent for a person representing not less than one-quarter in value of the creditors, or for the Accountant in Bankruptcy, to apply to the court for the removal of the trustee. Proposals are made to secure more effectively the replacement of a trustee who has demitted office.

Paras. 9.23-9.29

Clauses 27  
28

3.20 The permanent trustee should continue to be entitled to receive payment from the bankrupt estate in respect of his outlays in and remuneration for the execution of his office. The current practice by which his accounts are audited by the commissioners and his remuneration fixed by them should continue. In a case where there are no commissioners, as in a small assets case, these duties of the commissioners would be undertaken by the Accountant in Bankruptcy. There would be a right of appeal to the Accountant in Bankruptcy from the determinations of commissioners, and a right of appeal to the sheriff from the determinations of the Accountant. The remuneration and expenses of the permanent trustee should have priority, subordinated only to the claims of the interim trustee, in the distribution of the bankrupt estate. The ascertaining of the amount of the permanent

trustee's remuneration is discussed in para. 3.115 below.

Paras. 18.6	Clauses 48(1)(b)
20.6 and 20.7	50
	Sched. 2, paras. 5-7

### *The commissioners*

3.21 The creditors at their first (or statutory) meeting should elect commissioners as their representatives in the sequestration. The commissioners would be either creditors or their mandatories. It would not be competent to elect commissioners in a "small assets" case. The election of commissioners would no longer require to be confirmed by the court.

Paras. 4.31-4.33	Clauses 4
7.33	23(4)
	29

3.22 Instead of the present rule requiring the election of three commissioners, it should be provided that the creditors may elect one or more persons (not exceeding five in number) to act as commissioners. It should be competent for the creditors to elect new or additional commissioners at any meeting of creditors, but to remove a commissioner from office only at a meeting called for that purpose. It should no longer be mandatory for the trustee to call a meeting of creditors for the purpose of electing a new commissioner where a commissioner has declined to act, died, resigned or become incapacitated.

Paras. 4.32 and 4.34	Clauses 4
	29

3.23 Though it is not proposed that commissioners need possess professional qualifications, persons otherwise disqualified from holding office as permanent trustee should be disqualified also from the office of commissioner. In addition, any person who has a family or business relationship with the permanent trustee should be disqualified.

Para. 4.31	Clause 29(2)
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3.24 The functions of commissioners would be similar to those of commissioners under the present law. Their role in giving advice and directions to the trustee, and in consenting to certain specified steps, is described in para. 3.16 above. The commissioners, as explained in para. 3.20 above, would continue to audit the trustee's accounts and fix his remuneration.

Paras. 4.30, 4.36 and 4.37	Clauses 4(2)
20.6-20.9	38(1) and (2)
	50(1)-(6)

3.25 Proposals are made to simplify and clarify the law relating to the calling of meetings of commissioners, the recording of their deliberations, and

their resignation and removal from office.

Paras. 4.32-4.35

Clause 29  
Sched. 5, Part III

### ***Judicial factors***

3.26 Our proposal that an interim trustee should be appointed in every sequestration renders section 14 of the 1913 Act superfluous and it should be discarded. Section 163 of the 1913 Act should be retained.

Paras. 4.38 and 4.39  
21.8

3.27 In cases where a judicial factor has been appointed under section 163 within seven months of the date of death of an insolvent debtor, it is proposed to extend the powers of the judicial factor, notably to enable him to challenge gratuitous alienations, orders for the payment of a capital sum on divorce, unfair preferences, and preferences acquired by diligence. He would be conceded the common law powers to challenge gratuitous alienations and unfair preferences at present conferred upon trustees in sequestration.

Paras. 12.16, 12.19, 12.21,  
12.32, 12.44, 12.47  
21.21

Clauses 33(3)(b) and (7)  
34(2)  
35(4)(b) and (6)

### ***Estates subject to sequestration process***

3.28 Sequestration should remain available where it is available at present, but it should be generally available in the case of estates belonging to, or held for, trusts and incorporated or unincorporated bodies. It should not be available in the case of companies registered under the Companies Acts or otherwise where it appears, expressly or by implication, from the terms of any enactment, that sequestration of the entity in question is not to be competent. Sequestration should continue to be available in relation to the estates of ordinary partnerships, whether or not dissolved, and should become available in respect of limited partnerships.

Paras. 5.1-5.13

Clauses 5  
6(3)-(7)

### ***Debtors' petitions***

3.29 Petitions for sequestration should remain competent at the instance of the debtor. In a debtor's petition, the present requirement of the concurrence of a qualified creditor or creditors should be retained, except where a petition for the sequestration of a deceased person's estate is presented by an executor. In a debtor's petition it would be unnecessary to establish that the debtor is insolvent: that would be inferred from the presentation of the petition. In a debtor's petition the award of sequestration is made forthwith if duly presented. This is the first order in a debtor's

petition and fixes the date of the sequestration.

Paras. 5.14, 5.22–5.24,  
5.25–5.29

Clauses 5(2) and (3)  
6(3)–(7)

3.30 “Qualified creditors” are creditors in respect of liquid or illiquid debts (other than contingent or future debts) amounting, or amounting in the aggregate, to not less than £200 or such other sum as may be prescribed.

Paras. 5.30–5.33

Clause 5(4) and (5)

3.31 It should be left to the general law to determine who may present a petition for sequestration, whether on behalf of a debtor subject to a legal incapacity or on behalf of other entities, whether or not incorporated. In case of trusts, however, it should be provided that a petition is competent at the instance of a majority of the trustees.

Paras. 5.25–5.28

Clauses 5(2), (3), (7) and (8)  
6(3)–(8)

### ***Creditors’ petitions***

3.32 In a creditor’s petition the present requirement of a qualifying debt should be retained. A creditor should be entitled to found a petition for sequestration upon a liquid or illiquid debt, but not upon a debt which is future or contingent. In determining the amount of a petitioning or concurring creditor’s debt, the creditor would require to deduct the value of any security which he holds over the estate of the bankrupt, unless he surrenders it for the benefit of the estate. A creditor should not be bound to deduct the value of any claim he may have against a co-obligant of the debtor. In a creditor’s petition the court orders the debtor to appear to show cause why sequestration should not be awarded. This is the first order in such a petition, and fixes the date of the sequestration.

Paras. 5.30–5.33

Clauses 5(4) and (5)  
12(4)

### ***Oath in petitions***

3.33 A petitioning or concurring creditor should still be required to produce along with the petition an oath or affirmation. We propose that it should be made in a prescribed form. The distinction between an oath of verity and an oath of credulity should be abolished. A petitioning or concurring creditor should be required to produce, along with his oath, *prima facie* evidence of the debt and a petitioning creditor must also produce such evidence as may be available to him to establish the apparent insolvency of the debtor. New provision is proposed for the making of oaths abroad and for dealing with errors and omissions by allowing the production of a corrected oath.

Paras. 7.7, 7.8, 7.9,  
7.11 and 7.13.

Clause 11

### ***Citation on petitions***

3.34 The special provisions in sections 25 to 27 of the 1913 Act for citation on petitions for sequestration should be repealed and no comparable provisions should be enacted. It is suggested, however, to the rule-making authorities that personal service upon the bankrupt may be desirable in a creditor's petition.

Paras. 7.14 and 7.15

### ***Apparent insolvency in creditors' petitions***

3.35 The present law gives effect to the principle that a creditor's petition for sequestration is competent only if the debtor is unable to pay his debts as they fall due. We consider that this principle should be retained. The 1913 Act gives effect to the principle by requiring that the debtor should have been "notour bankrupt" at the date of presentation of the petition. But, to constitute notour bankruptcy, it suffices that the debtor has submitted to specified steps in diligence from which his inability to pay his debts as they fall due is presumed, unless he instantly demonstrates the contrary. There is a further condition that the petition is competent only within four months of the constitution of his notour bankruptcy. We recommend the retention of the substance of these rules replacing, however, the expression "notour bankruptcy" by the expression "apparent insolvency". "Apparent insolvency" should be constituted in a similar way, and should have similar incidents throughout the law (see, however, paragraph 3.70). Any reference in any enactment or deed to a debtor's "notour bankruptcy" should be construed as a reference to his "apparent insolvency".

Paras. 5.17–5.20

Clause 7  
Sched. 6

### ***Apparent insolvency***

3.36 A debtor's apparent insolvency would be constituted whenever—

- (a) his estate is sequestrated, or he is adjudged bankrupt in England or Wales or Northern Ireland; or
- (b) he gives written notice to his creditors that he has ceased to pay his debts in the ordinary course of business; or
- (c) any of the following circumstances occurs—
  - (i) he grants a trust deed;
  - (ii) following the service on him of a duly executed charge for payment of a debt, the days of charge expire without payment;
  - (iii) following a poinding or seizure of any of his moveable property in pursuance of a summary warrant for the recovery of rates or taxes, 14 days elapse without payment;
  - (iv) a decree of adjudication of any part of his estate is granted, either for payment or in security;
  - (v) his effects are sold under a sequestration for rent due by him; or

(vi) a receiving order is made against him in England or Wales;

unless it is shown that at the time when any such circumstance occurred, the debtor was able and willing to pay his debts as they became due.

We propose, too, that, where a debtor's estate has been sequestrated or where he has been adjudged bankrupt his apparent insolvency should continue until his discharge and, in other cases, that it should continue until he is able to pay his debts and pays them as they fall due.

Para. 5.20

Clause 7

3.37 Under the present law, partnerships and companies, whether or not registered under the Companies Acts, may be rendered notour bankrupt. The same principle should apply in relation to apparent insolvency and, where the appropriate conditions are fulfilled, it should be competent to impute apparent insolvency to any entity, including an unincorporated association.

Para. 5.20

Clause 7

3.38 In the case of a deceased debtor, a creditor's petition would not be competent until after the lapse of six months from the debtor's date of death unless he was apparently insolvent at the date of death.

Para. 21.11

Clause 8(3)

#### ***Effect of death of party***

3.39 A debtor's petition for sequestration should fall in the event of his death before the award of sequestration, but in a creditor's petition the proceedings should continue notwithstanding the death of the debtor. Recommendations are made to deal with cases where a petitioning, concurring, or opposing creditor withdraws or dies before an award is made.

Paras. 7.4 and 7.5

Clause 5(7) and (8)

#### ***Jurisdiction***

3.40 While the original jurisdiction of the Court of Session in sequestrations should be retained, sequestration should in principle be a sheriff court process and the Court of Session would retain its power to remit the sequestration to the appropriate sheriff court.

Para. 5.35

Clauses 9  
15(1) and (2)

3.41 The jurisdictional conditions of sequestration should be simplified and, in the case of the Court of Session, it should suffice that, at any time within the year preceding the date of presentation of the petition (or, in the case of a deceased debtor, the date of his death), an individual debtor had an established place of business in Scotland or was habitually resident there. In the case of other debtors, it should suffice that they had an established place

of business in Scotland at the relevant time or were constituted or formed under Scots law, and at any time carried on business in Scotland. In the case of a petition in the sheriff court the relevant criteria would have to be satisfied in relation to the appropriate sheriffdom.

Paras. 6.17–6.23

Clause 9

3.42 Provision should be made for the giving of notice of concurrent proceedings for sequestration or for an analogous remedy and of earlier awards. To minimise the risk of concurrent proceedings or of the making of more than one award, proposals are made to permit of the sisting or dismissal of petitions for sequestration and for the recall of awards.

Paras. 6.26–6.31

Clause 10

### ***Award of sequestration***

3.43 Sequestration should be awarded by the court and, as in the present law, should be mandatory if the relevant conditions are fulfilled. A right of appeal should be available against a refusal to award sequestration, but not against an award of sequestration. It should remain competent, however, to petition for the recall of the sequestration (see para. 3.55).

Paras. 7.16 and 7.17

Clauses 12  
15(3) and (4)

### ***Powers and duties of interim trustees***

3.44 In respect of his general duty to safeguard the debtor's estate until the appointment of a permanent trustee (see paragraph 3.11) the interim trustee should be given a number of specific powers, including that of requiring the debtor to deliver up to him money or valuables, as well as documents in his possession or under his control relating to his business or financial affairs. The court, on the application of the interim trustee, should be empowered *inter alia* to give directions to the debtor relating to the management of his estate.

Para. 7.20

Clause 18

3.45 In respect of the interim trustee's general duty to ascertain the state of the debtor's liabilities and assets (see para. 3.11), the debtor should deliver to the interim trustee a statement of affairs in a prescribed form. The interim trustee should be entitled to request the debtor to appear before him and to request the debtor or any other person who the interim trustee believes can give information relating to the debtor's assets, his dealings with them, or to his conduct in relation to his business or financial affairs, to give him such information. The interim trustee should be entitled to apply to the sheriff for the examination in private of the debtor and other persons and to require them to produce account books and other relevant documents (see para. 3.82).

Paras. 7.22 and 7.24

Clauses 19  
20(4) and (5)

3.46 The interim trustee should send to the Accountant in Bankruptcy a copy of the statement of affairs along with comments thereon relating to the causes of the insolvency and the extent to which the conduct of the debtor may have contributed to it. In any case where the interim trustee considers that the debtor's assets are unlikely to be sufficient to secure payment of a dividend to any creditor (preferred or ordinary) he should include a statement to that effect in his comments. These comments should receive absolute privilege. Before the statutory meeting of creditors the interim trustee should send to every creditor known to him a summary of the debtor's statement of affairs with his observations thereon. Where the interim trustee has concluded that the bankrupt's assets are insufficient to make payment of any dividend to any creditor, he should include a statement to that effect in his observations.

Paras. 7.26 and 7.27

Clauses 20(1)–(3)  
21(3)

#### *Claims to vote*

3.47 Apart from the special rules relating to voting rights in an election or removal of the trustee and commissioners (see para. 3.51), the rules relating to the admission and calculation of claims for ranking purposes (see paras. 3.91–3.95) should apply to their admission and calculation for voting purposes.

Paras. 16.3–16.9

Clauses 22  
23(1)(a) and (2)  
24(3)  
29(1)  
45–47

3.48 At or before any meeting, a creditor should submit to the interim trustee or permanent trustee a statement of claim in a prescribed form, and should be entitled to vote at such a meeting only if his claim is accepted by the trustee. A creditor whose claim depends upon a contingency which is unascertained at the date of the claim should not be entitled to vote until the claim has been valued by the permanent trustee or the contingency purified.

Paras. 16.13  
17.7, 17.8 and 17.12

Clauses 22(1)  
45(1)  
Sched. 1, para. 3

3.49 It should no longer be open to a trustee to require a creditor to submit an oath instead of a statement of claim.

Para. 17.3

#### *Statutory meeting of creditors*

3.50 A meeting of creditors—the first or statutory meeting—should be convened by the interim trustee for a date within 28 days of the date of the award of sequestration, unless this period is extended by the sheriff on cause shown. The main business of this meeting would normally be the election of

the permanent trustee, the fixing of the amount of his caution, and the election of commissioners. The sheriff should no longer preside over this or, indeed, over any meeting of creditors. The sheriff clerk should no longer be clerk to the meeting, and it would be for the interim trustee to arrange for the preparation of a record of the proceedings at the statutory meeting. The interim trustee would initially take the chair at the meeting for the purpose of verifying the entitlement of any creditor to attend the meeting and the extent of his voting right. He would superintend the election by the creditors of a chairman out of their own number. The interim trustee, however, would remain in the chair if no other person is elected.

Paras. 9.7-9.13

Clauses 21-23  
Sched. 5, Part II

3.51 After the election (if any) of a chairman the interim trustee would answer any questions and consider any representations put to him by the creditors regarding the debtor's business or financial affairs or his conduct in relation thereto. If, after considering those representations, the interim trustee remains satisfied that the case is not a small assets case (see para. 3.53), the creditors would proceed to the election of the permanent trustee. Any creditor whose claim had been admitted by the interim trustee would be entitled to vote in the election except (a) a creditor in a debt acquired by him (otherwise than by succession) after the date of the sequestration, and (b) any postponed creditor. Voting would be by a majority in number and value (as distinct from a majority in value only) of the creditors present or represented and entitled to vote. Where the creditors do not elect a permanent trustee, the interim trustee would be deemed to have been elected to the office. The interim trustee would also become permanent trustee in a small assets case (see para. 3.53). The meeting would then proceed to determine the amount of caution to be found by the permanent trustee and, except in a small assets case, to elect the commissioners.

Paras. 4.19 and 4.32  
9.12 and 9.13

Clauses 23(3) and (4)  
24  
29(1)  
Sched. 5, para. 12

#### ***Appointment of permanent trustee***

3.52 The interim trustee should make a report of the proceedings at the meeting to the sheriff. Any interested person should be entitled to object to the election by notice to the sheriff, and procedure to deal with such objections is proposed. Where there is no objection or where any objection has been rejected, and where the person elected, or deemed to have been elected, appears to be a qualified person, the sheriff would declare him to be permanent trustee and, on his lodging his bond of caution, he would be confirmed in office as permanent trustee. The judgment of the sheriff should be final in any question relating to or affecting the election or deemed election of the permanent trustee.

Paras. 9.14-9.17

Clause 25

### ***Small assets cases***

3.53 If at the statutory meeting of creditors the interim trustee determines that the assets are unlikely to be sufficient for the payment of a dividend to any class of creditors, the election by the creditors of a permanent trustee or of commissioners should be incompetent, and the interim trustee will be confirmed in office as permanent trustee without finding caution. As permanent trustee, he should have the normal powers to ingather, realise, and make payments out of the estate except that, as a safeguard against expense which might otherwise fall on the State, he could not take certain specified steps without the consent of the Accountant. The latter would audit the trustee's accounts and fix his remuneration. We refer to the payment of his outlays and remuneration above (paragraph 3.15).

Paras. 7.33-7.36

Clause 23(4)  
Sched. 2

### ***Other meetings of creditors***

3.54 The meeting referred to in the previous paragraph would be the only mandatory meeting of creditors. The permanent trustee, however, should be entitled to call a meeting of creditors at any time and should be obliged to do so when so requested by one-tenth in number and value of the creditors, by a commissioner, by the Accountant in Bankruptcy or on the instructions of the court. A commissioner should be entitled to call a meeting of creditors after giving written notice to the trustee. The quorum at any meeting should be one person qualified to attend and vote. At meetings of creditors, in the absence of other provision, all questions should be determined by a majority in number and value. The rules relating to the convening of meetings of creditors and to the conduct of these meetings should be restated.

Paras. 7.37-7.40  
10.29 and 10.30

Sched. 5, Parts I and II

### ***Recall of awards***

3.55 The Court of Session should continue to have exclusive jurisdiction in petitions for the recall of an award of sequestration. Such a petition should be competent at the instance of the bankrupt, any creditor, or any other person having an interest. The present time limits in petitions for recall should be discarded. During the ten weeks after the date of the sequestration the Court should be entitled to recall the award if it is satisfied that it is appropriate to do so: thereafter it should be entitled to do so only where it is both satisfied that recall is appropriate and that (a) the debtor has paid his debts in full or given security for their payment; or (b) the principle of *forum non conveniens* applies; or (c) competing awards have been made or analogous remedies granted.

Paras. 8.3-8.17

Clauses 16  
17

3.56 The effects of the recall of a sequestration should be more clearly stated. It should not affect the interruption of any prescription or limitation under Scots law or the suspension of the operation of any statute of limitations in England or Northern Ireland. Otherwise the effect of recall should be, so far as practicable, to re-invest the bankrupt in the sequestrated estate and to restore any other person to the position he would have been in if the sequestration had not been awarded. The recall should not invalidate any transaction entered into before such recall by the interim trustee or the permanent trustee with a person acting in good faith.

Para. 8.16

Clause 17(4) and (5)

### ***Deeds of arrangement***

3.57 The procedure by which a sequestration may be terminated by a deed of arrangement under sections 34 to 39 of the 1913 Act is rarely adopted and should now be discarded.

Paras. 8.20–8.27

### ***Resignation, removal and death of the permanent trustee***

3.58 The permanent trustee should not be entitled to resign at will but only—

- (1) where a majority in number and value of the creditors at a meeting called for that purpose accept his resignation and elect a new permanent trustee, or
- (2) where he is authorised to resign office by the sheriff.

It should be possible to remove the permanent trustee from office—

- (1) by a majority in number and value of the creditors (being creditors entitled to participate in the election of the permanent trustee) present at a meeting called for the purpose if they elect forthwith a new permanent trustee; or
- (2) by order of the sheriff on cause shown following an application by the Accountant in Bankruptcy or by a person representing not less than one-quarter in value of the creditors.

It should also be open to any creditor, any commissioner, the Accountant in Bankruptcy, or the debtor himself, to apply to the sheriff court to declare the office of permanent trustee to have become vacant and to make any consequential orders.

Paras. 9.23–9.29

Clauses 27  
28

### ***Vesting of the estate***

3.59 The law relating to the vesting of the bankrupt's estate in the permanent trustee should be simplified and clearly expressed to cover his whole estate wherever situated, including immoveable property situated abroad. The provisions of the 1913 Act relating to the vesting of heritable property in Scotland are stated obscurely and refer to cases for which provision need no longer be made. It should be provided that such estate



***Protection of persons transacting with the bankrupt***

3.64 Where the property is of a kind in respect of which registration or another similar act is required to complete the permanent trustee's title, there should not vest in the permanent trustee property already conveyed by the debtor by a disposition or other deed to a person who has acquired the property in good faith and for value but has not completed his title to it at the date of the sequestration.

Paras. 11.26–11.29

Clause 32(3)

3.65 Any dealing of or with the bankrupt relating to the sequestered estate after the date of the sequestration but before his discharge should be of no effect in a question with the permanent trustee unless the person seeking to uphold the dealing establishes (a) that the trustee abandoned the property in question to the bankrupt or is otherwise personally barred from challenging the dealing; or (b) that the other party to the dealing was unaware of the sequestration and the dealing is of a specified kind.

Paras. 11.37–11.39

Clause 31(7)–(9)

***Gifts, capital sums awarded on divorce, and preferences***

3.66 The rules of the common law relating to the challenge of gifts should be retained and should be available not only to creditors and a trustee in sequestration but also to a trustee under a protected trust deed and to a judicial factor on the estate of a deceased debtor where the estate is insolvent.

Para. 12.16

Clause 33(7)

3.67 In place of the 1621 Act, the law should provide for the challenge of gifts made during a specified period before sequestration, the granting of a trust deed that becomes a protected trust deed, or the date of death where sequestration or the appointment of a judicial factor on an insolvent estate follows within seven months after death. Challenge should be competent where the debtor alienates any significant part of his estate and should be available to the trustee in sequestration or (as the case may be) the trustee under the trust deed or the judicial factor. Challenge should also be open to any individual creditor. The relevant period before sequestration, the granting of the trust deed, or death, should be five years where the alienation has the effect of favouring a person who has a family or business relationship with the debtor, and two years in other cases. Where a challenge is competently made, the court should grant decree of reduction or for such restoration of property to the debtor's estate or other redress as may be appropriate, unless the person seeking to uphold the alienation establishes that the alienation was made for adequate consideration or that the debtor was solvent immediately after the alienation or at any time thereafter. The 1621 Act and the proviso to section 5 of the Married Women's Property (Scotland) Act 1920 should be repealed. Insurance policies under the Married

Women's Policies of Assurance (Scotland) Act 1880 and the rights of *bona fide* acquirers for value should continue to be protected.

Paras. 12.19–12.28

Clause 33

3.68 Where, within the five years preceding the date of sequestration of a debtor's estate, the Court of Session has made an order under section 5 of the Divorce (Scotland) Act 1976 for the payment of a capital sum by the debtor to his spouse, that order may be recalled by the court on application by the trustee if the debtor was insolvent at the time of the making of the order or was made insolvent by its implementation. Challenge should also be competent where within a like period the debtor grants a trust deed that becomes a protected trust deed, or where he dies and sequestration or the appointment of a judicial factor on his insolvent estate follows within seven months.

Paras. 12.30–12.32

Clause 34

3.69 The rules of the common law relating to the challenge of fraudulent preferences—which we describe as unfair preferences—should be retained, but the 1696 Act should be repealed. The right of challenge under the common law rules, which is at present enjoyed by creditors and by a trustee in sequestration, should be extended to a trustee under a protected trust deed and to a judicial factor on the insolvent estate of a deceased debtor.

Para. 12.44

Clause 35(6)

3.70 The 1696 Act should be replaced by a provision that an unfair preference should be of no effect when granted during the six months preceding the date of sequestration of a debtor's estate. An unfair preference is a transaction which has the effect of creating a preference in favour of one creditor to the prejudice of the general body of creditors. It does not include certain specified transactions, notably a transaction in the ordinary course of trade or business, *nova debita* and a payment in cash of a debt actually due. A mandate granted by a debtor during this period authorising payment by the arrestee to the arrester of the whole or part of an arrested fund should not of itself constitute an unfair preference. Challenge should be open to the trustee in sequestration or any creditor. Challenge should also be competent where the preference is created within six months before the granting of a trust deed that becomes a protected trust deed or within six months before the debtor's death where sequestration or the appointment of a judicial factor on his insolvent estate follows within seven months. The rights of *bona-fide* acquirers for value should be protected.

Paras. 12.45–12.49

Clause 35

3.71 The proposals in paragraphs 3.66, 3.67, 3.69 and 3.70 should apply with suitable modifications in relation to the winding-up of registered companies on account of insolvency, that is, the liquidator and individual creditors should enjoy similar rights of challenge of gratuitous alienations and unfair preferences. This entails a minor amendment of section 320 of the 1948 Act and the insertion in that Act of a new section relating to the



### ***Management and realisation of the estate***

3.75 The primary duty of the trustee should remain that of realising the debtor's estate and converting it into money. He should no longer do so subject to the directions of the creditors but subject rather to those of the commissioners (if any) or if there are no commissioners to those of the Accountant in Bankruptcy.

Paras. 4.30	Clauses 3(1)(a)
10.8–10.28	38

3.76 Where he considers it beneficial to the administration of the estate, the trustee should be entitled to exercise certain powers only with the consent of the commissioners (if any) or, in small assets cases, of the Accountant in Bankruptcy. These are the powers—

- (a) to carry on any business of the debtor;
- (b) to bring, continue or defend any legal proceedings relating to the estate of the debtor;
- (c) to create a right of security over any part of the estate;
- (d) to exercise in relation to any property a power of appointment or other power which might have been exercised by the debtor for his benefit; and

independently, with the consent of the commissioners (if any) he would have the power to refer to arbitration or to compromise any claim or question relating to the estate.

Para. 10.9	Clauses 38(2)
	63
	Sched. 2, para. 3

3.77 The trustee should be entitled to sell perishable goods without complying with the directions of the commissioners. He should retain the power to sell the copyright in a work belonging to the bankrupt subject to provisions modelled on those in section 102 of the 1913 Act, designed to safeguard the interests of the author of the work. The trustee should now be entitled, with the consent of the commissioners or, as the case may be, of the Accountant in Bankruptcy to sell book debts. In connection with realisation of the bankrupt's non-vested, contingent rights, the trustee should no longer have the power to require the bankrupt to submit to medical examination.

Paras. 10.10 and 10.12	Clause 38(5)–(7)
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3.78 Creditors should no longer be precluded from purchasing the debtor's estate by private bargain. The restrictions, however, on the purchase of any part of the estate by the commissioners and by the trustee (and by certain persons having a business connection with the trustee) should be maintained. These restrictions should be extended to include any person standing in a family or business relationship to the trustee.

Para. 10.11	Clause 38(9)
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### ***Sale of heritage***

3.79 The existing restrictions on the sale of the bankrupt's heritage by the trustee should be discarded, and the trustee should have the right, subject to any directions given to him by the commissioners or, as the case may be, by the Accountant in Bankruptcy to sell the bankrupt's heritable property by public roup or by private bargain. Similarly, the cumbersome procedures which at present govern the sale of heritage subject to a heritable security should be discarded and the trustee should be entitled to sell the bankrupt's heritage with or without the concurrence of any heritable creditor so long as he sells at a price that is sufficient to repay the heritable creditor's debt, and the heritable creditor has not intimated to the permanent trustee that he intends to exercise his power of sale. Conversely, a heritable creditor should not be entitled to enforce his security after the permanent trustee has intimated that he intends to sell the property. In the event of delay after such intimation in proceeding with the sale, the trustee or the creditor should be entitled to apply to the court for authority to sell the property or (as the case may be) to enforce his security.

Paras. 10.16–10.19

Clause 38(3) and (4)

3.80 The existing law relating to the adoption of the debtor's contracts by the permanent trustee should be retained but provision should be made to permit another party to a contract with the debtor to call upon the trustee to say whether he proposes to adopt or not to adopt the contract within a specified period and, if the trustee fails to reply within a specified period, he should be deemed to have refused to adopt the contract.

Paras. 10.21–10.26

Clause 39

### ***Sederunt book***

3.81 The permanent trustee should maintain a sederunt book as a record of important steps in the sequestration process. He would be required, also, to keep regular accounts of the affairs of the estate, a copy of which would be entered in the sederunt book. Entries in the sederunt book should be expressly declared to constitute sufficient evidence in matters relating to the estate except when founded upon by the trustee in his own favour.

Paras. 10.32–10.35

Clauses 3(1)(c) and (d)  
60

### ***Examination of bankrupt***

3.82 Provision should be made to permit the private examination before the sheriff of the bankrupt and any other person who may have information relating to his assets, his dealings with them or his conduct of his business or financial affairs, where any such person refuses or delays to give to the trustee the information he requests.

Paras. 7.23–7.25

Clauses 20(4) and (5)  
41

3.83 The public examination of the bankrupt should be retained. It should no longer be mandatory but should take place only when application for examination is made to the sheriff. The permanent trustee should have a discretion whether to apply for such examination, but should be bound to do so if so requested by one-quarter in number and value of the creditors, by the commissioners, or by the Accountant in Bankruptcy. Any application for the public examination of the debtor must be made not later than eight weeks before the end of the first accounting period. Where the trustee so applies, the sheriff should have no discretion to refuse the application.

Paras. 14.14, 14.16–14.22 and                      Clause 42  
14.26

3.84 The public examination of the debtor and of any other person whose examination is required by the sheriff should be conducted in open court before the sheriff and should be recorded in the manner prescribed by Rule 65 of Schedule 1 to the Sheriff Courts (Scotland) Act 1907. The bankrupt should no longer be required at the end of the examination to take a solemn oath in relation to his state of affairs. He should, however, be required to make a declaration on similar lines if he later elects to apply for accelerated discharge or if a creditor should apply for deferment of the bankrupt's discharge by operation of law (see paragraph 3.109).

Paras. 14.24–14.25 and                      Clauses 42(2)  
14.28–14.29                                      44(5)

3.85 At the public or private examination the debtor or any other person examined should be bound to answer all relevant questions relating to the debtor's assets, to his dealings with them, or to his conduct in relation to his business or financial affairs. A person should not be obliged to answer a question relating to any matter which is privileged between himself and any other person, not being a person called for examination. The bankrupt and other persons called for examination should not be excused from answering questions on the ground of self-incrimination, but their answers should not be admissible in evidence against them in subsequent criminal proceedings, except where the proceedings are in respect of a charge of perjury arising from the answers.

Paras. 14.30–14.36                              Clause 44

3.86 There should be ancillary provisions relating to the examination of the bankrupt and other persons on commission where this is necessary, to enforcement of the attendance of the bankrupt and other persons for examination, and to penalties for false answers. A record of the public examination should be entered in the sederunt book and a copy of the record sent to the Accountant in Bankruptcy.

Paras. 14.37–14.42                              Clauses 41(3)  
42(4) and (5)  
43  
44(4) and (7)

### ***Claims to a dividend***

3.87 A creditor who wishes to claim a dividend must submit a statement of claim in a prescribed form, together with any vouchers necessary to support the debt, to the permanent trustee. A suggested form of statement of claim is included as Appendix 3 to this Report. A trustee (with the consent of the commissioners, if any) should, however, be entitled to dispense with any such requirement in respect of any debt or any class of debts. While, as mentioned in paragraph 3.49, a trustee should no longer be entitled to require a claimant to submit an oath, a permanent trustee should be entitled to require a claimant to provide additional evidence about his claim in an appropriate case.

Paras. 17.7–17.11

Clause 45

3.88 Where a trustee is aware that there are creditors who neither reside nor have a place of business within the United Kingdom, he should inform them that they may submit claims to him. He should also be empowered to accept an informal claim in writing from any such creditor.

Para. 17.9

Clause 45(3)

3.89 To avoid the need for the re-submission of claims, a claim submitted by any creditor (including a secured creditor) for voting purposes or for both voting and ranking purposes (unless subsequently rejected or withdrawn) should be regarded as having been re-submitted for voting purposes in respect of every subsequent meeting and for ranking purposes in respect of each distribution of dividend throughout the course of the sequestration. It should be open, however, to any creditor to submit a revised claim at any time except that he cannot re-value a security after the trustee has intimated that he requires the creditor to discharge or assign the security at the value hitherto specified.

Para. 17.12

Clause 45(2) and (4)

3.90 A creditor may submit a statement of claim at any time, but he must submit it not later than eight weeks before the end of an accounting period to be entitled to participate in the dividend payable in respect of that period. Where the permanent trustee rejects a creditor's claim, he must notify the creditor and give reasons for the rejection. Rights of appeal would be available to the bankrupt and to any creditor dissatisfied with the acceptance or rejection of any claim.

Paras. 17.15, 17.18 and 17.19

Clauses 45(1)  
46(4) and (6)

### ***Calculation of amount of claims***

3.91 We propose the retention of the present rule that a creditor is entitled to claim in respect of the accumulated sum of principal and (in the case of interest-bearing debts) interest to the date of the sequestration. The value of debts payable at a future date is to be determined as under the present law by deduction of interest referable to the period from the date of

the sequestration until the due date of payment. A creditor should deduct from the amount of his claim discounts (other than discounts for payment in cash) which are allowable by the contract between the creditor and the debtor, by their course of dealing, or by usage of trade.

Paras. 16.10–16.12, 16.44

Clause 45  
Sched. 1, para. 1

3.92 A person entitled to aliment or to a periodical allowance payable on divorce should be entitled to claim for unpaid aliment or for unpaid periodical allowance for any period up to the date of the sequestration only where the amount of the aliment or periodical allowance has been quantified, and in respect of which there is a court decree or other evidence in writing and where, in the case of spouses, the parties are living apart. No person should be entitled to claim out of the bankrupt estate aliment or the amount of a periodical allowance in respect of any period after the date of sequestration.

Paras. 16.39 and 16.40

Sched. 1, para. 2

3.93 Simplified provision is made for the valuation of debts which depend upon a contingency or whose amount depends upon a contingency and, in the sequestration of the estate of a partner of a firm, for the valuation of the creditor's claim against the estate of the firm.

Paras. 16.13 and 16.33

Sched. 1, paras. 3 and 6

3.94 In calculating the amount of his claim, a creditor must deduct the value of any security held by him over the bankrupt's estate. The present rules designed to prevent the under-valuation of securities should be replaced by a single rule empowering the trustee at any time after the expiry of 12 weeks from the date of the sequestration to require a secured creditor to discharge his security or to convey or assign it to the trustee at the value specified by the creditor.

Paras. 16.15–16.25

Sched. 1, para. 5

3.95 It is proposed that—

- (1) interest to the date of sequestration on the interest-bearing debts ranked for payment will be admitted at the rate, conventional or otherwise, appropriate to the debt;
- (2) in the event of there being a surplus after payment in full of all the debts (other than the debts of postponed creditors)—including interest to the date of sequestration on interest-bearing debts—interest at eight per cent or at a rate to be prescribed will be paid on *all* the debts (other than the debts of postponed creditors) ranked for payment, in respect of the period from the date of sequestration to the date of payment;
- (3) if any residue of the estate remains after payment of post-sequestration interest in accordance with paragraph (2) above, it will be used to meet in whole or in part the claims of any postponed

creditors (including claims to post-sequestration interest where the estate available so permits);

- (4) secured creditors should retain all existing rights to satisfy their claims to interest out of the security subjects.

Paras. 16.44–16.48

Clause 48(1)(f)–(h) and (6)

3.96 In the event of revival of a sequestration following the failure of an arrangement for payment of a composition, the creditors should be entitled to claim the same amount as they would have been entitled to claim if they had not accepted the composition less any amounts paid to them under the composition contract.

Para. 16.14

Sched. 1, para. 4

### ***Order of distribution***

3.97 The order in which the divisible funds of the bankrupt estate should be distributed should be amended. That order should be as follows:

- (1) the outlays and remuneration of the interim trustee,
- (2) those of the permanent trustee,
- (3) the deathbed and funeral expenses of a deceased debtor together with any expenses of administering his estate, and
- (4) the expenses of the petitioning or concurring creditor in obtaining sequestration.

Thereafter preferred debts and those of ordinary creditors should be paid and, if any estate remains, post-sequestration interest at a prescribed rate on the preferred and ordinary debts. After these have been paid in full, any postponed debts should be paid. Thereafter, any surplus should be made over to the bankrupt.

Paras. 16.48  
18.5–18.13

Clause 48(1)–(5)

### ***Preferred debts***

3.98 Various enactments giving priority in the distribution of a bankrupt's estate to certain taxes, duties and contributions owed to government departments, to local rates for one year and to certain other debts should be repealed. The only debts which should retain the status of preferred debts (apart from those mentioned in the preceding paragraph) are employees' claims for wages (which by statute include certain other payments made to an employee) and holiday pay, and advances made by any person for the payment of the wages of employees.

Paras. 15.5 and 15.7–15.22

Clause 48(1)(e) and (g)(i),  
(2) and (7)



subsequent accounting period he should be entitled, on the acceptance of his claim, to receive out of any available money in the hands of the trustee, after making an allowance for contingencies, an equalising dividend equal to any dividend he may have failed to receive. This proposal would be general in its effect, making it unnecessary to re-enact section 120 of the 1913 Act.

Paras. 17.13  
18.23

Clause 49(8) and (9)

3.104 Provision is made for the acceleration of the payment of any dividend other than the dividend in respect of the first accounting period, and for the postponement of the payment of any dividend to a time which is not later than the time for payment of the dividend in respect of the next accounting period.

Para. 18.18

Clause 49(5) and (6)

3.105 The permanent trustee, notwithstanding the foregoing rules relating to accounting periods, should be entitled with the consent of the commissioners (if any) to pay at any time any preferred debt.

Para. 18.18

Clause 49(4)

3.106 Provision is made for the adjustment of dividends to correct the effect of earlier over-valuations and under-valuations of claims. Recommendations are made relating to the method of payment of dividends and the disposal of unclaimed dividends.

Paras. 18.25 and 18.28

Clause 50(7) and (9)

#### ***Discharge of the bankrupt without composition***

3.107 The rules for the discharge of the bankrupt without composition should be altered to enable him, without the consent of any creditor, to apply to the sheriff for his judicial discharge (an "accelerated" discharge) after the lapse of one year from the date of the sequestration. They should also provide for the bankrupt's discharge by operation of law on the expiry of five years from the date of the sequestration, unless the permanent trustee or a creditor makes a successful application to the court for an order deferring that discharge. Where the court makes an order deferring the bankrupt's discharge, he should be held to be discharged at the expiry of the period of deferment. The provisions for discharge by operation of law should be applied to sequestrations in existence before the new proposals come into force.

Paras. 19.13-19.22

Clauses 51-53

3.108 A bankrupt who has been discharged by operation of law should be entitled, on payment of a prescribed fee, to obtain from the Accountant in Bankruptcy a certificate that he has been so discharged.

Para. 19.15

Clause 53(2)

3.109 Among the conditions of any application by the bankrupt for his "accelerated" discharge or of his right to oppose an application for the deferment of his discharge by operation of law should be the lodging by him in court of a declaration that he has made a full and fair surrender of his estate and a full disclosure of all claims which he is entitled to make against other persons and that he has delivered to the interim or permanent trustee all title deeds and other documents in his possession or under his control relating to his estate or to his business and financial affairs.

Paras. 19.16, 19.22

Clauses 51(2)  
53(4)(b)

3.110 At any hearing on such applications the permanent trustee or, if he has been discharged, the Accountant in Bankruptcy would lodge in court a brief report on the bankrupt's assets and liabilities, upon his business and financial affairs and his conduct in relation thereto, and upon the sequestration and the bankrupt's conduct in the course of it. The consents of creditors or payment to them of a dividend of a specified amount should not be a condition of the debtor's discharge.

Paras. 19.17 and 19.22

Clauses 51(4)  
53(5)

#### ***Effects of bankrupt's discharge***

3.111 The effect of the bankrupt's discharge should be to discharge him, in England and Wales as well as in Scotland, of all debts or other obligations which could found a claim in the sequestration and should do so irrespective of the law which governs such debts or obligations. This discharge, however, should not free the debtor from certain liabilities, notably

- (1) any liability to pay a fine or other penalty due to the Crown;
- (2) any liability incurred by reason of fraud or breach of trust; and
- (3) any liability for aliment or for periodical payments on divorce, other than liabilities in respect of which a claim might have been made on the sequestered estate.

Paras. 19.23–19.24

Clause 54

#### ***Discharge on composition***

3.112 The facility of discharge on composition should be retained but the procedure should be simplified *inter alia* to make unnecessary meetings of creditors to consider the offer. The offer would be submitted in the first place to the permanent trustee, who would report on its terms to the commissioners or, if there are no commissioners, to the Accountant in Bankruptcy. The offer need not be placed before the creditors unless the commissioners or, as the case may be, the Accountant conclude that there is a reasonable assurance that the offer will be timeously implemented, that the caution or other security offered is satisfactory, and that implementation of the offer would be likely to secure payment of a dividend of at least 25 pence

in the pound in respect of the ordinary debts.

Paras. 19.27–19.29

Sched. 3, paras. 1–3

3.113 The trustee would then advise the creditors of the offer, report to them on its terms and the security offered, and invite its acceptance or rejection. Where the trustee concludes that a specified majority of the creditors have accepted the offer of composition, he would apply to the sheriff for approval of the composition. On its approval, the permanent trustee would submit his accounts for audit and a claim for his remuneration to the commissioners (or, as the case may be, to the Accountant in Bankruptcy). Having taken payment of his outlays and remuneration, the trustee would lodge with the sheriff clerk the bond of caution or other security for payment of the composition and a certificate relating to the payment of his outlays and remuneration. The sheriff would then make an order discharging the bankrupt (under reservation of the claims of the creditors against the bankrupt and cautioner for payment of the composition) and re-investing him in his estate and discharging the trustee.

Paras. 19.30–19.36

Sched. 3, paras. 4–16

3.114 A bankrupt should be entitled to submit two, but no more than two, offers of composition for consideration by the creditors.

Para. 19.37

Sched. 3, para. 15

#### ***Remuneration and discharge of the permanent trustee***

3.115 Having considered alternative methods for the auditing of the permanent trustee's accounts and the fixing of his remuneration, we propose that there should be no substantial departure from the existing law under which the trustee's accounts are audited by and his remuneration fixed by the commissioners. Where there are no commissioners (as in a small assets case) these tasks would be undertaken by the Accountant in Bankruptcy. We recommend also that, while the trustee's remuneration would continue to be calculated as a percentage of the assets realised, it should be admissible to take into account both the work carried out by the trustee and the extent of his responsibilities in the administration of the debtor's estate. It should also be provided that, until the trustee's final accounts are submitted, any remuneration paid to him should be treated as provisional only and that a final determination of his remuneration should not be made until the close of the sequestration.

Paras. 20.7–20.9

Clause 50(1)–(5)

3.116 It should no longer be necessary for the trustee to apply to the court for his discharge. After he has made a final division of the bankrupt's funds, deposited unclaimed dividends, and sent a copy of his audited accounts, a receipt for the deposit of the unclaimed dividends, and the sederunt book to the Accountant in Bankruptcy, he should be entitled to apply to the Accountant for a certificate of discharge. The sederunt book should contain such records of all proceedings in the sequestration as may be

necessary to give an accurate view of the management of the estate. There would be rights of appeal to the sheriff against the Accountant's decision to grant or to refuse to grant the discharge.

Paras. 20.11 and 20.16

Clauses 3(1)(c)  
56(1), (4)

3.117 The effect of the trustee's discharge should be stated in the legislation to follow on this Report. It should have the effect of discharging the trustee from all liability to the creditors or to the bankrupt in respect of any acts or omissions of the trustee in the exercise of his functions as trustee, other than liability arising from fraud.

Para. 20.18

Clause 56(5)

### *The estates of persons deceased*

3.118 The present alternative facilities for the winding-up of the estates of persons deceased either by sequestration or by the appointment of a judicial factor should be retained.

Para. 21.8

Clause 5(1)

3.119 A petition for sequestration at the instance of an executor of a deceased debtor should be competent at any time. This proposal together with our proposal (see para. 3.132) that a trustee under a private trust deed for creditors should be entitled to apply at any time for the sequestration of the estate of the granter of the deed makes it unnecessary to retain the provision in section 11 of the 1913 Act allowing a petition for sequestration at the instance of a mandatory of a deceased debtor.

Paras. 21.9 and 21.13  
24.18

Clauses 5(3)  
8(3)

3.120 Unless the apparent insolvency of the deceased has been constituted within the four months preceding his date of death, a creditor's petition for sequestration should not be competent until the lapse of six months from the deceased's date of death.

Para. 21.11

Clause 8(3)

3.121 When a deceased's estate is insolvent, his executor should be encouraged to petition either for the sequestration of the estate or for the appointment of a judicial factor to administer it. It should be provided, therefore, that, if an executor fails to do so within a reasonable period after he knew or ought to have known that the estate was insolvent, any subsequent intromission by him with the estate shall be deemed to be an intromission without a title.

Para. 21.10

Clause 8(4)

3.122 The date of death of a deceased debtor should be the relevant date for determining what preferred debts (that is, salaries or wages for a specified period) are payable to the deceased's employees. The date of death should

also be relevant for the reduction of preferences acquired by diligence or by the debtor's voluntary act where sequestration or the appointment of a judicial factor on an insolvent estate follows within seven months of death. In other respects the date of sequestration (or the date of appointment of the judicial fact) should be the relevant date.

Para. 21.18	Clauses 33(2) 34(1)(c) 35(1)(c) 36(6) 48(2)
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3.123 Sections 163 and 164 of the 1913 Act should not be repealed. A judicial factor on the insolvent estate of a deceased person appointed within seven months after the deceased's date of death should possess the same rights as a trustee in a sequestrated estate to challenge gratuitous alienations, unfair preferences and orders for financial provision on divorce under the proposed statutory provisions. The judicial factor should also have a right to challenge gratuitous alienations and unfair preferences under the common law rules.

Paras. 21.20–21.21	Clauses 33(3)(b) and (7) 34(2) 35(4)(b) and (6)
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#### ***Procedural and other defects***

3.124 Without prejudice to the powers of the Court of Session acting under the *nobile officium*, the sheriff should be entitled to make orders waiving any failure to comply with statutory provisions, and restoring persons prejudiced by such failure to the position they would otherwise have been in. The sheriff should also have power to make such orders as may be necessary to revive a dormant sequestration or to enable a sequestration to proceed.

Paras. 7.44–7.47	Clause 61
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#### ***Publication and registration requirements***

3.125 The requirement of publication in the *Edinburgh Gazette* of notices relating to the most important steps in the sequestration process should be retained, but the trustee should be given a discretion in relation to steps of less importance.

Para. 22.5	
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3.126 The present Register of Sequestrations should be widened to include notices relating to "protected" trust deeds for creditors, and should be re-named the Register of Insolvencies.

Paras. 22.6 and 22.12	Clause 1(1)(c)
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3.127 Notice of the more important steps in sequestration procedure should be given to the Accountant in Bankruptcy both to enable him to

exercise his general duty to supervise the performance by interim trustees, permanent trustees and commissioners of their duties under bankruptcy legislation and to enable him to prepare essential statistics.

Paras. 22.9–22.12

3.128 Provision similar to that in sections 44 and 145 of the 1913 Act for the registration of “abbreviates” in the Register of Inhibitions and Adjudications should be retained, but there should be sent for registration not abbreviates of orders pronounced by the court but copies of the orders. It is no longer necessary to retain the provision made by sections 75 and 101 of the 1913 Act for the registration in the Register of Inhibitions and Adjudications of abbreviates in connection with the appointment of the trustee and the recovery of estate of a deceased debtor.

Paras. 22.13–22.19

Clauses 14  
17(7)  
51(8)  
53(7)

### **Bankruptcy offences**

3.129 Where the permanent trustee has information in his possession which leads him to suspect that the debtor or any other person concerned with the administration of the debtor’s estate has committed an offence in relation to the sequestration, he shall report the matter to the Accountant in Bankruptcy.

Paras. 23.9–23.12

Clause 3(3)

3.130 When the Accountant in Bankruptcy has information which leads him to suspect that an interim trustee, permanent trustee or commissioner has committed an offence in the performance of his functions in the course of a sequestration, he should report the matter to the Lord Advocate. A similar duty should be imposed on the Accountant where he has information which leads him to suspect the commission by the debtor, or by other persons in their dealings with the debtor, of an offence in relation to the debtor’s assets or his business or financial affairs.

Para. 23.9

Clause 1(4)

3.131 New provisions for bankruptcy offences should be enacted avoiding, where practicable, any duplication of common law offences and embodying a consistent approach to *mens rea* and to the defences available to an accused person. It should be competent to prosecute bankruptcy offences both summarily and on indictment. It should be competent to commence summary proceedings at any time within six months after the date on which evidence sufficient in the opinion of the Lord Advocate to justify the proceedings comes to his knowledge.

Paras. 23.7 and 23.12

Clauses 65  
66



the trust deed relating to the surrender of any preferences acquired by arrestments or poindings during that period of 60 days.

Paras. 5.20  
13.6  
24.33

Clause 7(1)(c)(i)  
Sched. 4, para. 6(a)

## CHAPTER 4

### ADMINISTRATION OF BANKRUPTCY PROCEDURES

#### The Accountant in Bankruptcy

4.1 As we explained in Chapter 2, we consider that the Scottish system of bankruptcy administration should be strengthened by the institution of a system of interim trustees.<sup>1</sup> This and other changes which we propose in this Report make it necessary to review the role of the Accountant of Court in the bankruptcy process.

4.2 We considered reverting to the position under the 1856 Act, where a separate official, the Accountant in Bankruptcy, was charged with the supervisory functions in bankruptcy now assumed by the Accountant of Court. We concluded, however, that the balance of advantage lay rather in re-defining the responsibilities of the staff of the Accountant of Court's department. A department confined to Scottish bankruptcy administration would necessarily be a small one, which might find it difficult to recruit staff of the calibre required for its specialised tasks. We envisage, therefore, that the Accountant of Court, with certain exceptions occasioned by the changes which we recommend in sequestration procedure, would continue to exercise his existing functions in sequestrations but should assume certain additional functions envisaged in this Report. In our view, however, his functions should be the responsibility of a distinct division within his department, and the Accountant of Court in carrying out his administrative and supervisory duties in bankruptcy should be referred to by his original title of Accountant in Bankruptcy. We so recommend.

4.3 Some of the procedural simplifications which we propose would lead to a diminution of the tasks of the Accountant.<sup>2</sup> It is undoubtedly true, however, that the changes which we propose would tend to increase his tasks. The introduction of a system of interim trustees makes it necessary to impose a duty on the Accountant to maintain a list or panel of interim trustees, to supervise the performance of the duties of interim trustees, to audit their accounts, and to meet out of public funds their outlays and remuneration (including their outlays and remuneration when, in the absence of an election, they become permanent trustees), to the extent that the fees and outlays cannot be satisfied from the bankrupt estate. The simplified procedure which we propose for dealing with small assets cases, though designed as far as practicable not to occasion expense to the State, will also impose additional duties on the Accountant.<sup>3</sup>

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<sup>1</sup>See paras. 2.42-2.48.

<sup>2</sup>His consent, for example, to the sale of heritage by private bargain under s. 111 of the 1913 Act would no longer be required. His duty under s. 74 of that Act to report on the question of a special allowance to the bankrupt would disappear. We have proposed, notably, in para. 2.24 the abolition of the procedure of summary sequestration, so that the duties of the Accountant in relation to that procedure would eventually cease.

<sup>3</sup>Paras. 7.32-7.36.

4.4 We propose that the Accountant in Bankruptcy should be given notice of every petition for sequestration and other principal applications to the court in a sequestration process so that he may make, if he thinks fit, appropriate interventions or representations. He should exercise some of the duties of commissioners where none have been appointed by the creditors;<sup>4</sup> he would have the power to intervene in certain cases to ensure the protection of the public interest in sequestration procedure, for example, by calling for the public examination of the bankrupt<sup>5</sup> or, when the trustee has been discharged, presenting a report on the debtor's conduct in relation to this discharge.<sup>6</sup> He would be entitled to apply to the court for the removal of a trustee.<sup>7</sup> We envisage that he should have certain powers and duties for the purpose of ensuring that sequestrations are carried to their proper conclusion,<sup>8</sup> including a residual power to nominate a trustee where none has been elected,<sup>9</sup> and powers to fix caution where the creditors fail to do so<sup>10</sup> and to require the trustee to convene a meeting of creditors.<sup>11</sup>

4.5 Otherwise the functions of the Accountant in Bankruptcy would not be materially different from those of the Accountant of Court. The Accountant in Bankruptcy's main task would remain that of supervising the administration of bankruptcy procedures<sup>12</sup> by the permanent trustee and the commissioners and, as we propose, by the interim trustee. He would receive from the interim trustee, and would consider, the debtor's statement of affairs, and the interim trustee's comments thereon relating *inter alia* to the causes of the insolvency.<sup>13</sup> He would receive from the permanent trustee the trustee's inventory and valuation of the debtor's estate which at present are required to be submitted to the Accountant of Court under section 76 of the 1913 Act.<sup>14</sup> He would receive from the trustee copies of the trustee's accounts and would be empowered to require the interim trustee or the permanent trustee to supply such further information relating to the bankrupt or his estate as the Accountant considers necessary for the discharge of his statutory functions.<sup>15</sup> The Accountant, therefore, would be well placed to investigate, or call for the investigation of, matters connected with or arising from a sequestration.

4.6 The Accountant of Court, under section 158 of the 1913 Act, has a duty to:

"take cognizance of the conduct of trustees and commissioners in all sequestrations, and, in the event of their not faithfully performing their

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<sup>4</sup>Paras. 4.30, 10.9–10.16.

<sup>5</sup>Para. 14.22.

<sup>6</sup>Para. 19.17.

<sup>7</sup>Para. 9.25.

<sup>8</sup>Para. 9.28.

<sup>9</sup>Para. 9.28.

<sup>10</sup>Para. 9.13.

<sup>11</sup>Para. 10.29.

<sup>12</sup>*Cf.* 1913 Act, s. 158.

<sup>13</sup>Para. 7.26.

<sup>14</sup>Para. 10.34.

<sup>15</sup>Para. 10.35.

duties and duly observing all rules and regulations imposed on them by statute, act of sederunt, or otherwise relative to the performance of those duties, or in the event of any complaint being made to him by any creditor in regard thereto, he shall inquire into the same, and, if not satisfied with the explanation given, he shall report thereon to the Lord Ordinary or the Sheriff, who, after hearing such trustees or commissioners thereon, and investigating the whole matter, shall decide, and shall have power to censure such trustees or commissioners, or remove them from their office, or otherwise to deal with them as the justice of the case may require.”

In our view the Accountant in Bankruptcy should have similar duties in relation not only to the permanent trustee and commissioners, but also to interim trustees.

4.7 The Accountant of Court under the present law<sup>16</sup> has also a duty to report to the Lord Advocate where he possesses:

“information that shall lead him, on reasonable grounds, to suspect fraudulent conduct by the bankrupt, or malversation, or misconduct on the part of the trustee or commissioners, such as may infer punishment.”

We propose that, with minor modifications,<sup>17</sup> this duty should be retained in the legislation to follow on this Report. The Accountant in Bankruptcy will receive from the interim trustee at an early stage in every sequestration process the bankrupt’s statement of affairs together with the interim trustee’s comments thereon relating to the causes of the insolvency and to the extent to which the bankrupt’s conduct may have contributed to the insolvency. The statement of affairs and the comments should place the Accountant in a better position than he is at present to report to the Lord Advocate the possible commission of offences by the bankrupt and others.

## **Interim trustees**

### **General**

4.8 We considered in Chapter 2 the various justifications for the institution of a system of interim trustees. Its principal justification lies in the fact that the appointment early in the sequestration process of an interim trustee would enable him to receive from the debtor a statement of affairs<sup>18</sup> and investigate the state of the debtor’s liabilities and assets with a view to advising the creditors and to deciding what further procedures should be adopted to wind up the debtor’s affairs.<sup>19</sup> The bankrupt’s statement of affairs and the interim trustee’s written comments upon it, moreover, as we have explained, should place the Accountant in a better position to fulfil his duty to report to the Lord Advocate his suspicion of the commission of offences by the bankrupt. It is also a justification for the institution of a system of interim trustees that it should secure more effectively the interim

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<sup>16</sup>1913 Act, s. 161.

<sup>17</sup>Para. 23.9.

<sup>18</sup>See paras. 7.21–7.22.

<sup>19</sup>See paras. 7.23 and 7.28.

preservation of the debtor's assets between the date of the first deliverance in the sequestration and the issue of the act and warrant confirming the appointment of the permanent trustee. We propose, therefore, that in every sequestration, on (or in certain instances before) the grant of the award, there should be appointed an interim trustee who would be charged with the duties described below.

4.9 The period for which the interim trustee would hold office and discharge his duties would seldom exceed six weeks,<sup>20</sup> and could be less, but the fact that the period would be short does not in any way diminish the importance of his tasks. While no change is envisaged in the present rule by which the debtor is not divested of his property until it is vested in the permanent trustee, we consider that, on the appointment of the interim trustee, the debtor should be bound thereafter to comply with any general or particular directions from the interim trustee relating to the management of his estate. In some cases the mere existence of this rule should suffice, and the interim trustee need not intromit directly with the estate. In other cases, however, he would require to take protective measures to preserve the debtor's business books and property and, perhaps, his business as a going concern.<sup>21</sup>

4.10 The interim trustee would convene the statutory meeting of creditors by giving the creditors not less than seven days notice of the date, time and place of the meeting. In cases other than small assets cases the main purpose of this meeting would be to elect the permanent trustee. If, however, the creditors fail to elect a permanent trustee or if the interim trustee determines that the sequestration should proceed as a small assets case, the interim trustee would become permanent trustee. After the conclusion of the election proceedings (if any) and the confirmation of the appointment of the permanent trustee, the interim trustee (unless he himself became permanent trustee) would hand over to the permanent trustee such property and papers of the bankrupt as were in his possession or under his control.

#### *Qualifications of interim trustee*

4.11 We envisage that, normally, a person should be eligible for appointment as interim trustee only where—

- (a) he would not be disqualified for appointment as permanent trustee in the sequestration of the debtor's estate;<sup>22</sup>
- (b) he possesses such professional and other qualifications and fulfils such conditions as may be prescribed for permanent trustees by regulations made by the Secretary of State;<sup>23</sup>
- (c) he has complied with such requirements for the finding of caution or security for his intromissions as may be prescribed by regulations;<sup>24</sup>

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<sup>20</sup>It is proposed that the meeting for the appointment of a permanent trustee should normally take place not later than 28 days after the date of the award of sequestration—see para. 9.7.

<sup>21</sup>See paras. 7.19–7.20.

<sup>22</sup>See para. 4.20.

<sup>23</sup>See para. 4.21.

<sup>24</sup>Para. 4.13.

- (d) his name is included in a list of persons (to be maintained by the Accountant in Bankruptcy) from which interim trustees are to be appointed.

As we explain above,<sup>25</sup> responsibility for the maintenance of the list of interim trustees should lie with the Accountant in Bankruptcy. It should be provided that the Accountant must include in the list any applicant who has the prescribed qualifications and fulfils the prescribed conditions, and who resides within the jurisdiction of the Court of Session. Conversely, the Accountant should omit from the list the name of any person who does not meet these requirements and, when a person no longer meets these requirements, the Accountant should remove his name from the list. The Accountant should be bound to remove a person's name from the list at his own request, or if it appears to the Accountant that the person concerned has ceased to fulfil the prescribed qualifications or conditions or if, on an application by the Accountant to the sheriff of the sheriffdom in which the person is habitually resident or his principal place of business is, or was last, situated, the sheriff is satisfied that the person is incapacitated from acting as interim trustee or has so conducted himself that it is unfitting that his name should remain on the list. Any person aggrieved by the exclusion or the removal of his name from the list would have a right of appeal to the Court of Session. The fact that a person's name has been removed from the list at his own request would not absolve him from completing his duties as interim trustee in any subsisting sequestration.

#### ***Appointment of interim trustee***

4.12 In a petition for sequestration other than one presented by a creditor the interim trustee would be appointed by the court at the date of the award of sequestration, or as soon as may be thereafter, from the list of persons maintained by the Accountant in Bankruptcy. In creditors' petitions, the court should be required to appoint the interim trustee not later than the date of the award of sequestration but should be empowered to do so earlier, *i.e.* at or after the presentation of the petition but before the award—

(1) with the written consent of the debtor; or

(2) if a creditor or any other person with an interest shows cause.

The need to have an interim trustee in every sequestration implies that, in principle at least, a person whose name appears on the list maintained by the Accountant in Bankruptcy should not be entitled to decline to accept his appointment by the court. In practice, however, we envisage that the petitioning creditor or the court staff would have informally ascertained in advance who might be ready to accept the appointment. We recommend, therefore, that it be made clear that a person whose name appears on the list of interim trustees maintained by the Accountant in Bankruptcy should not be entitled to decline to accept appointment by the court.

#### ***Caution***

4.13 We have considered whether the interim trustee acting as such should be obliged to find security for his intrusions and for the

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<sup>25</sup>Para. 4.3.

performance of his duties. While trustees in sequestration must under present law find caution—a requirement which we consider should be retained<sup>26</sup>—the position of interim trustees would be significantly different. The debtor's estate would not be vested in them, their duties would be of an interim character, and they would be appointed from a panel of persons having prescribed qualifications and fulfilling prescribed conditions. We consider, however, that a person who is judicially appointed to administer another person's estate should be required to find caution for his intromissions. We recommend, therefore, that the power of the Secretary of State to make regulations should include power to make regulations in respect of the finding of caution by interim trustees. It should also be made clear that the premium on the interim trustee's bond of caution (or a proportion or part of that premium) will form a charge on the debtor's estate.

#### ***Resignation and replacement of interim trustees***

4.14 The period of office of an interim trustee would be relatively short<sup>27</sup> and for this reason we suggest that he should not be permitted to resign office unless authorised to do so by the court. The court would then appoint another interim trustee. In the event of a casual vacancy in the office of interim trustee, the bankrupt, any creditor or the Accountant in Bankruptcy should be entitled to apply to the court for the filling of the vacancy.

#### ***Outlays and remuneration of the interim trustee***

4.15 Some of the duties which, as we have recommended, should be imposed upon interim trustees have been so imposed mainly in the interests of the creditors. This applies to his duties relating to the interim preservation of the estate, the preliminary investigation of the debtor's affairs, and the convening of the first meeting of creditors. We have proposed, however, the imposition of other duties mainly in the public interest. This applies to the interim trustee's duty to secure the continued administration of the sequestration in small assets cases, to his duties to report on the causes of the bankruptcy and on the extent to which the conduct of the debtor may have contributed to the insolvency. While in principle the cost of the work done by the interim trustee in the interest of the creditors should be met from the bankrupt's assets and that of his work in the public interest from the public purse, any precise allocation of the interim trustee's fees and expenses, if not wholly impracticable, would certainly conduce to further expense. It would seem reasonable, therefore, to provide that the outlays and remuneration of the interim trustee should constitute a first charge on the free funds of the bankrupt's estate after provision has been made for the redemption of securities and other necessary payments in priority over all other claims, including those of the permanent trustee. In those cases, however, where the estate is insufficient to meet, in whole or in part, the outlays and remuneration of the interim trustee, those outlays and remuneration, or the balance of those outlays and remuneration, should be met out of public funds by the Accountant in Bankruptcy. We have

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<sup>26</sup>See paras. 4.22–4.23.

<sup>27</sup>See para. 4.9.

recommended above<sup>28</sup> that a person whose name appears on the list of interim trustees should not be entitled to decline to accept his appointment by the court. Without such contingent underwriting of their outlays and remuneration, eligible persons would be unlikely to agree to place their names on the list of interim trustees maintained by the Accountant in Bankruptcy. The same principle should apply where the interim trustee succeeds otherwise than by election to the office of permanent trustee, that is, where the interim trustee is deemed to have been elected as permanent trustee or where he becomes permanent trustee in a small assets case. In either of the two cases the interim trustee must undertake the duties of the permanent trustee, so that the contingent underwriting of his outlays and remuneration out of public funds seems appropriate. If the defects in the present system of bankruptcy administration in Scotland are to be cured, this assumption of liability by the State seems to be inescapable. Accordingly, we recommend—

- (a) that the outlays and remuneration of the interim trustee, whether acting as interim trustee or subsequently as permanent trustee in default of any election to that office, should enjoy in relation to the free funds of the bankrupt's estate a preference over all other claims in a sequestration;
- (b) that where the sequestrated estate is insufficient to meet the outlays and remuneration, the deficiency should be met out of public funds by the Accountant in Bankruptcy.

We consider below questions relating to the funding of this system of bankruptcy administration.<sup>29</sup>

4.16 The audit of the interim trustee's accounts requires consideration. We do not envisage that, in the ordinary case, the interim trustee would intromit to any extent with the bankrupt's estate, which is not vested in him. But he might take charge of funds in the hands of the bankrupt to protect the interests of creditors and incur incidental expenses, making it necessary for him to present at least rudimentary accounts. Where the interim trustee is acting as such and not as permanent trustee, there are no commissioners, and it seems appropriate that he should submit his accounts and a claim for his remuneration and expenses to the Accountant in Bankruptcy, who would audit these accounts and fix the amount of the remuneration and expenses payable to the interim trustee. The same principle, we propose, should apply to the auditing of the accounts and the claim for remuneration of the permanent trustee, wherever there are no commissioners. Thus in a small assets case, where no commissioners may competently be elected, the interim trustee necessarily becomes the permanent trustee and his accounts as permanent trustee would be audited and his remuneration fixed by the Accountant in Bankruptcy.

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<sup>28</sup>See para. 4.12.

<sup>29</sup>Paras. 4.40–4.49.

## The permanent trustee

### *Introduction*

4.17 The trustee has a central role in the present system of bankruptcy administration in Scotland. He is more than the mere agent or representative of the creditors. He becomes the proprietor in trust of the insolvent estate, and requires to take possession of it and to recover it, if need be, from third parties. He has important duties in the management of the estate, in advertising for claims by creditors, in judging (in the first instance at least) such claims and the ranking of such claims. He has duties relating to the realisation of the estate, its division among the creditors and, should any residue remain, its return to the debtor. He has consequential duties to account. In carrying out his duties to manage, realise and recover the estate he is subject to the directions given by the creditors at any meeting.<sup>30</sup> If no such directions are given, the trustee is bound to act under the advice, and in some cases subject to the consent, of the commissioners.<sup>31</sup> The latter, indeed, under the present law have a general duty to superintend the proceedings of the trustee.<sup>32</sup>

4.18 The implementation of our proposals would give the interim trustee a significant role in sequestrations, but at a stage before the permanent trustee enters upon his functions. The general duties of the permanent trustee would remain intact, but he would not act subject to the directions of the creditors at any meeting but rather subject to the directions of their representatives, the commissioners or, if there are no commissioners, subject to the directions of the Accountant in Bankruptcy. Only in a few specified cases would the consents of commissioners be required.<sup>33</sup> Where they are not required the permanent trustee should be entitled to act on his own initiative. The permanent trustee, therefore, would have enlarged freedom of action and enlarged responsibilities. He would remain, therefore, as he is today, the linchpin of the Scottish system of bankruptcy administration.

### *Election of the trustee*

4.19 Under the present law the trustee is elected by a majority in value of the creditors at their first meeting.<sup>34</sup> The only changes that we recommend are (a) that the election should be by a majority in number and in value of the creditors present or represented at the meeting (which seems to us to be a fairer basis for the election), and (b) that where the creditors fail to elect a permanent trustee, the interim trustee should be deemed to be elected to that office. Indeed, in a small assets case, the interim trustee would become permanent trustee by operation of law. The procedure for the hearing of any objections to the election and for the confirmation by the sheriff of the appointment of the trustee after he has lodged his bond of caution would remain substantially unaltered.

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<sup>30</sup>1913 Act, s. 78.

<sup>31</sup>*Ibid.*

<sup>32</sup>1913 Act, s. 81.

<sup>33</sup>See para. 10.9.

<sup>34</sup>1913 Act, ss. 64, 96.

### *Qualifications of the trustee*

4.20 Section 64 of the 1913 Act provides that:

“...it shall not be lawful to elect as trustee the bankrupt, or any person conjunct or confident with the bankrupt, or who holds an interest opposed to the general interest of the creditors, or whose residence is not within the jurisdiction of the Court of Session.”

We propose to retain the substance of this rule although, as we explain in Chapter 12, we recommend that the expression “conjunct or confident person” should be replaced by the expression “a person who has a family or business relationship with the bankrupt” which would have substantially the same connotation.<sup>35</sup> While there is a *prima facie* case for going further and excluding from the office of trustee other persons such as undischarged bankrupts, we consider that no special provision need be made because such persons are not likely to be able to find caution.

4.21 Under the present law no professional qualifications need be possessed by candidates for the office of trustee. It was suggested to us, however, that the possession of an appropriate professional qualification in Scotland would be desirable. At lowest, it was suggested, this would ensure that the trustee would have a measure of understanding of the issues involved and, at best it would help to ensure that appropriate standards of professional expertise were applied to a task which, in modern conditions, can be extremely complex.<sup>36</sup> We agree with that view and recommend, therefore, that no person should be appointed as a trustee unless he possesses appropriate professional or other qualifications and fulfils any other conditions that may be stipulated. These should be matters for the Secretary of State to prescribe by regulations made by statutory instrument, but we envisage that the persons concerned would be accountants or solicitors holding recognised and current qualifications to practise in Scotland.

### *Caution*

4.22 Under the present law, at the meeting for the election of the trustee, the creditors fix the amount of the security which the trustee has to find in connection with the performance of his duties. The person elected as trustee must thereafter obtain the required bond of caution and, within seven days of his election, lodge it with the sheriff clerk.<sup>37</sup> Our Working Party argued that caution should be required only where the sequestration was involuntary, that is, where it was initiated by a creditor without the consent of the debtor.<sup>38</sup>

4.23 On consultation there was a marked divergence of views on this question. Our view is that, whatever the theoretical attractions of

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<sup>35</sup>Para. 12.20.

<sup>36</sup>Few complaints have been drawn to our attention relating to the mis-management of sequestrations, but this result may arise because those who are appointed trustees are generally drawn from a relatively small number of accountants and solicitors with specialised knowledge of insolvency.

<sup>37</sup>1913 Act, s. 69.

<sup>38</sup>Memo. No. 16, p. 31.

distinguishing between voluntary and involuntary sequestrations in this context, the risk to the creditors is the same in both types of sequestration and that, if the requirement of caution is to be retained, it should be retained generally. Despite the fact that under our proposals the trustee will be a professionally qualified person, the wide range of persons affected by bankruptcy administration, and the extent of the prejudice which they may suffer by maladministration, make it desirable for the trustee to find caution. Accordingly, though we recommend changes in detail to section 69 of the 1913 Act, the principle that the trustee should find caution should be retained.<sup>39</sup> It should also be made clear that the premium on the bond of caution shall be a charge on the sequestrated estate.<sup>40</sup>

### ***Resignation and removal***

4.24 We examine in Chapter 9 the existing procedures for the resignation and removal of trustees. We reject a proposal that the trustee should be entitled to resign at will, but do recommend that the existing law should be widened to permit him to resign with the authority of the court.<sup>41</sup> In relation to the removal of the trustee, we propose the retention in substance of the existing law and make recommendations to allow a majority in number and value of the creditors to remove the trustee, and a person representing not less than one quarter in value of the creditors or the Accountant in Bankruptcy to apply to the court for the removal of the trustee.<sup>42</sup> In addition, we make certain recommendations designed more effectively to secure the replacement of a trustee who has demitted office.<sup>43</sup>

### ***Remuneration and expenses of permanent trustee***

4.25 The trustee is entitled to receive payment from the bankrupt's estate of appropriate remuneration and the expenses incurred by him in the execution of his office. The remuneration is fixed by the commissioners and, for the reasons which we give below,<sup>44</sup> this practice should in general continue and with it the right of appeal to the Accountant in Bankruptcy against the determination of the commissioners, and to the sheriff against the determination of the Accountant. In a case where there are no commissioners, such as a small assets case, the trustee's remuneration would be initially fixed by the Accountant in Bankruptcy, subject, of course, to the usual rights of appeal.<sup>45</sup> As we have recommended above,<sup>46</sup> in any case where the interim trustee becomes permanent trustee in default of an election to that office, the outlays and remuneration of the interim trustee, whether acting as interim trustee or subsequently as permanent trustee, should be a first charge on the free funds of the bankrupt's estate and, where that estate is insufficient to meet the whole or part of those outlays and remuneration, the deficiency should be met out of public funds.

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<sup>39</sup>Para. 9.16.

<sup>40</sup>*Cf.* 1913 Act, s. 69 *ad finem*.

<sup>41</sup>Para. 9.23.

<sup>42</sup>Paras. 9.20 and 9.24–9.26.

<sup>43</sup>Paras. 9.27–9.28.

<sup>44</sup>Para. 20.6.

<sup>45</sup>Para. 20.7.

<sup>46</sup>Para. 4.15.

## Commissioners

### *The present law*

4.26 The commissioners are the representatives of the creditors elected by them to supervise the trustee's intrusions with the sequestrated estate and to advise him as to its management, realisation and recovery. The commissioners have no executive functions in regard to the recovery and distribution of the estate, but they have both a general duty of superintendence and specific duties in matters such as the audit of the trustee's accounts and the declaration of dividends. They receive no payment for these duties.

4.27 The commissioners comprise three persons, creditors or their mandataries, elected by a majority in value of the creditors at the meeting held for the election of the trustee.<sup>47</sup> Their election is declared by a deliverance of the sheriff duly entered in the sederunt book. They are subject to the same personal disqualifications as trustees. They do not require to find caution. A commissioner may resign at any time. He may be removed from office by (a) recall of the mandate granted by his constituent,<sup>48</sup> or (b) a resolution by a majority of the creditors assembled at a meeting called for that purpose,<sup>49</sup> or (c) by the court on a report by the Accountant of Court.<sup>50</sup> The removal of a commissioner by creditors is effected not (as in the case of removal of a trustee) by a majority in number and value but by a majority in value only.<sup>51</sup> Where a commissioner has declined to act, resigns, becomes incapacitated, or has been removed from office, the trustee must call a meeting of creditors for the purpose of electing a new commissioner.<sup>52</sup>

4.28 The principal duties of the commissioners are to "superintend the proceedings of the trustee, concur with him in submissions and transactions, give their advice and assistance relative to the management of the estate, [and] decide as to paying or postponing payment of a dividend ...".<sup>53</sup> They have access to the sederunt books and accounts of the trustee, and to all confidential documents.<sup>54</sup> They may assemble at any time to ascertain the situation of the estate and they may make reports to any general meeting of the creditors.<sup>55</sup> With prior notice to the trustee, they may at any time call a meeting of creditors.<sup>56</sup> The more important duties of the commissioners include the audit of the trustee's accounts and the settlement of his fee,<sup>57</sup> and consenting to the price at which the heritable estate may be sold by public

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<sup>47</sup>1913 Act, ss. 72, 96.

<sup>48</sup>*Ibid.*

<sup>49</sup>s. 73.

<sup>50</sup>s. 158.

<sup>51</sup>s. 73; as read with s. 96.

<sup>52</sup>s. 72.

<sup>53</sup>s. 81.

<sup>54</sup>s. 80.

<sup>55</sup>s. 81.

<sup>56</sup>s. 93.

<sup>57</sup>s. 121.

sale,<sup>58</sup> or to the compromise or referral to arbitration of questions and claims regarding the estate.<sup>59</sup>

4.29 The above description of the role of the commissioners in the process of sequestration suggests that it was designed to be a significant and influential one. It certainly appears to have been such in earlier times when individual creditors took a close interest in bankruptcy administration. Today, however, the major creditors increasingly are large corporations for which an individual bankruptcy is likely to be unimportant. The interest of other creditors may be diminished by reason of the increasing share of estates taken by secured and preferred creditors. It may not always be easy to find creditors who are willing to accept appointment as commissioners. It is understood, too, that the machinery provided by the 1913 Act to facilitate the supervision of the trustee by representatives of the creditors does not always operate effectively in practice.<sup>60</sup>

### *Proposals for reform*

#### *General*

4.30 It seems important, despite occasional difficulties in finding commissioners and possible lack of enthusiasm for their tasks, to retain provision for the continued participation of creditors in the supervision of the trustee's administration through commissioners appointed by them. As we explain elsewhere,<sup>61</sup> we do not propose to retain the existing provision in section 78 of the 1913 Act that, in the recovery, management and realisation of the estate, the trustee should act subject to the directions of the creditors given at a meeting. We propose instead that he should comply with any general or specific directions given to him by the commissioners or, if there are no commissioners, by the Accountant in Bankruptcy.<sup>62</sup> The trustee, moreover, would require to obtain their consent as a condition precedent to taking certain steps in the administration of the estate. Where there are commissioners, therefore, they will retain an important role in the sequestration process. There will be certain cases, however, where there are no commissioners, as where none have been elected or where the elected commissioners have died or resigned. Another case is in "small assets" procedure where the simplicity of the procedure envisaged suggests to us that no commissioners are required.<sup>63</sup> In such cases some, but not all, the functions of the commissioners would devolve on the Accountant in Bankruptcy.<sup>64</sup>

#### *Qualifications of commissioners*

4.31 By virtue of section 72 of the 1913 Act, the disqualifications for office applicable to trustees are extended to commissioners. We consider that

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<sup>58</sup>s. 110.

<sup>59</sup>s. 172.

<sup>60</sup>This is not a new phenomenon. See *Leck v. Gairdner* (1855) 17 D. 1075 and the evidence presented to the Cullen Committee, items 693-6, 2203-9, 2312-7, 3233-5, 5582-9.

<sup>61</sup>See para. 4.18.

<sup>62</sup>Paras. 4.18 and 10.9.

<sup>63</sup>Para. 7.33.

<sup>64</sup>Para. 10.9.

this should remain the general principle but we recommend, in addition, that any person who has a family or business relationship<sup>65</sup> with the permanent trustee should be disqualified from acting as a commissioner. We do not consider that any special professional qualifications should be required of commissioners. They are creditors or their mandataries selected for their business sense and practical experience.

#### *Appointment and removal*

4.32 Commissioners, like the permanent trustee, are elected at the first meeting of creditors by a majority in value of those present and entitled to vote.<sup>66</sup> But, whereas removal of the trustee requires a majority *in number and value* of the creditors at a meeting called for that purpose,<sup>67</sup> a commissioner can be removed by a simple majority in value of the creditors at a meeting for that purpose.<sup>68</sup> We propose to recommend that both the election and removal of the trustee should require to be effected by a majority in number and value of the creditors, and we think that it would make for fairness and avoid confusion if a similar rule were introduced for the election and removal of commissioners. It should be competent for the creditors to elect new or additional commissioners at any meeting but to remove a commissioner from office only at a meeting called for that purpose. We recommend accordingly.

4.33 We also recommend that it should no longer be necessary for the sheriff to declare the election of a commissioner (an unnecessary formality). The adoption of our proposed rules applicable to meetings of creditors would entail that a copy of the minutes of every meeting of creditors would be sent to the Accountant who would, therefore, become aware of new appointments of commissioners.

4.34 We do not propose material changes in the present rules that a commissioner may resign office at any time or, in a case where the commissioner is a mandatory of a creditor, that he will cease to hold office on recall of the mandate. The recall, however, should be intimated to the permanent trustee. It should, we propose, be open to the trustee on his own initiative or if so requested by the commissioners to call a meeting of creditors for the appointment of a new commissioner; but the trustee should not be bound to call such a meeting.

#### *Meetings*

4.35 We have considered but rejected a proposal that the commissioners should meet at prescribed intervals.<sup>69</sup> It would be desirable, however, to provide that a meeting of the commissioners may be called by the trustee at any time on not less than seven days' notice and that he must call a meeting with similar notice on being required to do so by the court or requested to do so by any commissioner or by the Accountant in Bankruptcy. It should

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<sup>65</sup>See para. 12.20.

<sup>66</sup>1913 Act, s. 72, as read with s. 96.

<sup>67</sup>1913 Act, s. 71.

<sup>68</sup>1913 Act, s. 73, as read with s. 96.

<sup>69</sup>See 1914 Act, s. 20(3).

be open to the commissioners to waive the requirements relating to notice. If the trustee fails within 14 days of such a requirement or request to call a meeting, it should be open to a commissioner to call a meeting of commissioners. The quorum at such a meeting should be one, and commissioners should be entitled to act by a majority of their number. The permanent trustee would act as clerk at meetings of commissioners and would record their deliberations in the sederunt book. It would, however, be open to the commissioners to ask the trustee to withdraw from a meeting when they are considering the performance by the permanent trustee of any statutory function; and in that event one of the commissioners would act as clerk and would transmit to the trustee a record of the deliberations for insertion in the sederunt book.

#### *Auditing of the trustee's accounts and fixing his remuneration*

4.36 We recommend in Chapter 20<sup>70</sup> that there should be no substantial departure from the present law that the auditing of the trustee's accounts and the fixing of his remuneration should be a matter for the commissioners, subject to a right of appeal to the Accountant of Court.<sup>71</sup> The present law helps to ensure that the commissioners will examine carefully the actings of the trustee. The main alteration which we propose is that the Accountant in Bankruptcy would fulfil this duty where for any reason there are no commissioners. There would, of course, be rights of appeal by the permanent trustee, the bankrupt and any creditor against any determination by the Accountant, whether at first instance or on appeal.

#### *Miscellaneous*

4.37 We deal elsewhere with the other powers and duties of commissioners including those in relation to the payment of dividends.<sup>72</sup> In some matters we propose modifications but usually of a procedural rather than a substantive character and of no great significance. Our proposals in essence do not imply any fundamental alteration of the role of commissioners but rather its adaptation to serve present-day requirements.

#### **Judicial factors**

4.38 The 1913 Act has two provisions which entrust specific duties to judicial factors, namely, section 14 (which empowers the court to appoint a judicial factor for the immediate preservation of an estate which is the subject of a petition for sequestration) and section 163 (which provides for the winding-up by a judicial factor of the estate of a deceased person). Apart from those two provisions, the court, in the exercise of its *nobile officium*, has always been prepared to appoint a judicial factor on a sequestrated estate in any case where the circumstances point to the necessity for such an appointment, and no other course is available. It has been said that "there is no limit to the circumstances under which the Court, in the exercise of its

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<sup>70</sup>Paras. 20.2–20.9.

<sup>71</sup>1913 Act, ss. 121, 122, 127 and 129.

<sup>72</sup>Paras. 18.14–18.22.

*nobile officium*, may appoint a judicial factor, provided the appointment is necessary to protect against loss or injustice ...".<sup>73</sup>

4.39 If our recommendation for the appointment of an interim trustee in every sequestration is accepted, the retention of a provision akin to section 14 of the 1913 Act would become unnecessary and we recommend that it should be discarded. Section 163, however, is extremely useful in practice and, while it presents certain problems, we consider that, since the section applies whether or not the deceased's estate was insolvent, these problems would be more appropriately examined during the course of any general review of the law relating to judicial factors. We do, however, make certain proposals for extending the powers of judicial factors acting under section 163 to bring them into line with the powers of a trustee in a sequestration of a deceased person's estate.<sup>74</sup> We may add that, while we hope that our proposals for the expansion of the powers of the sheriff in relation to the remedying of procedural defects in sequestrations<sup>75</sup> will largely eliminate the need for petitions to the *nobile officium* of the Court of Session, cases might still arise where recourse to the *nobile officium* for the appointment of a judicial factor could be the only remedy.

#### **The funding of the system**

4.40 Since at present bankruptcy administration in Scotland is left almost entirely to the creditors themselves it is, from the point of view of the State, highly economical. The total expenditure<sup>76</sup> (referable to bankruptcy) of the Department of the Accountant of Court was £24,847 in 1980 and of this £22,805 was met by fees. These fees are regulated at present by the Act of Sederunt (Rules of Court Amendment No. 2) (Court Fees) 1980<sup>77</sup> and the principal fee is a fee of five per cent on the amount to be divided among the preferable and ordinary creditors.

4.41 In England, the General Annual Report of the Department of Trade relating to Bankruptcy contains a Table (No. 10 in the Report for the year 1978) of income and expenditure referable to the insolvency services generally. The total expenditure for the year ending 31st March 1978 was £11,331,000 and receipts £11,674,000 leaving a surplus of £343,000. The receipts include fees of £4,662,000 but the principal element in the receipts is a sum of £6,989,000, the interest on sums belonging to debtor estates invested in an account managed by the National Debt Commissioners. There is no breakdown of these accounts showing even approximately what income and expenditure are referable respectively to bankruptcy and company liquidations. It is understood, however, that the bulk of the interest received derives from sums proceeding from company liquidations. Whatever may be the total expenditure fairly referable to bankruptcy administration it is likely to be relatively greater on a population basis than the corresponding expenditure in Scotland.

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<sup>73</sup>*Leslie's Judicial Factor* 1925 S.C. 464, per Lord President Clyde at 469.

<sup>74</sup>See paras. 21.20-21.21.

<sup>75</sup>Paras. 7.41-7.47.

<sup>76</sup>Calculated from *Management Services Ready Reckoner for Staff Costs*.

<sup>77</sup>S.I. 1980/388.

4.42 The implementation of the proposals which we make in this Report would entail some extension of the present duties of the Accountant of Court in relation to bankruptcy administration. In addition, our proposals for dealing with small assets cases would necessarily entail some increase in public expenditure in Scotland referable to bankruptcy administration. The numbers and status of staff required by the Accountant will clearly be related to the future volume of bankruptcy cases in Scotland. This is extremely difficult to predict. In the five-year period 1974–1978 there were 642 sequestrations, an average of 128 per annum. This number is clearly likely to increase if sequestrations are normally to be carried to completion—as our proposals make possible—in small assets cases, but any estimate of numbers is hazardous since our proposals to enhance the effectiveness of private trust deeds for creditors might lead creditors to resort to such trust deeds with greater frequency. In England, in the period 1974–1978, there were 26,241 bankruptcies—that is, some 5,248 a year—and only 477 deeds of arrangement—that is, some 95 a year. While the English figures may suggest that the present Scottish figures may not reflect the true amount of insolvency in Scotland, business conditions in the two countries are different and we doubt whether English experience is a satisfactory guide.

4.43 It is hardly practicable to quantify accurately the possible increase in the number of sequestrations following the implementation of our Report, and it seems best to envisage staff requirements in the light of two assumptions, the first that the annual number of sequestrations will be in the region of 120 and the second that it will be in the region of 150. The number of current sequestrations would depend on the average time taken to complete them and we hope that our proposals for the simplification of sequestration procedure would permit of this time being reduced to an average of (say) four years. On this basis, we estimate that the Accountant would require a technical staff of some four or six persons depending on the case-load. We are not ourselves qualified to estimate the possible cost of this staff, but using the Civil Service Department's Ready Reckoner for Staff Costs for 1980 we estimate that for the lower case-load the annual expenditure should not exceed £50,000 and for the higher case-load some £70,000. From this there should be deducted the fees receivable by the Accountant. Their amount is difficult to predict with any degree of accuracy, but the fees received during 1980 amounted to £22,805. It would seem not unreasonable, however, to suppose that, depending on the case-load, they might amount to a sum between £20,000 and £30,000. This would give annual net expenditure on bankruptcy on the part of the Accountant's Department of, say, £30,000 for the lower case-load and of £40,000 for the higher case-load.

4.44 Further expense would be occasioned by our proposals that—

- (1) an interim trustee should be appointed in every sequestration and that his fees and outlays, where the insolvent estate itself is insufficient, should be met out of public funds; and
- (2) where no permanent trustee has been elected by the creditors and in every small assets case, the interim trustee will act as permanent

trustee. In such cases we envisage that to the extent that the fees and outlays of the interim trustee acting as permanent trustee cannot be met out of the insolvent estate, they should be met out of public funds.

4.45 Any estimate of the relevant expenditure under these heads will clearly depend on the number of sequestrations but, even if that were known, no accurate estimate of the expenses relevant to the separate duties of the interim trustee would be possible. In relation, however, to the first head, we cannot suppose that there will be insufficient assets to meet the expenses of the interim trustee in more than 10 per cent of cases—say 12 to 15—so that, assuming an *average* insufficiency of £100, the total expenditure under this head would not exceed £1,200 to £1,500 per annum. In relation to the second head, assuming an average insufficiency of £400, the total expenditure would not exceed £4,800 to £6,000. In other words, expenditure other than that internal to the office of Accountant of Court is likely to fall within the range of £6,000 to £7,500.

4.46 In England, as we have seen, a significant proportion of the costs of the Insolvency Service is met, in effect, if not in strict legal theory, from interest received on the Insolvency Investment Account. Trustees in bankruptcy and liquidators must lodge all funds as they receive them in an account with the Bank of England. Such capital in that account which the Department of Trade considers to be in excess of current withdrawal requirements is lodged in the Insolvency Services Investment Account and may be invested by the National Debt Commissioners. The interest produced from that course of investment is transferred annually to the Consolidated Fund. In practice, however, the interest is treated as a sum available to meet the current expenditure of the Insolvency Services of the Department of Trade, and meets almost one-half of that expenditure.

4.47 The Commission has considered whether a similar system should be adopted in Scotland to meet some part of the Accountant's costs in bankruptcy administration. The English system was based on the views that no interest could normally be received by trustees from the small amounts from time to time deposited by them in ordinary bank accounts, that by the accumulation of small amounts deposited in a central bank interest could be obtained and that, in consequence, the creditors would lose nothing.<sup>78</sup> The introduction of such a system has not found favour in Scottish opinion<sup>79</sup> on the ground that any interest obtainable on the debtor's assets in any estate belongs to the creditors of that estate and to them alone and, accordingly, that it is wrong to use the interest from the assets of one estate to pay for the general costs of the system of bankruptcy administration. We consider that this objection is well-grounded in principle and would not recommend the introduction into Scotland of any analogue to the English system.

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<sup>78</sup>See the remarks of the Solicitor General (Herschell) in Parl. Deb., ser. 3 (1883), vol. 277, col. 897.

<sup>79</sup>*Cf.* Richard Brown *The Law of Bankruptcy in England and Scotland* (Glasgow, 1897).

4.48 The cost of operations of the Accountant in Bankruptcy should, in our opinion, be met, or primarily met, out of public funds. The fact that these operations incidentally benefit the creditors in individual bankrupt estates may justify the imposition of small fees, but we would be reluctant to see any material increase in the present percentage fees. The nature of the functions in relation to bankruptcy of the Accountant—in particular his role as the guardian of the public interest in sequestrations—makes it inappropriate that his operations should be self-funding. For the same reason, the Accountant should meet out of public funds the fees and expenses of interim trustees, and of interim trustees acting as permanent trustees in default of another appointment and in small assets cases so far as those fees and expenses cannot be met out of the funds of the estate. Since the object of these proposals is to secure in the public interest that sequestration procedures are properly carried to a conclusion in every case, and since the net cost should be small, we think it right that their cost, so far as not recoverable from the insolvent estate, should be wholly borne out of public funds.<sup>80</sup>

4.49 It is clear from the foregoing that only a conjectural estimate can be made of total additional annual expenditure likely to be directly occasioned to public funds by reason of our proposals. We consider, however, that this expenditure is likely to fall within a range between £30,000 and £50,000.<sup>81</sup> We consider that such expenditure would be modest in relation to the probable benefits of the system, both to creditors and to the public as a whole. Moreover, against this prospective additional expenditure there must be set the reductions which our proposals would entail in the use of expensive resources within the judicial system. The most obvious benefit arises from our proposals for dispensing with the judicial examination of the bankrupt unless it is specifically required. But benefits will also arise from the dispensing with or the simplification of judicial procedures in the context of the discharge of the bankrupt and of the trustee. We have also reduced, wherever this appeared to be practical, formal steps in registration procedures and, notably, have proposed a procedure which is likely to be less expensive than recourse to the *nobile officium* of the Court of Session, to deal with formal and other defects in procedure. All in all, we believe that our proposals for the revision of sequestration procedures should entail little additional State expenditure in the course of the administration of bankruptcy law.

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<sup>80</sup>We develop this argument in para. 2.47.

<sup>81</sup>Our calculations above, indeed, suggest that the lower limit of the range would be £34,000 and the upper limit £45,500.

## CHAPTER 5

### CONDITIONS (OTHER THAN JURISDICTIONAL CONDITIONS) OF SEQUESTRATION

#### Estates which may be sequestrated

##### *Introduction*

5.1 In our view the utility of sequestration to the creditors of an insolvent debtor and the protection it affords to the debtor make it desirable that the law should render competent in appropriate cases the sequestration of the estates of any person or entity whether or not incorporated, unless it appears expressly or by implication from the terms of any enactment that sequestration should not be available in relation to that person or entity. We have had regard to this principle throughout this Chapter.

##### *Individual debtors*

5.2 At one time the process of sequestration was regarded as a form of protection from diligence to be extended only to merchants who, from the nature of their activities, might incur losses without personal fault.<sup>1</sup> This restriction was finally removed by the 1856 Act,<sup>2</sup> and the process of sequestration is now available for all individual debtors. Though in certain countries bankruptcy procedures are still limited to traders or particular classes of traders,<sup>3</sup> the general tendency is towards the abandonment of such restrictions and there would seem no case for their re-introduction into Scots law.

5.3 In England it has been considered that there are obstacles to bankruptcy proceedings against infants,<sup>4</sup> because of the difficulty of establishing that they are debtors, and persons suffering from mental disorder<sup>5</sup> on the view that they cannot form the intent necessary to commit certain "acts of bankruptcy" under English law. These obstacles do not arise in Scots law and there is authority for the proposition that minors with or without curators, and even pupils, may be rendered notour bankrupt and their estates sequestrated in respect of debts lawfully contracted by them or on their behalf.<sup>6</sup> We do not think that the substitution, as we propose,<sup>7</sup> of the apparent insolvency of the debtor for his notour bankruptcy will make any difference in this respect. We do not consider, therefore, that specific provision need be made for the sequestration of the estates of pupils and minors.

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<sup>1</sup>1839 Act, s. 5.

<sup>2</sup>1856 Act, s. 13.

<sup>3</sup>In Belgium and Luxembourg only traders may be rendered bankrupt. In Italy small traders may not be rendered bankrupt.

<sup>4</sup>Fridman, Hicks and Johnson, *Bankruptcy Law and Practice* (London, 1970), p. 10.

<sup>5</sup>*Ibid*, 11.

<sup>6</sup>Erskine, *Institutes* I. 7.33; Bell, *Comm.* ii. 157; Goudy, pp. 70 and 114.

<sup>7</sup>Paras. 5.18–5.20.

### *Estates of deceased persons*

5.4 It has been competent since 1839<sup>8</sup> to sequestrate the estate of a deceased person and, in addition, there is an independent facility under section 163 of the 1913 Act for the appointment of a judicial factor on a deceased person's estate. We deal with these matters in detail in Chapter 21. Here it suffices to say that we recommend *inter alia* that the executors of a deceased person should have a right to apply at any time for the sequestration of the deceased's estate without the concurrence of creditors.

### *Trust estates*

5.5 The 1913 Act makes provision for the sequestration of the estates of any person.<sup>9</sup> The generality of the language suggests that sequestration of an estate may be competent both where it is held by an individual in his own right and where it is held by him in a fiduciary or representative capacity. This supposition receives some support from decided cases relating to estates owned by trustees and executors.<sup>10</sup> It seems to us to be both just and convenient that estates held by trustees should be capable of sequestration where they have become so as a result of debts incurred by the trustees as such. Since the decided cases to which we have referred can hardly be considered conclusive, we recommend that it should be made clear that the remedy of sequestration is available in relation to estates being administered by trustees.

5.6 The sequestration of trust estates (as indeed of partnerships and associations) presents certain technical difficulties in relation to such questions as who should prepare the debtor's statement of affairs, whether the trustees should be bound to submit to private examination by the interim trustee or, possibly, to private or public examination by the permanent trustee. We propose that the normal rules and procedures of bankruptcy law should apply, so far as may be practicable and appropriate, to the circumstances of the particular case.

### *Partnerships*

5.7 In Scots law a partnership has a species of legal personality separate from that of its members,<sup>11</sup> and may be rendered notour bankrupt although its individual partners are not notour bankrupt. It is competent, under the present law, to sequestrate the estates of insolvent partnerships.<sup>12</sup> This should remain competent either at the instance of the partnership or at the instance of a qualified creditor or creditors if the apparent insolvency of the partnership or, except in the case of a limited partnership, of any of the partners for a firm debt has occurred. It should also be expressly provided that the estate of a dissolved partnership may be sequestered.<sup>13</sup>

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<sup>8</sup>1839 Act, s. 4. See now 1913 Act, s. 11.

<sup>9</sup>s. 11. As to companies, however, registered under the Companies Acts, see para. 5.10.

<sup>10</sup>*J. & W. Campbell & Co.* (1899) 6 S.L.T. 406; *Bain* (1901) 9 S.L.T. 14.

<sup>11</sup>Under the common law, saved by the Partnership Act 1890 (c. 39), ss. 4(2), 47.

<sup>12</sup>1913 Act, ss. 2, 11.

<sup>13</sup>*Cf. Stewart and McDonald v. Brown* (1898) 25 R. 1042.

5.8 It has been suggested to us that the court should have the power its own accord to award sequestration of the estate of any individual partner along with that of the partnership. This could not be justified. It does not necessarily follow that, because a partnership is insolvent, the individual partners are themselves insolvent. In practice, however, the estates of a partnership and the separate estates of its individual partners are often wound up by the same trustee. In such a case it may be convenient for the same court to superintend the winding-up both of the partnership estate and of the estates of its individual partners. We recommend, therefore, that any court having jurisdiction to sequester the estate of a partnership should also have jurisdiction to sequester the estates of the individual partners.

### **Limited partnerships**

5.9 Limited partnerships present certain specialities. They do so because, although possessing some of the characteristics of limited companies, they are on the whole more like ordinary partnerships. They are a creation of the Limited Partnerships Act 1907, which makes provision for the affairs of such a partnership to be wound up by the general partners or by order of the court.<sup>14</sup> It is not clear whether sequestration is competent in the case of an insolvent limited partnership. In *Muirhead v. Borland*<sup>15</sup> the court formed the view that the relevant statutory provisions gave it a choice between ordering a winding-up under the Companies Acts and a winding-up by a judicial factor. It is doubtful, however, whether winding-up under the Companies Acts is available in the case of a limited partnership registered in Scotland having fewer than eight members.<sup>16</sup> We need not dwell upon those questions because we are of the opinion that the bankruptcy legislation should be applied to every limited partnership, whatever its size, and that winding-up under the Companies Acts should be excluded. We so recommend. It would, of course, be possible to provide optionally for their winding-up under the Companies Acts, but the unusual structure of a limited partnership demands particularised rules for the winding-up of its affairs—rules which are at present contained in the Limited Partnerships (Winding-up) Rules 1909<sup>17</sup>—and it would make for unnecessary complications to have one set of rules for sequestration and another for winding-up under the Companies Acts. The legislation following on this Report should empower the Secretary of State to make appropriate rules by statutory instrument.

### **Bodies corporate**

5.10 It is competent to sequester the estates of “bodies corporate, politic, or collegiate”.<sup>18</sup> This imprecise description would appear to be of very general application, and has been held to include local authorities.<sup>19</sup> It has been decided nevertheless that, although companies incorporated under

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<sup>14</sup>Limited Partnership Act 1907 (c. 24), s. 6(3).

<sup>15</sup>1925 S.C. 474.

<sup>16</sup>Companies Act 1948, s. 398; but see Lindley, *Partnership* (12th ed.), p. 805.

<sup>17</sup>S.R.&O. 1909/327 (Rev. ed. 17, p. 23).

<sup>18</sup>1913 Act, ss. 2, 11.

<sup>19</sup>*Wotherspoon v. Linlithgow Magistrates* (1863) 2 M. 348.

the Companies Acts may be rendered notour bankrupt,<sup>20</sup> their estates may not be sequestrated.<sup>21</sup> Our Working Party were of the opinion that the sequestration of the estates of "bodies corporate, politic, or collegiate" should no longer be competent.<sup>22</sup> We agree that the quasi-governmental functions of local authorities, and the wide range of services which they provide, suggest that they should not be subject to sequestration proceedings, and the same may be said of other authorities created by statute for a specific public purpose. But it would be still less appropriate if they were subject to procedures, such as the winding-up procedures of the Companies Acts, which involved the dissolution of such entities. A remedy, however, should be available to creditors in the event of the insolvency of such entities. We recommend, therefore, that sequestration procedure should be available for such an entity unless it appears, expressly or by implication, from the terms of any enactment that such procedure is incompetent in relation to it. It seems to us that the provision of a different procedure dealing with the insolvency of local authorities, universities and other public bodies is a matter not for bankruptcy legislation but rather for the legislation which regulates the constitution and activities of the body in other respects.<sup>23</sup>

### ***Unincorporated bodies***

5.11 The present law does not permit of the sequestration of unincorporated bodies. Goudy explains:<sup>24</sup>

"Unincorporated associations, such as clubs, trade unions, etc., cannot be made notour bankrupt as such, for they have in the eye of the law no existing *persona*. For debts, therefore, incurred in the name of the association, diligence must be done, and bankruptcy constituted, either against the individual members, or in some cases against those members of the association who are appointed to represent it."

In *Pitreavie Golf Club v. Penman*<sup>25</sup> the Lord Ordinary gave effect to Goudy's view and recalled an award of sequestration of the estates of a golf-club and of office-bearers and members of the committee of the club. He held that the club was neither an individual nor a company within the meaning of the 1913 Act and so not capable of being rendered notour bankrupt. The 1948 Act permits the winding-up under its provisions of an association which has eight or more members,<sup>26</sup> but the remedy is not available where an association has fewer than eight members. And in the case of a larger association, it may be desirable to deal with their insolvency by the process of sequestration rather than by winding-up, which would inevitably result in

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<sup>20</sup>See *Clark v. Hinde, Milne & Co.* (1884) 12 R. 347.

<sup>21</sup>*Standard Property Investment Co. Ltd. v. Dunblane Hydropathic Co. Ltd.* (1884) 12 R. 328.

<sup>22</sup>Memo. No. 16, p. 59.

<sup>23</sup>So, for example, s. 87 of the Friendly Societies Act 1974 (c. 46) makes provision for the winding-up under the Companies Acts of a friendly society in the circumstances therein specified, and s. 47(1) of the Insurance Companies Act 1974 (c. 49) excludes from sequestration proceedings certain insurance companies (even where unincorporated) and makes them subject only to winding-up under the Companies Acts.

<sup>24</sup>At p. 72.

<sup>25</sup>1934 S.L.T. 247.

<sup>26</sup>ss. 398, 399.

dissolution of the association. We recommend, therefore, that sequestration should be a competent remedy in relation to an unincorporated association, whether or not it may be wound up under the Companies Acts.

5.12 Problems arise as to the estates which may be subject to sequestration and as to the person or persons against whom the petition may be directed. At common law an association cannot own property and it cannot sue or be sued in its own name without the addition of persons acting for it in a representative capacity. The property of the association belongs in law to all its members, although practicalities or conveyancing technicalities may require that it be managed or possessed by persons in a representative capacity or vested in named or designated trustees on behalf of the association. In relation to actions against the association no hard-and-fast rule can be laid down: under the common law it is necessary to ascertain in every case which persons properly represent or are properly answerable for the association in relation to the issue which is being contested.<sup>27</sup> The Court of Session still adheres to the common law rules, but there has been a procedural relaxation as regards the title of an association to sue, or its liability to be sued, in the sheriff court. The Sheriff Courts (Scotland) Act 1907<sup>28</sup> provides that:

“any ... association carrying on business under a firm or trading or descriptive name may sue or be sued in such name without the addition of the name or names ... of any member or official of such ... association, and any extract of a decree pronounced in the sheriff court ... against such ... association under such firm, trading or descriptive name, shall be a valid warrant for diligence against such ... association.”<sup>29</sup>

5.13 Despite the apparent simplicity of the rule in the 1907 Act, the creditor who seeks decree against an unincorporated association in any forum may be well advised to conjoin as defenders those persons who properly represent the association.<sup>30</sup> In *Somerville v. Rowbotham*,<sup>31</sup> the court agreed that in an action against a large unincorporated insurance society, the proper defenders were the committee of management, it being practicable to direct the action against only them in the case of a body “so fluctuating and indefinite”.<sup>32</sup> It is implicit in the judgment that decree against the persons who properly represent an association will enable the pursuer to reach the

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<sup>27</sup>For illustrative cases see *Somerville v. Rowbotham* (1862) 24 D. 1187; *Renton Football Club v. McDowall* (1891) 18 R. 670; *Pagan & Osborne v. Haig* 1910 S.C. 341. Cf. McLaren, *Court of Session Practice*, at pp. 253 *et seq.*

<sup>28</sup>c. 51.

<sup>29</sup>Rule 11, Sched. 1 to Sheriff Courts (Scotland) Act 1907 as amended.

<sup>30</sup>Cf. *Aitchison v. McDonald* 1911 S.C. 174.

<sup>31</sup>(1862) 24 D. 1187.

<sup>32</sup>The quoted words are those of Lord Neaves (at 1189), who also observed that in every case where it was proposed to sue an association, there were two relevant considerations: “first, the nature and constitution of the association; and secondly, the nature of the contract out of which the obligation sued for has arisen”.

assets of the association, and Graham Stewart comments that “a charge will be given by or against [nominated] office-bearers as representing the society. It would appear unnecessary to charge the society or the individual members”.<sup>33</sup> The reasonable inference is that a pouncing may follow upon such a charge, if it does not result in satisfaction of the decree, and it seems appropriate, therefore, that the association’s property should be amenable to sequestration following upon the expiry of the days of charge without payment. We recommend that the estate belonging to, or held for or jointly by, the members of an association should be capable of being sequestrated. This recommendation is intended to extend to property held in trust by any person for the purposes of the association, as is the invariable position in relation to heritable property.

### **Insolvency as a condition of sequestration**

5.14 In a debtor’s petition for sequestration his notour bankruptcy is not a condition of an award.<sup>34</sup> The law, we take it, assumes that a debtor would not apply for his sequestration unless he thought that he was insolvent. In this respect we see no reason to propose any change in the law.

5.15 A creditor’s petition for the sequestration of the estate of a living debtor is competent only if the debtor is notour bankrupt.<sup>35</sup> Where a creditor petitions for the sequestration of the estate of a deceased debtor, there can be no award of sequestration until six months after the date of the debtor’s death unless he was notour bankrupt at the time of his death.<sup>36</sup> Notour bankruptcy, in addition to being constituted by sequestration or by an adjudication of bankruptcy in any part of the United Kingdom outside Scotland, is constituted by the debtor’s insolvency concurring with the execution of certain steps in diligence which point to his insolvency.<sup>37</sup> The fact of the debtor’s insolvency is itself presumed from the execution of those steps in diligence without payment by the debtor.<sup>38</sup> When proof of those steps is adduced, the debtor must show that he is able and willing to pay the debt and that any delay in payment is well justified in the circumstances. A debtor cannot oppose an award of sequestration on the ground that he is solvent if he declines to pay a lawful debt.<sup>39</sup>

5.16 Legal systems take various approaches to the prerequisites of bankruptcy. In England, a receiving order may be made against the debtor if he commits one of a number of “acts of bankruptcy”, often of a quasi-criminal character, which might justify applying to him the rigours of bankruptcy law.<sup>40</sup> It has been objected to this approach that it is out of

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<sup>33</sup>p. 303.

<sup>34</sup>Goudy, p. 116. An award of sequestration, however, has the effect of rendering the debtor notour bankrupt as at the date of the first deliverance: 1913 Act, s. 5(1).

<sup>35</sup>1913 Act, s. 11.

<sup>36</sup>1913 Act, s. 13.

<sup>37</sup>1913 Act, s. 5.

<sup>38</sup>*Knowles v. Crooks* (1865) 3 M. 457; *McNab v. Clarke* (1889) 16 R. 610.

<sup>39</sup>*Scottish Milk Marketing Board v. Wood* 1936 S.C. 604.

<sup>40</sup>1914 Act, s. 1(1) (b), (c) and (d).

keeping with current views of the purposes of bankruptcy.<sup>41</sup> We would prefer to select acts or events which point more directly to the state of a debtor's finances and which do not have overtones of criminality on the part of the debtor. A legal system on the other hand could conceivably make it a necessary condition of a creditor's petition for sequestration or for bankruptcy that the debtor should be insolvent in an absolute sense, that is to say that his aggregate assets are not sufficient to meet his total financial liabilities.<sup>42</sup> It would be very difficult, however, for a creditor to establish the debtor's "absolute" insolvency which, in many instances, could be determined only by the realisation of his assets. Scots law, therefore, in common with other systems,<sup>43</sup> merely requires that the debtor should be unable or unwilling to pay his debts as they fall due, *i.e.* that he is insolvent in a practical sense. We consider that this principle should remain. A debtor who refuses to pay his debts should not be heard to say that he is in fact solvent. A trading debtor who is unable to pay his debts as they fall due will soon be deprived of credit and this loss of credit, by preventing his trading, will often lead to his absolute insolvency.

5.17 There are, however, differences of view as to how the debtor's practical insolvency should be determined. The Tassé Report recommended, therefore,<sup>44</sup> that:

"The petitioning creditor should be entitled to a receiving order if he can show, in any manner, with or without the aid of [certain] presumptions, that the debtor has ceased to pay his debts generally as they mature."

But the questions whether, and more especially when, the debtor has ceased to pay his debts in the ordinary course of business would be difficult to establish without proof, which would be highly undesirable in relation to matters where certainty and expedition are of the essence. We consider, therefore, that the legislation should specify acts or events which are likely to indicate without ambiguity the fact that the debtor is practically insolvent. These acts or events must be recent acts or events. Under the present law sequestration is competent under a creditor's petition only when the debtor is notour bankrupt, and although notour bankruptcy continues until the debtor's insolvency ceases the petition for sequestration must be presented no later than four months from the constitution of the notour bankruptcy.<sup>45</sup> We recommend that the debtor's practical insolvency within that period should remain a condition of a creditor's petition.

5.18 To many, notour bankruptcy is a confusing concept. A person is popularly described as a bankrupt if his estates have been sequestrated in

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<sup>41</sup>See Treiman, "Acts of Bankruptcy" 52 *Harvard Law Review* (1938) 189, at 200; *Tassé Report*, p. 105.

<sup>42</sup>In the South African Insolvency Act of 1936, s. 10(b) "absolute" insolvency is stated as a sufficient condition of bankruptcy.

<sup>43</sup>For France, see Argenson and Toujas, *Réglement Judiciaire* 4th ed. (Paris, 1973), pp. 23-31.

<sup>44</sup>At p. 105.

<sup>45</sup>1913 Act, s. 13.

Scotland or if he has been adjudged bankrupt in England. But a person who is notour bankrupt is not necessarily bankrupt in this sense: in the usual case he will simply be a person against whom certain diligences have been executed in circumstances which point to his practical insolvency. He may be described as having the status of a bankrupt only in the sense that the law deems his practical insolvency to continue until the contrary is demonstrated. We consider that it would avoid confusion if the term "bankruptcy" were applied only to persons whose estates have been sequestrated and that circumstances pointing to a person's practical insolvency should be otherwise described. We propose to use the term "apparent insolvency" to describe those circumstances, and those circumstances only.

5.19 In our view, these circumstances fall into two categories. In the first category, his state of practical insolvency is so clear that he should not be entitled to deny it. This category should comprise cases where he has admitted his state of insolvency in writing and cases where his estate has been sequestrated in Scotland or where he has been adjudged bankrupt elsewhere in the United Kingdom. The second category comprises circumstances (such as the expiry of a charge for payment) which do not point sufficiently unequivocally to the debtor's practical insolvency that he should not be able to deny such insolvency.

5.20 We propose, therefore, that a debtor's apparent insolvency should be constituted whenever—

- (a) his estate is sequestrated, or he is adjudged bankrupt; or
- (b) he gives written notice to his creditors that he has ceased to pay his debts in the ordinary course of business; or
- (c) any of the following circumstances occurs—
  - (i) he grants a trust deed;
  - (ii) following the service on him of a duly executed charge for payment of a debt, the days of charge expire without payment;
  - (iii) following a poinding or seizure of any of his moveable property in pursuance of a summary warrant for the recovery of rates or taxes, 14 days elapse without payment;
  - (iv) a decree of adjudication of any part of his estate is granted, either for payment or in security;
  - (v) his effects are sold under a sequestration for rent due by him;  
or
  - (vi) a receiving order is made against him in England or Wales;

unless it is shown that at the time when any such circumstance occurred, the debtor was able and willing to pay his debts as they became due.

We propose, too, in accordance with section 7 of the 1913 Act, that a debtor's apparent insolvency should continue where his estates have been sequestrated or he has been adjudged bankrupt until his discharge and, in other cases, until he becomes able to pay his debts and pays them as they

become due. We may add that, in so far as debtors other than individual debtors are liable to sequestration—a matter discussed above<sup>46</sup>—the conditions of sequestration specified above, so far as appropriate, should apply. In relation to partnerships, in consonance with the present law,<sup>47</sup> sequestration should proceed on the same conditions or when one of the partners has committed or suffered any of the specified acts or events in respect of a firm debt.

### **Mandatory nature of award**

5.21 Under the present law, where the conditions for sequestration are fulfilled, the court must award sequestration. The debtor's offer to prove that he is solvent is not a ground for a refusal to make an award.<sup>48</sup> Bell states that:

“The only proof of solvency which is admissible is payment of the petitioner's debt, and of the debt whereupon the diligence proceeded; together with the debts of those who may have concurred in the application.”<sup>49</sup>

There are good reasons for this approach. It is in the interest of all concerned that an award of sequestration may be obtained without the risk of issues of fact being contested and of consequential delays and expense.<sup>50</sup> Creditors at present have little enough incentive to apply for sequestration and protracted controversies as to the desirability of sequestration are clearly to be avoided.

### **Concurrence of creditors in debtors' petitions**

5.22 In the ordinary procedure for sequestration a debtor's petition for sequestration is never competent without the concurrence of a qualified creditor.<sup>51</sup> There is no such requirement in summary sequestration<sup>52</sup> and we must consider whether retention of the requirement is justified. It might be said that creditors may be reluctant to concur in petitions by debtors for the sequestration of their estates so that a debtor may be unable to obtain an award of sequestration, however appropriate in the circumstances of the case.

5.23 There are, however, a number of considerations which tend to support the retention of the requirement. A not unimportant consideration is that sequestration procedure assumes the participation of creditors, and the requirement ensures that one at least of the creditors considers that a sequestration is appropriate and so is at least likely to take an interest in the sequestration procedure. The requirement is also a safeguard, even if an imperfect safeguard, against applications presented by debtors not to secure

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<sup>46</sup>See paras. 5.5–5.13.

<sup>47</sup>1913 Act, s. 6.

<sup>48</sup>*Scottish Milk Marketing Board v. Wood* 1936 S.C. 604.

<sup>49</sup>*Comm.* ii. 286.

<sup>50</sup>*Scottish Milk Marketing Board* above, *per* Lord President Normand at 611.

<sup>51</sup>1913 Act, s. 11. It may be noted, however, that sequestration of the estate of a deceased debtor can be awarded without a creditor's concurrence where the petition is presented by a mandatory to whom the debtor had granted a mandate to apply for sequestration.

<sup>52</sup>1913 Act, s. 175(i).

the ordering of their affairs but for ulterior purposes. This is particularly important against the background of our own proposal that, where the interim trustee becomes the permanent trustee because no other person is elected or because, as in a small assets case, no election is competent, the outlays and remuneration of the trustee, in so far as these cannot be met from the bankrupt's estate, will be a charge on public funds. Subject, therefore, to the one exception noted in the following paragraph, we recommend that the requirement of the concurrence of a creditor to a debtor's petition for sequestration should be retained.

5.24 The one exception that we recommend relates to the case of a deceased debtor. Under existing law<sup>53</sup> a mandatory to whom a debtor has granted a mandate to apply for sequestration may present a petition for sequestration of the estate of the debtor at any time after his death. The concurrence of a qualified creditor is not required. For reasons discussed more fully in Chapter 21 of this Report, we recommend that a deceased's executors should be entitled to apply for the sequestration of the estate of a deceased debtor without a creditor's concurrence.

#### **Persons who may present debtors' petitions**

5.25 In the case of "living debtors" the question who may present a petition on behalf of the debtor arises only in the case of persons under age or under disability. We consider, however, that the question should be answered by the general law concerning the management of such persons' property and should not be dealt with in the legislation to follow on this Report.

5.26 Where a partnership applies for its own sequestration, the law at present requires such consents as are contemplated in the partnership agreement, failing which the consent of all the partners.<sup>54</sup> Though it may be that in some cases the latter requirement may delay a desirable immediate application for sequestration, any alternative rule would entail making detailed provision to safeguard the interests of dissenting partners. We consider that such a complication is better avoided in a situation where, if the financial difficulties of the firm are real, its creditors will themselves be prepared to petition. We propose, therefore, merely to recommend the retention of the existing law.

5.27 As regards what the present law describes as "bodies corporate, politic, or collegiate",<sup>55</sup> it appears that a petition by such an entity for its own sequestration is competent when authorised by procedures provided for in its constitution and (under the present law) concurred in by a qualifying creditor.<sup>56</sup> We recommend that a petition on behalf of such a body for the

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<sup>53</sup>1913 Act, s. 11(2) (A).

<sup>54</sup>Goudy, p. 127; Wallace, p. 61. We note that s. 24(8) of the Partnership Act 1890 (c. 39) provides that "no change may be made in the nature of the partnership business without the consent of all existing partners".

<sup>55</sup>1913 Act, s. 2.

<sup>56</sup>1913 Act, ss. 11, 13; *Wotherspoon v. Linlithgow Magistrates* (1863) 2 M. 348.

sequestration of its estate should be competent at the instance of any person duly authorised to act on behalf of the body.

5.28 The question of petitions by unincorporated bodies such as clubs and associations raises similar considerations. Again, therefore, we recommend that a petition on behalf of such a body for the sequestration of its estate should be competent at the instance of any person duly authorised to act on behalf of the body.

5.29 We have already stated that our recommendations in connection with the sequestration of the estate of a deceased debtor include a recommendation that the executors should have an independent right (that is, without the concurrence of a qualified creditor) to apply for the sequestration of the deceased's estate.<sup>57</sup> It seems desirable, however, that not only executors but also any body of trustees should have the right to apply for the sequestration of the trust estate. If, for example, trustees have contracted debts in their administration of the trust estate, it seems entirely reasonable that they should be entitled to apply for the sequestration of the estate—but, of course, with the concurrence of a duly qualified creditor.<sup>58</sup> To deal with the not infrequent case where a trustee cannot be found or is unavailable, we recommend that a petition for sequestration should be competent at the instance of a majority of the trustees.

### **Qualifying debt in petitions for sequestration**

#### ***Present law***

5.30 A qualifying debt under the present law is always a condition of sequestration whether in a creditor's petition or in a debtor's petition with the concurrence of a creditor. We make no recommendation for alteration of the law as regards the necessity for, or the amount of, a qualifying debt,<sup>59</sup> though the power to vary its amount should be included in the legislation to follow on this Report.

#### ***Nature of the debt***

5.31 The debt or debts may be "liquid or illiquid, provided that they are not contingent".<sup>60</sup> A liquid debt is a debt which is admitted or which is so constituted as to admit of immediate diligence. In practice commercial debts are usually illiquid and the facility of basing a petition on an illiquid debt clearly must be retained. There is authority for the view that future debts which are not contingent on the occurrence of an uncertain event may at

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<sup>57</sup>See paras. 5.4 and 21.9.

<sup>58</sup>But concurrence would not be necessary where the trustees were administering the estate of a deceased person and the debt was that of the deceased and not that of the trustees—see Chapter 21.

<sup>59</sup>Existing law requires presentation or concurrence by "one or more creditors whose debt or debts together amount to not less than two hundred pounds"—see 1913 Act, s. 12 and 1976 Act, s. 1. The amount of the qualifying debt is variable by regulations made under s. 1 of the 1976 Act.

<sup>60</sup>1913 Act, s. 12.

present found a bankruptcy petition.<sup>61</sup> While the position appears to be similar in England,<sup>62</sup> we consider it anomalous that a creditor who may not necessarily be in a position to raise an action for payment of the debt may use it to support a bankruptcy petition. We consider that it should be made clear in the legislation to follow on this Report that a petition for sequestration may be founded upon a liquid or illiquid debt, but not upon a debt which is future or contingent.

### ***Secured debts***

5.32 The next question is whether a secured debt may support a petition for sequestration and, if so, subject to what conditions. A petitioning or concurring creditor must specify in his oath "any security which he holds over the estate of the bankrupt or of other obligants".<sup>63</sup> But it is not clear whether the amount of the qualifying debt is assessed by reference to the total amount of the debt or only by reference to the amount (if any) remaining after deduction of the value of the security. Goudy says cautiously that the amount of the security "does not, it is thought, require to be deducted".<sup>64</sup> The case law on the question is obscure, but section 21 of the 1913 Act in contradistinction to the sections relating to voting and ranking<sup>65</sup> makes no express provision as to the deduction of the value of a security. In our view, a creditor who holds a security from which his debt can be satisfied should not be entitled to elect to have the estate of his debtor sequestrated.<sup>66</sup> We recommend, therefore, that a secured creditor who petitions or concurs in a petition for sequestration should be bound to deduct from the total amount of his debt his estimate of the value of such security, and that only the outstanding balance should represent the amount of the debt for the purposes of the petition. The trustee on his appointment should be entitled to take over the security at its declared value. A secured creditor should be entitled, alternatively, to petition on the basis of the whole amount of his debt if he undertakes to surrender his security for the benefit of the creditors in general.<sup>67</sup>

### ***Claims against co-obligants***

5.33 Section 21 of the 1913 Act requires a petitioning or concurring creditor in his oath to specify any security which he holds not only over the estate of the bankrupt but over that of other obligants. Since we propose<sup>68</sup> that a creditor in submitting claims (whether for voting or for ranking purposes) should not be bound to deduct the value of his claim against a co-obligant, the above requirement of section 21 becomes inappropriate and may be discarded. We so recommend.

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<sup>61</sup>Bell, *Comm.* ii. 289; Goudy, p. 121; *Thom v. Black* (1828) 7 S. 158.

<sup>62</sup>1914 Act, s. 4(1)(b).

<sup>63</sup>1913 Act, s. 21. In *Nakeski-Cumming v. Gordon* 1924 S.C. 217, Lord Constable observed (at 220) that "it is difficult to see the object of the statutory requirement".

<sup>64</sup>At p. 122.

<sup>65</sup>See e.g. ss. 55, 61.

<sup>66</sup>See *Elder v. Thomson* (1850) 12 D. 994, per Lord President Boyle at 998.

<sup>67</sup>*Cf.* 1914 Act, s. 4(2).

<sup>68</sup>Para. 16.4.

### Where sequestration proceedings may be instituted

5.34 Original jurisdiction in bankruptcy is at present shared between the Court of Session and the sheriff court.<sup>69</sup> Sequestration proceedings were at first a matter almost exclusively for the Court of Session, and in the period prior to the 1856 Act there were frequent complaints relating to their expense. The 1856 Act gave the sheriff court concurrent jurisdiction,<sup>70</sup> and from that time onwards the role of the Court of Session became preponderantly that of a court of review.<sup>71</sup> There are some matters which remain appropriated to the Court of Session: for example, it alone has the power to recall a sequestration under section 30 of the 1913 Act and it alone may grant a warrant to apprehend a bankrupt residing furth of Scotland and to bring him before the court for public examination under section 85. The original jurisdiction, however, of the Court of Session is very little invoked and, where it is invoked, it is usual for the case to be remitted, after the award of sequestration, to a sheriff court for further procedure in terms of section 17 of the 1913 Act.

5.35 The members of the Working Party considered whether it was necessary to retain the original jurisdiction of the Court of Session. They concluded that it should be retained, *inter alia*, to deal with cases where a creditor would be unable to establish jurisdiction against the debtor in any one sheriff court.<sup>72</sup> There was a distinct division of opinion on this question on consultation. We have concluded that, while it would be possible to cater otherwise for cases where the jurisdiction of a particular sheriff court was doubtful, it would be convenient to retain the existing radical jurisdiction of the Court of Session. That court, however, should retain<sup>73</sup> its power to remit the sequestration to such sheriff court as in the whole circumstances it considers appropriate. We understand that such a remit is always made in practice.

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<sup>69</sup>See 1913 Act, ss. 11, 16.

<sup>70</sup>ss. 18, 19.

<sup>71</sup>See 1913 Act, *inter alia*, ss. 14, 17, 19, 166 and 167.

<sup>72</sup>Memo. No. 16, p. 60.

<sup>73</sup>See 1913 Act, s. 17.

## CHAPTER 6

### JURISDICTIONAL CONDITIONS OF SEQUESTRATION

#### Grounds of jurisdiction

##### *The present law*

6.1 We have already explained<sup>1</sup> that it is proposed to retain the present concurrent original jurisdiction in sequestration of the Court of Session and of the sheriff courts. Where the application is made to the Court of Session we propose that the case will normally be remitted, after the award of sequestration, to a specified sheriff court for further procedure as envisaged at present by section 17 of the 1913 Act.

6.2 It is assumed throughout this Chapter that the person or entity in question fulfils the conditions (other than the jurisdictional conditions) of sequestration. We are concerned here only with the conditions precedent to the assumption of jurisdiction over the person or entity concerned by the Court of Session or a sheriff court. We do so in the light both of the existing law and of the rules proposed in the draft European Bankruptcy Convention. The existing jurisdictional requirements for sequestrations other than summary sequestrations<sup>2</sup> are contained in sections 11 and 16 of the 1913 Act as amended by section 12 of the Law Reform (Miscellaneous Provisions) (Scotland) Act 1980.<sup>3</sup> Section 11 appears to set out general jurisdictional criteria relevant to any petition for sequestration and section 16, apart from dealing with the contingency of concurrent petitions, allocates jurisdiction among the sheriff courts.

6.3 The general jurisdictional criteria in section 11 present difficult problems of construction. A “living” debtor must, first, be “subject to the jurisdiction of the supreme courts of Scotland”, but in creditors’ petitions there is a second requirement that the debtor should “have at any time during the year before the date of the presentation of the petition resided or had a dwelling-house or place of business in Scotland”. The first requirement derived from an earlier provision that the debtor should be “subject to the laws of Scotland”,<sup>4</sup> which was at first construed as including the debtor’s domicile in Scotland.<sup>5</sup> The intention of the legislature may well have been to ensure that, before a debtor’s estate may be sequestrated on a creditor’s petition, the debtor should be subject to the general jurisdiction of the Court of Session (for example, on the grounds of his domicile in Scotland or of his ownership of an interest in heritage there) but, in addition, that within a year before the petition, he had the practical social or business connection with Scotland implied by his residence, or by his having there a dwelling-house or

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<sup>1</sup>Paras. 5.34–5.35.

<sup>2</sup>As to which see 1913 Act, s. 175. The relationship between that section and s. 11 is obscure.

<sup>3</sup>c. 55.

<sup>4</sup>1859 Act, s. 5.

<sup>5</sup>See Wallace, *A Manual of the Law of Bankruptcy in Scotland* (Edinburgh, 1907), pp. 50–60; Goudy. *The Law of Bankruptcy* (3rd ed.), p. 129.

place of business. In *Joel v. Gill*,<sup>6</sup> however, the Lord Justice-Clerk (Ingليس), in delivering the unanimous judgment of the court, declared that “a debtor with no domicile of succession in Scotland was nevertheless subject to the jurisdiction of the Supreme Court of Scotland” after 40 days residence in furnished lodgings there, and also rejected the view that the debtor’s domicile of succession would suffice. It was confirmed in *Tasker v. Grieve*<sup>7</sup> that in patrimonial actions generally the Court of Session no longer possessed jurisdiction on the ground that the defender was domiciled in Scotland, but only when he possessed heritage in Scotland or had resided there continuously for at least 40 days. This principle was directly applied to a petition for sequestration in *Strickland, Petitioner*.<sup>8</sup>

6.4 The relationship of sections 11 and 16 of the 1913 Act is such that it seems likely that the general jurisdictional criteria in section 11 also apply to sheriff court petitions for sequestration, and that the principal role of section 16 is that of allocating jurisdiction among the sheriff courts of Scotland. Section 16 in its original form provided for the award of sequestration by the sheriff of any county in which the debtor had resided or carried on business for the year preceding the date of the petition, or in the case of a deceased debtor for the year preceding the date of his death. The use of the words “for the year ...” seemed to imply that the sheriff could assume jurisdiction only where the debtor had resided or carried on business throughout the relevant period of one year. This stringent requirement has been removed by the recent amendment of section 16, which now provides that sequestration may be awarded by the sheriff of any sheriffdom within which the debtor:

- “(a) resided or had a dwelling house or place of business at the date of the presentation of the petition for sequestration; or
- (b) resided or carried on business for any period of forty or more days during the year before the said date.”

### *Criticism of present law*

6.5 Whatever the intention of those who framed the original statutory provisions on which section 11 of the 1913 Act is based, there is now an undesirable element of duplication and confusion. If the first requirement that the debtor should be subject to the jurisdiction of the supreme courts of Scotland is construed to include residence in Scotland for 40 days, that introduces an element of duplication since, if the debtor fulfils it, he automatically fulfils the requirement of having “at any time during the year before the date of the presentation of the petition resided ... in Scotland”. Conversely, if the debtor fulfils the second requirement by having a dwelling-house in Scotland, he will automatically fulfil the first requirement if that is fulfilled, as would appear to be the case, by the possession of *any* interest in heritage in Scotland.

6.6 Difficulties also arise in the case of “companies”, an expression defined by section 2 of the 1913 Act to include “bodies corporate, politic, or

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<sup>6</sup>(1859) 21 D. 929.

<sup>7</sup>(1905) 8 F. 45.

<sup>8</sup>1911, 1 S.L.T. 212; cf. *Wylie, Petitioner* 1928 S.L.T. 665.

collegiate, and partnerships". These are dealt with under the same general heading relating to "living debtors subject to the jurisdiction of the supreme courts of Scotland". This is contextually inappropriate and the consequential practical difficulties have attracted judicial criticism.<sup>9</sup> It is possible, however, that in contradistinction to "living debtors", a "company" need fulfil only a single set of jurisdictional requirements, namely that at any time during the year before the date of presentation of the petition it has carried on business in Scotland, and at any such time it has either had a place of business in Scotland or any partner has resided or had a dwelling-house in Scotland. The matter, however, is not clear.

6.7 In relation to the sheriff court the amended version of section 16 cures its principal defect.<sup>10</sup> In the case of a deceased debtor, however, there is now an apparent omission. In its original form section 16 authorised the award of sequestration of the estate of a deceased debtor by the sheriff of any county in which the deceased debtor had resided or carried on business for the year preceding the date of his death. The amended version of section 16 contains no reference to the date of death of a deceased debtor. The result appears to be that the relevant criteria must, as in the case of living debtors, have been fulfilled by reference to the deceased debtor's residence or business activities during the year preceding the date of presentation of the petition. This will create a species of time limit for the presentation of petitions for the sequestration of the estates of deceased debtors, which in practice may or may not be material.

6.8 The legislative scheme incorporated in sections 13 and 18 of the 1856 Act (and reproduced in sections 11 and 16 of the 1913 Act) was criticised in evidence to the Cullen Committee, though that Committee's Report does not examine the criticism. Its gravamen is that "bankruptcy jurisdiction against a foreigner ceases the moment he leaves Scotland. A foreigner might leave the country and his creditors would have to follow him".<sup>11</sup> The accuracy of this criticism is shown by the decision in *Strickland, Petitioner*,<sup>12</sup> which construed section 13(1) of the 1856 Act (now section 11(1) of the 1913 Act) as requiring in all cases that a living debtor should be subject to the jurisdiction of the supreme courts of Scotland at the date of the petition, and held that a debtor ceased to be subject to that jurisdiction immediately he left the country. This applied not only to "foreigners" but also to Scots domiciliaries who left the country. The recent amendments to sections 11 and 16 of the 1913 Act (while themselves beneficial) do not remove this difficulty, since they merely relate to the qualifications that are additional to the general requirement of section 11(1) that the debtor should be subject to the jurisdiction of the supreme courts of Scotland.

6.9 Quite apart, therefore, from the possible requirements of a future E.E.C. Bankruptcy Convention, there is a strong case for reviewing and

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<sup>9</sup>See *Stewart and McDonald v. Brown* (1898) 25 R. 1042.

<sup>10</sup>See para. 6.4.

<sup>11</sup>Minutes of Evidence, paras. 5062 and 5106.

<sup>12</sup>1911, 1 S.L.T. 212.

clarifying the jurisdictional provisions of the 1913 Act and for ensuring that they are based on a coherent set of principles. The earlier scheme may well have been influenced by the view prevalent in the eighteenth and early nineteenth centuries that, since bankruptcy affected the status of the individual, jurisdiction to sequester should be vested in the country to which the debtor belonged by virtue of such ties as those of home, family and sentiment and that, conversely, the jurisdiction of the domiciliary country should be universally recognised. In the case of creditors' petitions the scheme was qualified, presumably in the interest of a workable allocation of bankruptcy jurisdiction throughout the United Kingdom, by further requirements relating to a current or recent social or business connection. The Scottish court, however, found it impracticable to confine its assumption of jurisdiction to cases where the debtor was domiciled in Scotland<sup>13</sup> or to confine its recognition of foreign decrees to those of the domicile.<sup>14</sup> This development reflected the subsequent view of the courts that the primary purpose of the bankruptcy process is not to alter the status of the bankrupt but to secure the rational distribution among his creditors of such assets as he may have within the country.

### ***The European Bankruptcy Convention***

6.10 The defects in the existing Scottish jurisdictional rules prompt us to consider the jurisdictional rules incorporated in the draft European Bankruptcy Convention. The draftsmen of the Convention sought to minimise the risk of concurrent bankruptcies by selecting rules designed to point to a single forum.

6.11 The fundamental rule is contained in Article 3(1), which provides that:

“Where the centre of administration of the debtor is situated in one of the Contracting States, the courts of that State shall have exclusive jurisdiction to declare the debtor bankrupt.”

The centre of administration is defined as:

“... the place where the debtor usually administers his main interests. In the case of firms, companies or legal persons that place shall be presumed, for the purposes of this Convention and until the contrary is proved, to be their registered office, if any.”<sup>15</sup>

Where the debtor does not have his centre of administration in a Contracting State, Article 4(1) provides that:

“... the courts of any Contracting State in which the debtor has an establishment shall have jurisdiction to declare the debtor bankrupt.”

Article 4(2) provides that, for the purposes of the Convention:

“an establishment exists in a place where an activity of the debtor comprising a series of transactions is carried on by him or on his behalf.”

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<sup>13</sup> *Joel v. Gill* (1859) 21 D. 929.

<sup>14</sup> *Obers v. Paton's Trustees* (1897) 24 R. 719.

<sup>15</sup> Article 3(2), but see also the qualification in Article 3(3).

Unlike the possession of a "centre of administration", that of an "establishment" is not an exclusive jurisdiction, but where the courts of one Contracting State have already exercised jurisdiction on this ground, the court of any other Contracting States in which the debtor also has an establishment must sist proceedings before it until it is established whether the first court will exercise jurisdiction.<sup>16</sup> Where the debtor has neither his centre of administration nor an establishment in another Contracting State, nothing precludes the courts of any Contracting State from declaring the debtor bankrupt according to their domestic law. Such a bankruptcy does not fall within the Convention.<sup>17</sup>

6.12 Those provisions are supplemented by other Articles which deal with cases where the debtor has recently transferred his centre of administration or an establishment from one Contracting State to another or to a non-Contracting State<sup>18</sup> and which make special provision for cases where, by reason of its internal law, the State which would otherwise have jurisdiction under the Convention cannot exercise it,<sup>19</sup> for cases of conflicts of jurisdiction,<sup>20</sup> for the assumption of jurisdiction over persons who have directed firms, etc,<sup>21</sup> and for actions arising out of the bankruptcy.<sup>22</sup>

6.13 It seems clear that these rules are designed to allocate jurisdiction among Contracting States rather than to prescribe the rules to be adopted within Contracting States for the allocation of jurisdiction among their courts and that, in consequence, their implications for the jurisdictional rules of the Scottish courts are primarily negative. If the Convention in its present terms were to come into force within the United Kingdom, a series of rules would fall to be enacted requiring the Scottish courts to decline jurisdiction or to sist proceedings in the circumstances specified below.<sup>23</sup> Otherwise, however, it would be open to Parliament to apply within the United Kingdom and, in particular, within Scotland rules of its own choice. It would be convenient if the rules of the Bankruptcy Convention were also to regulate the internal allocation of bankruptcy jurisdiction among the sheriff

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<sup>16</sup>Article 13(1).

<sup>17</sup>Article 5, but reference should be made to the qualification in Article 7.

<sup>18</sup>Articles 6, 7 and 8.

<sup>19</sup>Article 10.

<sup>20</sup>Articles 13 and 14.

<sup>21</sup>Article 11.

<sup>22</sup>Articles 15 and 16.

<sup>23</sup>It would have to be provided *inter alia* that—

- (a) where a court in another Contracting State has already "opened" bankruptcy proceedings against a debtor, the Scottish courts must decline jurisdiction in bankruptcy proceedings [Article 2], subject to the qualifications stated in Article 66;
- (b) where a court in another Contracting State is considering whether to open bankruptcy proceedings relating to the same debtor and the jurisdiction of that court prevails under the Convention, the Scottish courts must of their own motion either declare that they have no jurisdiction or sist the proceedings [Article 13]; and
- (c) irrespectively of whether or not bankruptcy proceedings have been "opened" against a debtor in another Contracting State, where the debtor has, or had within a specified period, his centre of administration or an establishment within another Contracting State the Scottish courts must decline jurisdiction unless one or other of a complicated series of exceptions specified in Articles 6, 7, 8 and 10 applies.

courts of Scotland, since a pursuer, when presenting a petition for sequestration with an international aspect, would then not require to satisfy two different sets of jurisdictional rules. We do not, however, regard the rules of the Convention as being appropriate for the internal allocation of jurisdiction within Scotland.

6.14 The primary jurisdictional criterion in the Convention is the "centre of administration" of the debtor. This is defined as "the place where the debtor usually administers his main interests". This criterion is open to the objection that the petitioning creditor will not always be aware where the debtor administers his main interests. The force of this objection is recognised by the terms of Article 3(2) which, in the case of firms, companies or legal persons presumes that place to be their registered office, if any. There is no corresponding presumption for individual debtors and so the criterion opens up wide horizons of uncertainty. The need to avoid jurisdictional disputes in bankruptcy proceedings points compellingly to the rejection of the criterion of "centre of administration" as a test for the internal allocation of jurisdiction. In our view the choice of this criterion is based on the unjustified premise that, to avoid conflicts of jurisdiction, the rules of jurisdiction in bankruptcy must point to a unique forum. It would seem preferable, however, to allow creditors to petition for the sequestration of a debtor's estate wherever he has adequate and readily ascertainable business or personal connections with the State of the forum. Conflicts of jurisdiction are unlikely to be frequent and the problems which they present may otherwise be resolved.

6.15 In this perspective the subsidiary criterion of "establishment" used in Article 4(1) of the Convention is more promising. The existence of an "establishment" will be known to creditors. This criterion, therefore, is not vulnerable to the objections stated above in relation to "centre of administration". Though the concept refers primarily to business establishments, Article 4(2) makes it clear that it is intended to apply also to establishments of an administrative character. That provision declares that "an establishment exists in a place where an activity of the debtor comprising a series of transactions is carried on by him or on his behalf". The last words would appear to include the place of an independent agent, but we do not consider that the fact that a person carries on business in a country through an independent agent should render the former vulnerable to its bankruptcy jurisdiction.<sup>24</sup>

#### ***Should an assets jurisdiction be introduced?***

6.16 The E.E.C. Bankruptcy Convention admits of the operation of other, and possibly exorbitant, grounds of jurisdiction where the debtor has neither his centre of administration nor any establishment in a Contracting State.<sup>25</sup> In this context we have considered whether it would be appropriate

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<sup>24</sup>*Cf. Laidlaw v. Provident Plate Glass Insurance Co. Ltd.* (1890) 17 R. 544.

<sup>25</sup>Article 5.

to introduce an assets jurisdiction into Scots law. We came to the conclusion, however, that this was undesirable in principle. The effects of bankruptcy extend beyond the distribution of the debtor's assets and have repercussions on the personal status of the bankrupt. The procedures, too, for investigation of the bankrupt's affairs would be less effective in his absence. It is not clear, moreover, that jurisdiction assumed on this ground would attract recognition abroad. If such a ground of jurisdiction were adopted by countries generally, it would inevitably lead to an undesirable proliferation of bankruptcy proceedings. We therefore reject an assets basis of jurisdiction in bankruptcy. Consistently with this view, we consider that the fact that the debtor had or has a dwelling-house or other interest in heritage in Scotland should no longer be a factor relevant to the assumption of the bankruptcy jurisdiction by the Scottish courts. The possession of a dwelling-house or other interest in heritage in Scotland is not, in present times, a clear demonstration of a debtor's practical ties with Scotland.

### ***Our proposals***

6.17 We conclude, therefore, that it would be desirable to adopt new jurisdictional criteria which would reflect the presence of a real and substantial connection between the debtor and the territory of the court assuming jurisdiction. They should, in principle, be criteria lending themselves to ready ascertainment by a petitioning creditor. They should also, preferably at least, be criteria which may be adopted equally by the Court of Session to delimit the sphere of Scottish bankruptcy jurisdiction in relation to other countries and by the sheriff courts, both for this purpose and to ensure an appropriate allocation of bankruptcy jurisdiction among those courts.

6.18 Evidence was given to the Cullen Committee that the present law of Scotland was unsatisfactory in so far as bankruptcy jurisdiction ceases the moment the debtor leaves Scotland.<sup>26</sup> English law deals with this problem in relation to some at least of its grounds of jurisdiction by allowing it to suffice that the debtor "*within a year before the date of the presentation of the petition has ordinarily resided, or had a dwelling-house or place of business, in England*".<sup>27</sup> The E.E.C. Bankruptcy Convention achieves a similar result by prolonging the jurisdiction of the court where the debtor has transferred his centre of administration or establishment to another Contracting State.<sup>28</sup> We prefer the simplicity of the approach adopted in section 4(1)(d) of the 1914 Act and recommend, in relation to the grounds of jurisdiction whose adoption we later recommend, that it should suffice for the relevant test to be fulfilled at any time during the year preceding the date of presentation of the petition.<sup>29</sup>

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<sup>26</sup>See para. 6.8.

<sup>27</sup>1914 Act; s. 4(1)(d) (emphasis added).

<sup>28</sup>Articles 7 and 8.

<sup>29</sup>In the case of a deceased debtor, the relevant period would be the year preceding the date of the debtor's death.

6.19 We suggest that the principal criterion of jurisdiction should be the fact that the debtor possessed within the territory of the court at any time during the year preceding the date of the presentation of the petition for sequestration an "established place of business" in Scotland. We have noted that in sections 11 and 16 of the 1913 Act the fact that the debtor *carried on business* in Scotland is utilised as a jurisdictional criterion and that it is applied also in English law by virtue of section 4(1)(d) of the 1914 Act. But the fact that this ground of jurisdiction is inapplicable where the debtor is domiciled in Scotland or [Northern] Ireland or the debtor firm has its principal place of business in Scotland or [Northern] Ireland, points to its exorbitant character. Trade and business are no longer of a merely local character, and the fact that a person or company has carried on business even for a relatively long period within Scotland through an agent or representative,<sup>30</sup> or perhaps even in person in the course of occasional visits, does not appear to be a sufficiently good reason to subject that person or company to the bankruptcy jurisdiction of the Scottish courts. We therefore reject the mere fact of carrying on business as a criterion of bankruptcy jurisdiction. But the question is one of degree, and it would not seem inappropriate to assume bankruptcy jurisdiction over a person or entity having *an established place of business* in Scotland. The debtor's place of business is already a principal criterion of jurisdiction in section 11 of the 1913 Act, and we add the qualification "established" only because the term "place of business" has received a wide construction in other contexts,<sup>31</sup> and we wish to emphasise the requirement of the settled nature of the place of business. We would add that the term "business" has been construed to cover *inter alia* activities of an administrative character.<sup>32</sup> We recommend, therefore, that the Court of Session and the sheriff court should have jurisdiction to sequester the estates of an individual or entity where the debtor has had an established place of business in Scotland and, in the case of a sheriff court petition for sequestration, in the appropriate sheriffdom, at any time in the year immediately preceding the date of presentation of the petition. A similar rule should apply in petitions to sequester the estate of a deceased debtor but, in that case, the relevant date should be the date of death.

6.20 A living debtor, however, may not necessarily possess an established place of business, and it seems right to adopt in relation to such a debtor an alternative criterion of jurisdiction pointing to the existence of close ties between the debtor and the territory of the court. The criterion of the debtor's (simple) residence is utilised in section 11 of the 1913 Act. But the assumption, of course, is that the debtor is also "subject to the jurisdiction of the supreme courts of Scotland". Simple residence by itself does not seem to us to be an adequate criterion for the assumption of bankruptcy jurisdiction,

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<sup>30</sup>*Laidlaw v. Provident Plate Glass Assurance Co. Ltd.* (1890) 17 R. 544.

<sup>31</sup>*Cf. Young v. Livingston* (1860) 22 D. 983; *Hughes v. J. & W. Stewart* 1907 S.C. 791. But see *O'Brien v. A. Davies & Son Ltd.* 1961 S.L.T. 85.

<sup>32</sup>See *Rolls v. Miller* (1884) 27 Ch. D. 71, *per Lindley L.J.* at 88; *Re Williams Will Trusts* [1953] Ch. 138, *per Danckwerts J.* at 141; *Hills (Patents) Ltd. v. University College Hospital Board of Governors* [1956] 1 Q.B. 90; *Willis and another v. Association of Universities of the British Commonwealth* [1965] 1 Q.B. 140.

since the debtor's residence in Scotland may well be transitory. Under section 4(1)(d) of the Bankruptcy Act 1914 a creditor may not present a bankruptcy petition unless the debtor has *inter alia* ordinarily resided in England within the past year. We considered, therefore, whether "ordinary residence" would be a more appropriate criterion. The matter is complicated by a divergence of views as to whether there is any difference, or any significant difference, between ordinary residence and (simple) residence,<sup>33</sup> though the latest English decision on the interpretation of section 4(1)(d) suggests that there is no significant difference between the two terms.<sup>34</sup>

6.21 A debtor's domicile in the ordinary sense of the term would be an inappropriate criterion by reason of its artificial character, in particular because a person is held not to acquire a domicile in a country unless he intends to remain there indefinitely. We considered adopting the test of "domicile" as defined for general purposes in the European Judgments Convention, but were not encouraged, by the complication of the definitions proposed, to regard it as being appropriate as a criterion for bankruptcy jurisdiction. We decided, therefore, to adopt the analogous test of the bankrupt's habitual residence in Scotland, a test increasingly adopted in modern legislation.<sup>35</sup> The use of the term "habitual" suggests that something more than ordinary residence is required, perhaps, as Lane J. has accepted, something "similar to the residence normally required as part of domicile, although in habitual residence there is no need for the element of animus which is necessary in domicile".<sup>36</sup> We recommend, therefore, that the Court of Session and the sheriff court should have jurisdiction to sequester the estates of a living debtor if the debtor was habitually resident in Scotland and, in the case of a sheriff court petition, in the appropriate sheriffdom, at any time during the year immediately preceding the date the petition was presented. A similar rule should apply in petitions to sequester the estate of a deceased debtor but, in that case, the relevant date should be the date of death.

6.22 It is possible also, though clearly unlikely, that an entity (not being a natural person) formed under Scots law may have no identifiable *place* of business in Scotland and yet may contract debts in Scotland which render it an appropriate subject for sequestration proceedings here. We have rejected as a criterion of jurisdiction the *mere* carrying on of business in Scotland; but we do consider that the constitution of an entity under Scots law

<sup>33</sup>Dicta supporting the view that there is a difference may be found in *Re Erskine* (1893) 10 T.L.R. 32 (a bankruptcy case), *per* Lord Esher M.R.; *Ex p. Bright* (1901) 18 T.L.R. 37, *per* Vaughan Williams L.J.; *I.R.C. v. Lysaght* [1928] A.C. 234, 243, 248, *per* Lords Sumner and Buckmaster; and *Stransky v. Stransky* [1954] P. 428, 437, *per* Karminski J. The view that there is no difference is supported by dicta in *Forsyth v. Forsyth* [1948] P. 125; *Macrae v. Macrae* [1949] P. 397, where Somervell L.J. stated that "ordinary residence can be changed in a day"; *Levene v. I.R.C.* [1928] A.C. 217 at 225, *per* Lord Cave; *Hopkins v. Hopkins* [1951] P. 116, 121, *per* Pilcher J.; and *Lowry v. Lowry* [1952] P. 252, *per* Lord Merriman at 255.

<sup>34</sup>*Re Brauch (a debtor) ex parte Brittanian Securities & Investments Ltd.* [1978] 1 All E.R. 1004.

<sup>35</sup>Administration of Justice Act 1956 (c. 46), s. 4; Wills Act 1963 (c. 44), s. 1; Adoption Act 1968 (c. 63), s. 11; Recognition of Divorces and Legal Separations Act 1971 (c. 53), s. 3; Domicile and Matrimonial Proceedings Act 1973 (c. 45), ss. 5(2), 7(2).

<sup>36</sup>*Cruse v. Chittum* [1974] 2 All E.R. 940 at 943.

coupled with the fact of its having carried on business in Scotland should render that "entity" or firm amenable to the bankruptcy jurisdiction of the Scottish courts. Such a ground of jurisdiction may be particularly appropriate in the case of unincorporated associations, which may not even have any fixed place for the administration of their affairs. We recommend, therefore, that any entity (other than a natural person), which may otherwise competently be the subject of sequestration proceedings in Scotland, should be liable to sequestration if it was constituted or formed under the law of Scotland and, in the case of a Court of Session petition, has at any time carried on business in Scotland or, in the case of a sheriff court petition, has at any time carried on business within the appropriate sheriffdom.

6.23 We have already proposed, when discussing the conditions for the sequestration of partnerships, that any court having jurisdiction to sequester the estate of a partnership shall have jurisdiction to sequester the estate of any of the individual partners. We consider that this rule requires no other justification than its convenience and we recommend its enactment.

### **Concurrent proceedings**

6.24 The 1913 Act deals with the problems created by concurrent proceedings for sequestration and competing awards by re-enacting an earlier provision that:

"no sequestration shall be awarded by any court after the production of evidence that a sequestration has already been awarded in another court, and is still undischarged",<sup>37</sup>

by providing that:

"where a prior petition for sequestration is in dependence before any court the court to which a subsequent petition has been presented may remit such subsequent petition to the court in which the prior petition is in dependence",<sup>38</sup>

by re-enacting an earlier provision to the effect that where sequestration has been awarded against a debtor by the sheriffs of two or more counties, the later sequestration should be remitted to the sheriff of the first award;<sup>39</sup> and by re-enacting an earlier provision permitting the recall of a sequestration where it appears to the court that:

"a majority of the creditors in number and value reside in England or in [Northern] Ireland, and that from the situation of the property of the bankrupt or other causes his estate and effects ought to be distributed among the creditors under the bankrupt or insolvent laws of England or [Northern] Ireland."<sup>40</sup>

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<sup>37</sup>s. 16.

<sup>38</sup>s. 16.

<sup>39</sup>s. 17.

<sup>40</sup>s. 43.

6.25 The revised grounds of jurisdiction which we propose will not in all cases avoid the risk of concurrent petitions for sequestration in the Court of Session and in the sheriff court on the one hand or, on the other hand, in two sheriff courts. There may also be concurrent petitions for sequestration and petitions for the appointment of a judicial factor on the estate of a deceased debtor. Nor will our proposals in relation to jurisdiction necessarily avoid the risk of simultaneous petitions for sequestration in Scotland and petitions for analogous remedies in courts outside Scotland. It seems necessary, therefore, to make provision to avoid as far as practicable the risk of concurrent proceedings.

6.26 In the first place, the present rules do not require a petitioner for sequestration to bring to the notice of the court the existence of any prior award of sequestration or of an analogous remedy, or of any concurrent proceedings for sequestration or for an analogous remedy. It would seem clearly desirable to put the court in a position to decide what action to take in these circumstances. We propose, therefore, to impose a duty upon the debtor whose estates it is sought to sequester, and upon any petitioning or concurring creditor who possesses knowledge of any relevant petition for sequestration or for an analogous award or remedy or of the existence of another sequestration or analogous award or remedy, whether in Scotland or elsewhere, to bring the fact to the notice of the court.

6.27 In the second place, the remedies provided by sections 16 and 17 of the 1913 Act for dealing with competing petitions for sequestration or competing awards of sequestration rely largely upon priority being given to the earlier petition or the earlier award. Where, however, despite the above requirement for notice, there are concurrent petitions for sequestration, a simple system of temporal priority<sup>41</sup> would not necessarily be adequate in view of the complexity of the situations which may arise. Where, for example, a petition for the sequestration of the estates of a partner of a firm is followed by a petition for the sequestration of the firm and of its individual partners, it may be more satisfactory to give priority to the later petition.<sup>42</sup> We propose, therefore, that, where a petition for sequestration is before a court and that court finds that another petition for the sequestration of the estate of the same debtor is in dependence, the court concerned with any such petition, of its own motion or at the instance of a creditor or other person having an interest, may allow the petition to proceed or may sist or dismiss it, and the Court of Session, whether or not a petition for sequestration is before it, may direct any sheriff before whom such a petition is pending to sist or dismiss it or to order all the petitions to be heard together.

6.28 We propose, in the third place, that rules similar to those outlined in the preceding paragraph should apply whenever the court finds—

- (1) that an award of sequestration has already been made;

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<sup>41</sup>Proposed by Anon., 15 S.L.R. (1899) 87 and, to some extent at least, embodied in proviso (2) to s. 16 of the 1913 Act.

<sup>42</sup>Cf. *Duncan v. Trotter* 1936 S.N. 23.

- (2) that a petition for the appointment of a judicial factor on the debtor's estate is before a court in Scotland or that such a judicial factor has been appointed; or
- (3) that a petition is before a court in Scotland for the winding-up of the debtor under Part IX of the Companies Act 1948 or the debtor has been wound up under Part IX.

We do not propose to retain the rule in section 16 that no award of sequestration may competently be made after production of evidence that sequestration has already been awarded in another court. That would re-introduce a system of temporal priority. Faced with a prior award of sequestration, or prior appointment of a judicial factor or prior winding-up, a court is unlikely to make another award or an award of sequestration unless the first award or appointment was made in a wholly inappropriate forum. In the exercise of its discretion, moreover, a sheriff court will be controlled by the Court of Session directly or in proceedings for recall.<sup>43</sup> We propose in Chapter 8 that the Court of Session, without prejudice to its general power to recall an award of sequestration, should be entitled to recall an award of sequestration on the ground that other awards of sequestration (or the analogous remedies to which we refer in the following paragraphs) have been granted.

6.29 Finally, we consider cases where there are concurrently proceedings analogous to sequestration in other countries or where an analogous remedy is already in force. Section 16 of the 1913 Act, which precludes the making of an award of sequestration on production of evidence that a sequestration has already been awarded in another court, contextually refers only to an award of sequestration in Scotland and not to an adjudication in bankruptcy elsewhere. Section 43 of the 1913 Act permits the recall of a sequestration on the ground that:

“... a majority of the creditors in number and value reside in England or in [Northern] Ireland, and that from the situation of the property of the bankrupt or other causes his estate and effects ought to be distributed among the creditors under the bankrupt or insolvent laws of England or [Northern] Ireland.”

Section 43 does not apply to wholly foreign awards.

6.30 It is true that Lord President Inglis has declared that:

“... whenever the Court of the domicile has by proceedings in bankruptcy vested the moveable estate of the bankrupt in a trustee or assignee for the purpose of equal distribution among his creditors, no part of the moveable estate, wheresoever situated, can be touched or affected except through the bankruptcy proceedings and by the orders of the Court of that country in which those proceedings take place. The jurisdiction of that Court is exclusive.”<sup>44</sup>

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<sup>43</sup>See para. 8.12.

<sup>44</sup>*Phosphate Sewage Co. v. Lawson* (1888) 5 R. 1125, 1138.

While adherence to this principle is clearly desirable, the Lord President states the principle in a more rigid way than the complexity of international situations would appear to admit. Moreover, he uses as the criterion for the competence of the foreign court the test of domicile. This no longer seems appropriate.

6.31 We consider that these problems would be best resolved in accordance with the general pattern of the scheme proposed above to deal with concurrent proceedings in Scotland. We propose, first, that where in respect of the same estate a petition for sequestration is before a court in Scotland and an application for an analogous remedy is before a court elsewhere in the United Kingdom or in any other country or an analogous remedy is in force, the Scottish court on its own motion or at the instance of the debtor or any creditor should be entitled to allow the petition for sequestration to proceed or to sist or dismiss it. Since this power is discretionary we consider that an "analogous remedy" might safely include the making of an administration order under section 148 of the County Courts Act 1958 in England or Wales or in Northern Ireland under the Judgments Enforcement (Northern Ireland) Order 1981.<sup>45</sup> We propose, secondly, in Chapter 8 that section 43 of the 1913 Act should be replaced by a more general provision entitling the Court of Session to recall an award of sequestration *inter alia* on the ground (1) that a majority in number and in value of the creditors reside in a country other than Scotland and that it is more appropriate for the debtor's estate to be administered in that country; and (2) that one or more remedies analogous to sequestration have been granted elsewhere.

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<sup>45</sup>S.I. 1981/226, articles 80-87.

## CHAPTER 7

### ASPECTS OF SEQUESTRATION PROCEDURE

#### Form of the petition and associated matters

7.1 We envisage that, as at present, sequestration proceedings will normally be initiated in the sheriff court, although nothing will preclude the commencing of those proceedings in the Court of Session.<sup>1</sup> It was suggested to us that forms of petition for sequestration should be prescribed by Act of Sederunt. We consider that such prescription of forms is unnecessary and undesirable. It is unnecessary because forms would soon evolve in practice, and undesirable because of the inevitable introduction of inflexibility. In any event the essential elements of a petition for sequestration will remain straightforward—in a petition by a debtor the grounds of jurisdiction, and in a petition by a creditor the specification of his debt, the grounds of jurisdiction and a statement as to the debtor's apparent insolvency within the period of four months preceding presentation of the petition.

7.2 Goudy states that a creditor must produce *written* evidence of the debtor's notour bankruptcy.<sup>2</sup> The authority for this proposition is not clear but it may be based on the general proposition that the execution of diligence by an officer of court can be competently proved only by the documents recording the execution. The matter was discussed in *Drummond v. Chinas Tiles and Mosaics Ltd.*,<sup>3</sup> where the debtor had deliberately destroyed the evidence of his notour bankruptcy. The Second Division refused the debtor's petition for recall of the sequestration on the ground that in the circumstances the best available evidence had been produced. A similar question could arise in the context of proof, under our proposals, of the apparent insolvency of the debtor. We consider, however, that the matter should be allowed to rest on the common law rules relating to evidence, and that it should suffice to provide that a petitioning creditor shall produce along with his oath such evidence as may be available to him to establish the apparent insolvency of the debtor.

7.3 Petitions at the instance of the debtor himself must be signed by him, or there must be produced with the petition:

“a mandate authorising the same, signed by him, or in the case of a company, signed by a party entitled to act for the company”.<sup>4</sup>

Although, in view of the drastic consequences of sequestration, this provision is not inappropriate, it would, if retained, require to be amended to extend to the various entities in respect of whose estates sequestration will become competent.<sup>5</sup> We consider, however, that the matter is one best left to Rules of Court and we make no recommendation except that the relevant portion of section 20 of the 1913 Act should not be re-enacted.

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<sup>1</sup>Para. 5.35.

<sup>2</sup>p. 131.

<sup>3</sup>1909 S.C. 1049.

<sup>4</sup>1913 Act, s. 20.

<sup>5</sup>Paras. 5.1–5.13.

7.4 Where the debtor dies after the petition for sequestration has been presented but before the award of sequestration has been made, section 33 of the 1913 Act provides that:

“the proceedings shall notwithstanding be followed out in terms of this Act, so far as circumstances will permit”.<sup>6</sup>

It is not wholly clear whether this provision applies to debtors' petitions as well as to creditors' petitions. The rule seems appropriate to creditors' petitions and in that context should be retained. In relation to debtors' petitions, the fact that the petitioner is dead presents difficulties,<sup>7</sup> and it would seem appropriate for the petition to fall in such a case. We so recommend.

7.5 The same section provides that if (a) a petitioning or concurring creditor should withdraw or die, or (b) a creditor who has appeared to oppose a petition for sequestration should withdraw or die, any other creditor may be sisted in his place and follow out the proceedings.<sup>8</sup> This rule is a convenient one and should be retained, but it should be provided that as regards case (a) the sisted creditor must have been duly qualified at the date of presentation of the petition for sequestration and remain so at the date of the sist.

#### **Petitioning creditor's oath and further particulars**

7.6 In all petitions for sequestration the petitioning or concurring creditor must produce with the petition an oath to the verity or credulity of the debt claimed by him.<sup>9</sup> The creditor in this oath must state “what other persons, if any, are, besides the bankrupt, liable for the debt or any part thereof, and specify any security which he holds over the estate of the bankrupt or of other obligants”.<sup>10</sup>

7.7 Our Working Party proposed the abolition of the requirement of an oath<sup>11</sup> and their recommendation was endorsed by the majority of those who commented on their proposal. Since these comments were received, the Insolvency Act 1976<sup>12</sup> has dispensed with the requirement of an oath in claims by creditors unless the trustee specifically requires the making of an oath, but the requirement is retained for the petitioning creditor, presumably on the view that the consequences of a petition founded upon a false claim are more serious. We consider that the recent consideration of this matter by Parliament makes it inappropriate for us to recommend further changes. But the contents of the oath by a petitioning creditor and of the statement of claim by a creditor should in principle be the same even although the two

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<sup>6</sup>Cf. the earlier cases of *Younger & Son Ltd.* (1902) 40 S.L.R. 102; *British Linen Co. Ltd* (1893) 1 S.L.T. 385; *Orr* (1882) 10 R. 53.

<sup>7</sup>See *Orr* (1882) 10 R. 53.

<sup>8</sup>Cf. *Forsyth* (1883) 10 R. 1061; *Stewart v. Wetherdair Ltd*, 1928 S.C. 577.

<sup>9</sup>1913 Act, ss. 20, 24.

<sup>10</sup>*Ibid.* s. 21.

<sup>11</sup>Memo. No. 16, p. 27.

<sup>12</sup>s. 5(3), repealing s. 45 of the 1913 Act.

documents differ in form. Accordingly we recommend that the form and contents of the oath should be prescribed by regulations made by the Secretary of State and that the contents of the oath should be similar to those of a statement of claim.<sup>13</sup>

7.8 With regard to the form of the oath we consider that the distinction between an oath of verity and an oath of credulity is unnecessary and confusing and could be discarded in the context of bankruptcy petitions. Instead, we suggest to the rule-making authority that the oath should set out the required particulars to the best of the deponent's knowledge and belief.

7.9 Separate provision is made in section 22 of the 1913 Act to regulate the making of oaths by creditors outside the United Kingdom. It is provided that the oath shall be made "before a magistrate or justice of the peace, or other person qualified to administer oaths in the country where the creditor resides". It would be advantageous, however, to permit deponents who live abroad to make the oath before British representatives and officials, who are likely to be more familiar with our language and procedures than foreign judges and notaries. It should be provided, therefore, that where a creditor makes the oath outside the United Kingdom, he may make it before any British diplomatic or consular officer, or any person having authority to administer an oath or affirmation under the law of the place where the oath is made. The identities of the person making the oath and of the person before whom the oath is made and their authority to make and to administer the oath respectively should be presumed to be correctly stated, and the seal and signatures on the oath shall be presumed to be authentic, unless the contrary is established.

7.10 Existing law<sup>14</sup> provides that where the creditor is a corporation the oath may be made "by the secretary, manager, cashier, clerk, or other principal officer of such corporation" and that "in case of other companies an oath by a partner shall be sufficient". Where the creditor is under age or incapable of making the oath, it may be made "by his authorised agent, factor, guardian, or manager". This approach is too particularised, and it should be sufficient to provide that the oath may be made by the creditor or by any other person authorised to do so on his behalf.

7.11 Under section 20 of the 1913 Act it is necessary for a petitioning or concurring creditor to produce with his oath "the account *and* vouchers of the debt". The literal wording of that provision has not been followed. All that is required to be produced is an account or voucher (according to the nature of the debt) which constitutes *prima facie* evidence of the debt. We propose that the legislation to follow on this Report should give legislative sanction to the existing practice and state that what must be produced with the creditor's oath is *prima facie* evidence of the debt according to its nature.<sup>15</sup>

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<sup>13</sup>See paras. 17.2-17.8.

<sup>14</sup>1913 Act, s. 24.

<sup>15</sup>*Turnbull v. McNaughtan* (1850) 12 D. 1097, *per* L.J.C. Hope at 1100. See also para. 17.10 for a similar requirement where a creditor lodges a claim for voting purposes.

7.12 Section 23 of the 1913 Act requires certain statements as to jurisdiction to be made by the creditor in his oath in the case of petitions for the sequestration of the estate of a deceased debtor. This requirement was criticised in evidence to our Working Party,<sup>16</sup> and there is no corresponding requirement for such statements in oaths relative to petitions for the sequestration of the estate of a living debtor. We suggest that this requirement could safely be omitted, since the matter could be dealt with, if it were thought necessary, in the regulations prescribing the form and contents of the oath.<sup>17</sup> We recommend, therefore, that no analogue to section 23 should be included in the legislation to follow on this Report.

7.13 An examination of the cases relating to oaths suggests that many petitions have been dismissed because of errors in, or omissions from, statements in the oath. While some of these errors could be corrected by our proposals to confer on the sheriff powers to remedy defects in procedure,<sup>18</sup> we think it appropriate to allow a reversion to the earlier practice of the sheriff court referred to by Lord Moncrieff in *Younger and Son Ltd.—Petitioners*,<sup>19</sup> and to give the court a discretion to allow the production of another oath correcting any errors in, or omissions from, statements in the oath as originally produced. We recommend accordingly.

#### Citation on petition

7.14 The 1913 Act makes detailed and comprehensive provision for citation in petitions for sequestration.<sup>20</sup> These provisions are in some respects less liberal and in other respects more liberal than the general law relating to citation. They are less liberal, for example, in so far as a petition for sequestration cannot be served by *leaving it* at the debtor's dwelling house,<sup>21</sup> and more liberal in that personal service may be made by a competent officer without witnesses.<sup>22</sup> No coherent policy, therefore, appears to inform these provisions for citation in bankruptcy. With certain amendments they reproduce the corresponding provisions of the 1856 Act, and we question whether there is a need for special rules for citation in bankruptcy matters. In any case we do not consider that bankruptcy legislation is the appropriate place for the specification of such rules. We think that the question should be considered by the appropriate rule-making authorities. We merely suggest to those authorities that, in view of the drastic effects of sequestration, there is a case for requiring personal service upon the bankrupt in creditors' petitions unless the court otherwise directs.

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<sup>16</sup>Memo. No. 16, p. 64.

<sup>17</sup>See para. 7.7.

<sup>18</sup>See para. 7.47.

<sup>19</sup>1926 S.L.T. 238.

<sup>20</sup>ss. 25–27.

<sup>21</sup>This appears to follow from a deliberate departure in s. 25 of the 1913 Act from the language of s. 26 of the 1856 Act and may be assumed to have been intentional—see Fyfe, *The Scottish Bankruptcy Code* (1913), p. 35. This result has been criticised by the Law Society of Scotland, who consider that the provisions of the 1913 Act are not sufficiently flexible for the citation of elusive debtors.

<sup>22</sup>s. 171.

7.15 A minor problem remains. Section 26 of the 1913 Act does not make it clear whether, in the case of a creditor's petition for the sequestration of a partnership estate, the partners must be cited separately from the partnership if it is proposed also to seek sequestration of the estates of the individual partners.<sup>23</sup> Having regard to the distinct legal personalities of a firm and its several partners and to the practical desirability of ensuring that all the partners are aware of what is happening, we consider that the individual partners should receive notice in every case where there is a creditor's petition for the sequestration of the estate of a firm. Where the petition relates only to the sequestration of the estate of the firm, notice of the citation on the petition should be sent to each partner of the firm. If it is proposed also to sequester the estate of any partner of the firm, then he should be cited separately. We draw the attention of the rule-making authority to this matter.

#### **Award of sequestration**

7.16 Under the present law the court must award sequestration if the relevant conditions are fulfilled unless there is a valid objection to the competency of the proceedings, or unless the debtor has discharged or instantly discharges his indebtedness.<sup>24</sup> The debtor's offer to prove that he is solvent is not a ground for a refusal to make an award.<sup>25</sup> As Lord President Normand explained in *Scottish Milk Marketing Board v. Wood*:<sup>26</sup>

"To allow a debtor, before the granting of sequestration, a parole proof that he has resources available to meet debts which he refuses to pay would have the most harmful results. There would be many petitions which could not be disposed of without proof. The debtor would remain vested in his estate pending proof, and would have full opportunity of making away with his assets."

We entirely agree. In the interests of both the debtor and his creditors there should be objective and readily ascertainable criteria for an award of sequestration, so that sequestration may normally be obtained without the risk of issues of fact being contested and of consequential delays and expense. We propose, therefore, that there should be no departure in principle from the provision of section 29 of the 1913 Act whereby the court is bound to make an award of sequestration on a creditor's petition unless the debtor can "show cause why the sequestration cannot be competently awarded" or if he does not "instantly pay the debt or debts in respect of which he was made bankrupt, or produce written evidence of the same being paid or satisfied, and also pay or satisfy, or produce written evidence of the payment or satisfaction of the debt or debts due to the petitioner or to any other creditor appearing and concurring in the petition".

7.17 Section 30 of the 1913 Act provides that "the deliverance awarding sequestration shall not be subject to review", but an appeal to the Court of

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<sup>23</sup>Differing views were expressed in *Central Motor Engineering Co. v. Galbraith* 1918 S.C. 755.

<sup>24</sup>1913 Act, s. 29.

<sup>25</sup>Bell, *Comm.* ii. 286.

<sup>26</sup>1936 S.C. 604 at 611.

Session against a deliverance of the sheriff refusing to make an award of sequestration is competent.<sup>27</sup> It is provided in section 17 that:

“in any case where the sheriff has refused to sequester, it shall be competent to present a petition for sequestration to the Court of Session notwithstanding such judgment of refusal”.

We do not propose any alteration of those provisions except that (a) it should be provided expressly that the dismissal of a petition for sequestration may be appealed against in the ordinary way, and (b) the provision in section 17 should be omitted as unnecessary. Where the sheriff refuses to award sequestration, appeal to the Court of Session will be a petitioner's normal remedy. Where for any reason appeal is inappropriate, the previous presentation of a petition for sequestration in the sheriff court will be no impediment to the presentation of a subsequent petition in the Court of Session.

### **Appointment of interim trustee and interim preservation of the estate**

7.18 It is fundamental to our proposals that in every sequestration, whether initiated by the debtor or by a creditor, an interim trustee should be appointed from an approved list of persons who have declared themselves willing to accept such appointment. We describe the procedure in detail in Chapter 4 but, in petitions by the debtor himself, the interim trustee is to be appointed by the court on the presentation of the petition or as soon as may be thereafter. In other petitions, the court will make the appointment when making the award of sequestration, but will be entitled to do so earlier where either the debtor consents or the petitioner or any other person with an interest shows cause.<sup>28</sup> The selection of the interim trustee should be a matter completely within the discretion of the court. It may have regard to, but should not be bound by, the representations of interested persons. The decision of the sheriff would be subject to appeal only on the ground that the person appointed is disqualified from acting as interim trustee.

7.19 An important function of the interim trustee will be that of securing the interim preservation of the debtor's estate. The 1913 Act contains in section 15 provisions empowering the sheriff to cause to be sealed up the bankrupt's papers and effects and to grant warrant to search the bankrupt's house and business premises. Section 14 empowers the court to which a petition for sequestration is presented, whether it can be immediately awarded or not, to take immediate measures for the preservation of the estate *inter alia* by the appointment of a judicial factor.<sup>29</sup>

7.20 The institution of the office of interim trustee, in our view, makes the retention of these provisions, including the appointment *ad hoc* of a judicial factor, unnecessary. We suggest that the interim trustee should be empowered to take all measures reasonably required for the interim

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<sup>27</sup>*Marr & Sons v. Lindsay* (1881) 8 R. 784.

<sup>28</sup>Para. 4.12.

<sup>29</sup>This provision is discussed in *Partridge v. Baillie* (1873) 1 R. 253.

preservation of the estate and, in particular, should have the following powers—

- (a) to require the debtor to deliver up to him any of the debtor's money or valuables, or any document relating to his business or financial affairs which is in his possession or under his control;
- (b) to place in safe custody anything mentioned in the preceding subparagraph;
- (c) to require the debtor to deliver up to him any perishable goods belonging to the debtor or under his control and to arrange for the sale or disposal of such goods;
- (d) to make or to cause to be made an inventory or valuation of any property belonging to the debtor; and
- (e) where he considers that this would benefit the estate, to require the debtor to implement any transaction entered into by him.

The court, moreover, should be empowered, on application by the interim trustee, to give directions to the debtor relating to the management of his estate and, on cause shown, to authorise the interim trustee to enter the debtor's house or his business premises and to search for and take possession of any item of the debtor's estate, if need be by opening locked places.<sup>30</sup>

### *Statement of affairs*

7.21 In Scottish bankruptcy procedure the debtor is required to make up a statement of affairs and to present it at the meeting for the election of the trustee, to the clerk of that meeting.<sup>31</sup> No special form is prescribed, the debtor merely being called upon to specify:

“his whole property, wherever situated, the property in expectancy or to which he may have an eventual right, the names and designations of his creditors and debtors, and the debts due by and to him, and a rental of heritable property, which state and rental shall be subscribed by the bankrupt, and shall then be delivered to the trustee, and the same shall be engrossed in a sederunt book to be kept by the trustee”.

We understand, however, that, except in summary sequestrations, where it forms part of the original application,<sup>32</sup> the debtor's statement of affairs is rarely available at the meeting for the election of the trustee.

7.22 In our view it is essential that the bankrupt's statement of affairs should be prepared by the bankrupt and submitted to the interim trustee as soon as possible after the appointment of the interim trustee. As we explained above,<sup>33</sup> one of the duties of the interim trustee is to examine the bankrupt's statement of affairs and to report thereon both to the creditors and to the Accountant in Bankruptcy. To permit the interim trustee to do so

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<sup>30</sup>See 1913 Act, s. 15 *ad finem*.

<sup>31</sup>1913 Act, s. 77.

<sup>32</sup>1913 Act, s. 175(3).

<sup>33</sup>Para. 4.8.

effectively, he must be furnished by the debtor with a statement of his affairs as soon as practicable. Its receipt at the meeting for the election of the permanent trustee would come too late. We propose, therefore, that the debtor should be required to lodge with the interim trustee, within seven days of the latter's appointment in the case of a debtor's petition, and within seven days of the interim trustee's notification of his appointment to the debtor in any other petition, a statement of affairs in a prescribed form.<sup>34</sup> The contents of the form will clearly be dictated by the purposes of the statement of affairs. It should contain *inter alia*—

- (a) particulars of the debtor's assets with an estimate of their recoverable value;
- (b) a list of creditors, with the amounts of their debts and their securities (if any);
- (c) a statement relating to (i) substantial gifts made by the debtor within the preceding period of five years, (ii) securities given to individual creditors and payments made to them in advance within the preceding period of six months, and (iii) subsisting diligences executed against the debtor's property; and
- (d) a statement by the debtor relating to the causes of his insolvency.

#### *Preliminary enquiries*

7.23 The debtor's statement of affairs has a variety of purposes, including those of assisting the interim trustee to identify cases where interim measures to protect the debtor's estate are required, to fulfil his duty to advise the Accountant in Bankruptcy of the probable causes of the insolvency and to what extent the conduct of the debtor may have contributed to it, and to enable the interim trustee to determine whether the debtor's assets are likely or unlikely to be sufficient to make payment of any dividend to any creditor. Where the trustee determines that the assets are unlikely to be sufficient to pay a dividend, a special procedure (which we call a "small assets" procedure) will apply. It is described in detail below.<sup>35</sup>

7.24 To assist the interim trustee to carry out these duties, we propose that he should be empowered to request the debtor to appear before him and to request the debtor or any other person who the interim trustee considers can give information relating to the bankrupt's assets, his dealings with them, or to his conduct of his business or financial affairs, to give him such information. The information obtained from these preliminary private inquiries by the interim trustee (together with the information obtained from any similar inquiries by the permanent trustee) should make the debtor's public examination less often necessary.

7.25 The debtor may fail to appear before the interim trustee or, even if he does appear, may be reluctant to answer the trustee's questions, and the debtor and the other persons referred to in the previous paragraph may fail

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<sup>34</sup>We envisage that appropriate forms should be available in the Court of Session and the sheriff court.

<sup>35</sup>See paras. 7.29–7.36.

to furnish the interim trustee with the required information. It should, therefore, be open to the interim trustee to apply to the sheriff for the examination in private before him of the debtor or other person. The sheriff should also be entitled to require the debtor or other person for whose examination application is made to produce for inspection all relevant account books or other documents in his or their possession or control relating to the debtor's assets, his dealings with them or his conduct in relation to his business or financial affairs, and to cause the same or copies thereof to be delivered to the interim trustee for further examination by him. Applications for private examination may, in practice, not often be necessary, but where an application is made by the interim trustee and duly granted, any failure by the debtor or other person to appear or to answer questions or to produce documents should be punishable in like manner as any such failure at the public examination of a bankrupt. There should be provision for the apprehension, where necessary, of the bankrupt or other person, for their examination on commission, for the payment of the expenses of witnesses and for other ancillary matters.

#### ***Duties of interim trustee following upon completion of the statement of affairs***

7.26 The interim trustee, as soon as possible after he has received the bankrupt's statement of affairs and in any event not later than 21 days after his appointment, should send to the Accountant in Bankruptcy a copy of the statement of affairs along with his written comments upon it. The written comments would indicate what in the opinion of the interim trustee were the causes of the insolvency and to what extent the conduct of the debtor may have contributed to it. In a case where the interim trustee considered that the debtor's assets were unlikely to be sufficient to secure payment of a dividend to any creditor (whether preferred or ordinary) he would include a statement to that effect in the comments.

7.27 It is essential that the Accountant should be given all relevant information at an early date about the causes of an insolvency, and nothing should inhibit the trustee from making his written comments for the information of the Accountant as frank and as full as possible. For this reason we recommend that such comments should receive absolute privilege.

7.28 As mentioned above<sup>36</sup> we envisage that the interim trustee should convene a meeting for the appointment of the permanent trustee and send to the creditors and to the Accountant in Bankruptcy, not less than four days before the date of the meeting, a summary of the bankrupt's statement of affairs with his (the interim trustee's) observations thereon. The summary of the statement of affairs and the trustee's observations thereon would not necessarily give a complete history of the events leading to the insolvency or amount to a complete analysis of the present state of the bankrupt's affairs, but should be sufficient to enable creditors to form a general view of the causes of the failure, of the present state of his affairs, and the prospects of a dividend. While the summary would be based on the bankrupt's own statement of affairs, the interim trustee's observations on it would include

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<sup>36</sup>Paras. 4.8, 4.10 and 7.22.

conclusions drawn from his examination of the bankrupt. The interim trustee's observations, we assume, would indicate points on which further inquiries seem necessary, including inquiries into gifts, preferences and doubtful claims or the unexplained disappearance of assets. He would also explain what interim measures he had taken for the protection of the estate. Where the interim trustee has concluded that the bankrupt's assets are insufficient to make payment of any dividend to any creditor, he should include a statement to that effect in his observations on the summary of the bankrupt's statement of affairs.

### **Small assets procedure**

7.29 It is convenient at this point to explain the nature of our proposals to deal with small assets cases. Our remodelled procedures for sequestration have been devised to reduce formality and expense so far as this is consistent with the protection of the diverse interests in a sequestration process. Accordingly, we do not propose any radically different procedure in a small assets case but simply (a) the elimination of any procedural step which may be inappropriate in the context of a small assets case, and (b) a requirement upon the trustee not to do specified acts (such as making application for the public examination of the bankrupt) without the consent of the Accountant in Bankruptcy. One obvious method of saving unnecessary expense would be to allow the interim trustee to become permanent trustee. Any transfer of duties occasions additional expense, and it seems better to leave in charge a person familiar with the debtor's situation and already in touch with the creditors. We propose, therefore, that in a small assets case the interim trustee should become permanent trustee and that no election to that office should take place.

7.30 Another question that arises is whether or not there should be any statutory provision for a meeting of creditors. It might be suggested, for example, that the interim trustee should simply intimate to the creditors that there can be no dividend from the bankrupt's estate and thereafter ingather, realise and distribute the estate without further reference to the creditors. It may be argued that this would save the expense of a meeting in which the creditors had *ex hypothesi* no interest. There are, however, cogent arguments for the holding of such a meeting. Sequestration is a creditor-controlled process. One or more of the creditors may have relevant information about the conduct of the debtor or his commercial activities. Such information may serve the public interest (as where the bankrupt has been guilty of fraud or has exploited his creditors in an unscrupulous way) or the private interest of the creditors (as where the bankrupt has made gifts or created preferences in favour of particular creditors). It may not be practicable, indeed, to conclude finally whether the case is a small assets one until after a meeting of creditors has been convened. Creditors, too, may well feel that they ought to have an opportunity as interested parties to participate in examination and discussion of the bankrupt's affairs. The very fact that there is an opportunity for all the creditors to assemble and exchange information with the trustee may often reduce rather than generate expense. We recommend, therefore, that a meeting of creditors should be convened in small assets cases.

7.31 It might also be thought that in a small assets case there should be a statutory vesting of the bankrupt's estate in the interim trustee, making unnecessary the steps for judicial confirmation of the trustee's appointment. An important practical objection to such a course is that the trustee must have evidence that the bankrupt's estate is vested in him. It would be difficult for the trustee to recover the bankrupt's property, even his moveable property, unless he is clothed with judicial authority to do so. There is no ready or convenient substitute in this respect for the judicial act and warrant, and we recommend its retention in small assets cases.

7.32 There are, of course, procedural steps which need not be taken because they have no relevance in the context of a small assets case. These include the adjudication by the trustee upon the claims of creditors; and the procedure relating to accounting periods. There are other steps, however, which are possibly relevant but the taking of which would involve unwarrantable expense. Since we propose that the State should undertake to pay the outlays and remuneration of the permanent trustee in a small assets case in so far as these cannot be met out of the bankrupt's estate, it seems appropriate that such steps should not be taken except with the consent of the Accountant in Bankruptcy. We recommend, therefore, that the trustee should not, except with the consent of the Accountant, be entitled to apply to the sheriff for a warrant for the private or public examination of the bankrupt or any other person. We also recommend that, except with such consent, he should not be entitled to carry on any business of the bankrupt, engage in legal proceedings, create securities or exercise certain powers in relation to the bankrupt's property. It follows also from our proposal that the State should pay the outlays and remuneration of the permanent trustee in a small assets case (at least so far as they cannot be met out of the bankrupt's estate) that the audit of the trustee's accounts and the fixing of his remuneration should be a matter for the Accountant in Bankruptcy. This makes it unnecessary for commissioners to be appointed in small assets cases, and we recommend that their election should be incompetent.

7.33 We shall now describe the procedure to be followed where the interim trustee has concluded that the bankrupt's assets are unlikely to be sufficient for payment of any dividend when the expenses are paid. The interim trustee will convene the first meeting of creditors in the usual way and his observations on the summary of the bankrupt's statement of affairs will (as we have noted) contain a statement that he has determined that the assets are unlikely to be sufficient for payment of a dividend to any creditor (whether preferred or ordinary). If the interim trustee, after considering any representations put to him by the creditors at the meeting, remains satisfied that his determination is correct, he will so inform the creditors and advise them that the question of electing a permanent trustee and commissioners does not arise. He will thereafter make a report of the proceedings at the meeting to the sheriff. On submission of the report to the sheriff, the interim trustee will be confirmed in the office of permanent trustee by the sheriff, and the sheriff clerk will issue an act and warrant confirming him in this office. The trustee will not be required to find caution for his expenses in a small assets case.

7.34 The trustee would then proceed to take possession of the bankrupt's estate and to realise it. He would thereafter prepare and submit to the Accountant in Bankruptcy—

- (a) his accounts of his intromissions (if any) with the bankrupt's estate, both as interim trustee and as permanent trustee, for audit; and
- (b) a note of his outlays and a claim for his remuneration both as interim trustee and as permanent trustee.

7.35 The Accountant in Bankruptcy would (a) audit the trustee's accounts, and (b) fix the amount of the trustee's remuneration. Where the funds of the bankrupt's estate were insufficient to meet the amount of the outlays and remuneration of the trustee, that amount to the extent of the insufficiency would be met out of public funds. Accordingly, the Accountant in Bankruptcy would also specify the respective amounts to be met from the bankrupt's estate and from public funds in any such case.

7.36 The trustee would make the audited accounts and the Accountant's determination of his remuneration available for inspection by the bankrupt and the creditors. It would be open to the trustee, the bankrupt or any creditor to appeal to the sheriff against the Accountant in Bankruptcy's decision as to the trustee's remuneration within the period of 14 days after its issue. In the event of there being no appeal, or on the conclusion or abandonment of any appeal, the trustee would apply the estate towards payment of the claims upon it in accordance with the statutory rules of priority. The trustee would then make application to the Accountant for discharge in the usual way.<sup>37</sup>

### Meetings and their procedure

7.37 We have examined the provisions of the 1913 Act relating to the calling of meetings of creditors and to procedure at those meetings. Certain changes of a minor character were suggested by our Working Party or by those who submitted comments on their Report. Other changes are clearly required in view of changes in bankruptcy procedure which we recommend in this Report. Our approach is informed by the desire to simplify procedure where that is possible and to create a largely uniform procedure at all meetings in the course of a sequestration. But we have considered the rules applicable in company liquidations and have borne in mind the desirability of ensuring consistency between those rules and those in the course of a sequestration.

7.38 We have set out the rules which we propose for meetings of creditors in Schedule 5 to the draft Bill which is annexed to this Report and we think that little comment, beyond the explanations in the Notes on Clauses, is required. We draw attention, however, to the following matters. The most important meeting of creditors is the meeting required by statute—the statutory meeting—for the election of the permanent trustee. We discuss

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<sup>37</sup>See para. 20.16.

in Chapter 9 the procedure at that meeting.<sup>38</sup> The creation of the office of interim trustee permits us to place the duty of calling the statutory meeting on the interim trustee and to allow a longer period than at present for the calling of that meeting. This would enable the interim trustee to present at that meeting both the debtor's statement of affairs and his own observations thereon.

7.39 The 1913 Act envisages the convening of a second meeting of creditors after the examination of the bankrupt.<sup>39</sup> This meeting is required—

- (a) to enable the trustee to present a report on the bankrupt's state of affairs;
- (b) to allow the creditors to receive an offer of composition from the bankrupt;
- (c) to allow the creditors the opportunity of determining the method of sale of the bankrupt's heritable property; and
- (d) to permit of the creditors authorising an allowance to the bankrupt.<sup>40</sup>

7.40 Under our proposals the interim trustee presents his observations on the bankrupt's statement of affairs at the first meeting of creditors; a composition offer may be made to the permanent trustee at any time; subject to any directions given to him by the commissioners (or by the Accountant where there are no commissioners), the method of sale of the debtor's assets, including heritable property, is to be a matter for the trustee; and, lastly, our proposals for safeguarding the bankrupt's earnings and alimentary payments make it unnecessary to retain the existing (and rarely used) provision for making an allowance to the bankrupt. We conclude, therefore, that there is no need to require a second meeting of creditors to be held in all sequestrations. The trustee should be empowered to convene meetings of creditors when he considers it necessary or desirable, and should be required to convene a meeting when called upon to do so by the court, one-tenth in number and value of the creditors, a commissioner or the Accountant in Bankruptcy. We also propose that, after giving written notice to the trustee, a commissioner may at any time call a meeting of creditors.

#### **Power to remedy defects in procedure**

7.41 The statutory provisions governing Scottish bankruptcy are often of a peremptory character and require exact compliance with formalities, especially time-limits for submitting notices and holding meetings. In devising our proposed scheme of bankruptcy administration we have sought, wherever possible, to reduce these formalities. Some, however, are inevitable in a system which attempts to balance the interests of different classes of persons. No special provision was made in the 1913 Act to deal with cases

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<sup>38</sup>Paras. 9.7-9.13.

<sup>39</sup>s. 92.

<sup>40</sup>s. 74.

where there has been a failure, whether by error, neglect or otherwise, to comply with formalities. Persons concerned, therefore, have had recourse to the *nobile officium*, or inherent equitable jurisdiction, of the Court of Session. Petitions have also been addressed to the *nobile officium* in other cases, especially where a sequestration has become dormant or where a situation arises for which the Act has made no provision.

7.42 The *nobile officium* is exclusive to the Court of Session and no corresponding power is vested in the sheriff court.<sup>41</sup> Within the Court of Session it is exercised only by the Inner House, to which all such petitions must be addressed.<sup>42</sup> In consequence of the expense of petitions to the Inner House<sup>43</sup> our Working Party<sup>44</sup> recommended that, in the event of any failure, by error or neglect, to comply with any statutory provision, the sheriff should have a discretion to remedy it.<sup>45</sup>

7.43 It appears from Dr. McBryde's article on "Sequestration and the *Nobile Officium*"<sup>46</sup> that from 1973 to 1977 inclusive more than one-half of the petitions to the *nobile officium* of the Court of Session were petitions relating to sequestrations. The total number of such petitions in this period was 113 and the total number of awards of sequestration was 624. Since some sequestrations involved more than one petition to the *nobile officium* a percentage figure, as Dr. McBryde explains, cannot be produced; but the statistics are disturbing. The need for such petitions is occasioned chiefly by the short time-limits imposed by the 1913 Act for the taking of certain procedural steps,<sup>47</sup> but may be occasioned also by events which cannot be attributed to a failure on the part of a concerned person to comply with statutory provisions, such as delays caused by a snow-storm or industrial action.<sup>48</sup>

7.44 No fewer than 22 of the cases examined by Dr. McBryde were cases where no trustee had been elected at the first meeting of creditors. Our recommendation that an interim trustee should be appointed in all sequestrations—who, if no person is elected as permanent trustee, would be deemed to have been elected to that office—should deal with this problem.

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<sup>41</sup>*Thomson* (1863) 2 M. 325; *Hutton* (1872) 10 M. 620; and see *Forbes v. Underwood* (1886) 13 R. 465, per Lord President Inglis at 468.

<sup>42</sup>*Shaw* (1884) 11 R. 814; *Whyte v. Northern Heritable Securities Investment Co.* 18 R. (H.L.) 37, per Lord Watson at 40; R.C.S. iv, 190. Exceptionally, this jurisdiction may be exercised by the Vacation Judge, but only in matters of urgency—see *Buchanan* 1910 S.C. 685 and the cases there cited.

<sup>43</sup>In 1978 the cost to a petitioner is understood to have been in the region of £100.

<sup>44</sup>Memo. No. 16, p. 34, para. 61.

<sup>45</sup>A similar recommendation has been made by Dr. W. W. McBryde in "Sequestration and the *Nobile Officium*" 1978 S.L.T. (News) 265.

<sup>46</sup>1978 S.L.T. (News) 265.

<sup>47</sup>Notably, the presentation to the keeper of the Register of Inhibitions and Adjudications of the abbreviate of the first deliverance—1913 Act, s. 44 and Conveyancing (Scotland) Act 1924 (c. 27), s. 44(4), (6); the insertion of *Gazette* Notices relating to the award—1913 Act, s. 44; the reporting of proceedings to the sheriff—1913 Act, s. 66; and the lodging of the trustee's bond of caution—1913 Act, s. 69.

<sup>48</sup>*Ross* (1852) 14 D. 546; *Macdonald* (1861) 23 D. 719; *Law Society of Scotland* 1974 S.L.T. (Notes) 66.

Apart from this, we would hope that the longer periods which we propose for the taking of procedural steps might reduce the occasions when recourse to the *nobile officium* would be required. There remain cases where, owing to administrative failures or misunderstandings, errors have been made or time-limits have been disregarded.<sup>49</sup> Since the issues are seldom complex, we propose that the sheriff should be granted powers to remedy such defects. It would not, however, be appropriate in a report on bankruptcy law to make recommendations which would permit the sheriff to afford remedies outwith the general scope of the law of sequestration. We do not propose, therefore, that the sheriff should be entitled to deal with such problems as arose in *Ballantyne*.<sup>50</sup> We consider that the powers of the sheriff should be limited to those of making orders waiving any failure to comply with a provision made by or under our proposed legislation, restoring persons prejudiced by such failure to the position they would otherwise have been in, and ensuring that any sequestration procedure which is dormant or suspended may be revived or enabled to proceed. We do not envisage that the sheriff should be empowered to discharge a bankrupt otherwise than under the provisions of our proposed legislation.<sup>51</sup>

7.45 Under rule 4 of the Act of Sederunt (Rules of Court, consolidation and amendment) 1965:<sup>52</sup>

“the Court may in its discretion relieve any party from the consequences of any failure to comply with the provisions of these Rules which is shown to be due to mistake, oversight or other cause, not being wilful non-observance of the same, on such terms and conditions as shall appear to be just;...”

We considered, therefore, whether the powers of the sheriff under the preceding recommendation should not apply to cases where the failure resulted from some wilful act or omission on the part of the trustee. We decided, however, to make no recommendation in this sense on the view that it was inappropriate to cause third parties to suffer loss by reason of wilful breach of duty on the part of the trustee.

7.46 One further matter remains to be considered. The cases to which we have referred illustrate the complexity of the situations which arise in bankruptcy. While we recommend that the sheriff should be given powers to remedy procedural defects and to remove obstacles to the completion of sequestration proceedings, we consider that provision should be made, where issues of importance or complexity are raised, for the case to be remitted to the Court of Session whether on the sheriff's own initiative, on the application of any person having an interest, or on the sheriff being directed to do so by the Court of Session following an application to that court by any such person.

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<sup>49</sup>*J. & D. Garden* (1848) 10 D. 1509; see *Allan* (1861) 23 D. 972; *Foubister* (1869) 8 M. 31; *Train & McIntyre* 1923 S.C. 291; *White Cross Insurance Association* 1924 S.C. 372.

<sup>50</sup>(1900) 2 F. 1077, and see *MacLeish's Trustees* (1896) 24 R. 151.

<sup>51</sup>In this we accept the views expressed by Dr. McBryde in 1978 S.L.T. (News) 265 at 269.

<sup>52</sup>S.I. 1965/321.

7.47 We may summarise our recommendations relating to defects in procedure as follows—

- (1) In any case where there has been a failure to comply with any requirement of the proposed legislation or of any regulations made thereunder, the sheriff should have power, on the application of any person having an interest, to make an order waiving any failure to comply with the requirement and restoring persons prejudiced by such failure to the position they would otherwise have been in, on such conditions (including conditions as to expenses) as he may think fit.
- (2) In any case where for any reason the sequestration has become dormant or any action to enable the sequestration to proceed cannot be taken, the sheriff should have power, on the application of any person with an interest, to make any order necessary to revive the sequestration, or to enable it to proceed, on such conditions (including conditions as to expenses) as he may think fit.
- (3) The sheriff's powers in any case falling within paragraph (1) or (2) above would include the power—
  - (a) to authorise or dispense with the performance of any act in the sequestration process;
  - (b) to appoint an eligible person as trustee on the bankrupt's estate, whether or not in place of any existing trustee;
  - (c) to extend or waive any time limit specified in or under the proposed legislation.
- (4) At any stage of the proceedings the sheriff of his own accord or on application by any person having an interest may, and if directed by the Court of Session on an application by any such person shall, remit an application under paragraph (1) or (2) above to the Court of Session if the sheriff or, as the case may be, the Court of Session considers such remit desirable because of the importance or complexity of the matters at issue.
- (5) The powers given to the sheriff above should not exclude application to the *nobile officium* of the Court of Session in any appropriate case.

## CHAPTER 8

### RECALL OF AWARD OF SEQUESTRATION

#### Termination by recall

##### *Introduction*

8.1 Section 30 of the 1913 Act sets out the primary rule that “the deliverance awarding sequestration shall not be subject to review”. An appeal in the ordinary sense against an award of sequestration is therefore incompetent, but provision is made for the *recall* of a sequestration by petition to the Court of Session. A petition for recall may be presented within 40 days after the date of the award of sequestration where it is at the instance of (a) a debtor whose estate has been sequestrated without his consent, (b) the successors of a deceased debtor whose estate has been sequestrated without their consent, or (c) any creditor.<sup>1</sup> But it may be presented at any time where it is at the instance of nine-tenths of the creditors in number and value.<sup>2</sup> Where the successor of a deceased person whose estate has been sequestrated has been edictally cited, he or any person with an interest may petition for recall at any time before the publication of the advertisement for the payment of the first dividend.<sup>3</sup> There is also a special procedure for recall within three months of the date of sequestration where a majority of creditors in number and value reside in England or in Northern Ireland,<sup>4</sup> and the common law remedy of reduction remains available in exceptional cases.<sup>5</sup> The judgment in the petition for recall (whether granting or refusing recall) is subject to review.<sup>6</sup>

##### *Recall or appeal?*

8.2 The justification for the absence of normal rights of appeal lies in the need for expedition if the assets of the bankrupt are not to disappear, and in the need to put an immediate end to further diligence on the part of individual creditors. It was suggested to us, nevertheless, that it was anomalous that ordinary procedures for appeal were not available in respect of an order so drastic in its effects as an award of sequestration, and that the requirements of expedition and of the protection of third parties could be met by allowing the sequestration to proceed notwithstanding any appeal and by declaring that transactions carried out bona fide until the determination of the appeal should be treated as valid.

8.3 We have much sympathy for the underlying reason for this suggestion, namely that the present procedures for the recall of a sequestration occasion unnecessary expense and inconvenience. Two separate points require consideration, namely, whether a procedure for appeal should

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<sup>1</sup>s. 30.

<sup>2</sup>s. 31.

<sup>3</sup>s. 30.

<sup>4</sup>See 1913 Act, s. 43 and para. 8.10.

<sup>5</sup>See para. 8.18.

<sup>6</sup>*Marr v. Lindsay* (1881) 8 R. 784.

be instituted rather than a procedure for recall, and whether whatever challenge may be thought appropriate should lie in the Court of Session or in the sheriff court. There is an important distinction between the concept of appeal and that of recall, though the distinction is not fully brought out in the cases. The *de quo* in an appeal is whether or not the court whose decision is the subject of the appeal was entitled to come to that decision in the light of the facts then before it. The *de quo* in proceedings for recall, in our view, ought to be not *simply* whether the original court was entitled to come to its decision in the light of the facts then before it but rather whether, in the light of both those facts and the facts before the court entertaining the proceedings for recall, the original order should be recalled. Thus in *Macnab v. Hunter and Geddes*<sup>7</sup> the order for sequestration should not have been made because the concurring creditor was himself an undischarged bankrupt, but the court refused the petition for recall on the ground that the sequestration had been adopted and acted upon by the general body of creditors.<sup>8</sup> In Scots law, moreover, an appeal is in principle open only to the parties to an action but, having regard to the extensive effects of an award of sequestration, we consider that such an award should be open to challenge by any person with an interest. The effects, too, of sustaining an appeal against an order of the court and of recalling it are materially different. In the former case, in principle at least, the order should be annulled and its whole consequences reversed while, in the latter, the original order is considered to have been valid until recalled. It seems desirable to maintain this distinction. For these reasons, and because it seems important to stress the finality of the original award, we reject the proposal to replace the procedure for recall with a procedure for appeal against awards of sequestration.

#### *Forum in petitions for recall*

8.4 Under the present law a petition for recall must in all cases be presented to the Court of Session.<sup>9</sup> It is undoubtedly true, as was represented to us, that this requirement may occasion additional expense. We consider, nevertheless, that the Court of Session is the appropriate forum because, although in form a petition for recall is not an appeal, in many cases it will call into question the basis of the original award. In the special case of recall on the ground that another award of sequestration has already been granted, the Court of Session may be the only appropriate forum. In other cases the grounds of recall will be analogous to those under which a decree may be reduced, and actions for the reduction of decrees are in principle a matter within the exclusive jurisdiction of the Court of Session. A further reason for retaining the exclusive jurisdiction of the Court of Session in petitions for recall lies in the fact that, where the sequestration has proceeded for any length of time, the restoration of the debtor to the status quo may present a variety of complex problems involving the interests of persons other than the

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<sup>7</sup>(1851) 14 D. 182.

<sup>8</sup>The same approach was adopted in *Ure v. McCubbin* (1857) 19 D. 758 and in *Gillon v. Caesar* (1882) 10 R. 59. A different view was taken in *Ballantyne v. Barr* (1867) 5 M. 330, where the defect was patent.

<sup>9</sup>1913 Act, s. 30.

debtor and his creditors. It is not possible to envisage all the circumstances of such cases and it seems inevitable that the law should confer a wide discretion on the court. Such a discretion is more appropriately exercised by the Court of Session. For these reasons, and because we wish to stress the finality of an award of sequestration, we advocate the retention of the existing exclusive jurisdiction of the Court of Session to recall an award of sequestration.

#### ***Who may petition for recall?***

8.5 We have mentioned that section 30 of the 1913 Act provides that a petition for recall of a sequestration within the period of 40 days after the date of the award is competent at the instance of any debtor whose estate has been sequestrated without his consent, the successors of a deceased debtor whose estate has been sequestrated without their consent, or any creditor. We do not consider, however, that the fact that the bankrupt or any other person has consented to the petition for sequestration should be an absolute barrier to his petitioning for its recall. His consent should merely be a factor to be taken into account by the court in exercising its discretion to recall the award and in awarding expenses. We also consider that there may be a few rare cases where the Accountant in Bankruptcy should be entitled to petition for recall, even where the debtor, the creditors and the trustee are content to allow the sequestration to proceed. A possible case is where the trustee confirmed lacks the qualifications to act as a trustee. We recommend, therefore, that a petition for recall of sequestration should be competent at the instance of the bankrupt, any creditor, or any other person having an interest (including the interim trustee, the permanent trustee and the Accountant in Bankruptcy) and that whether or not the petitioner for recall presented or concurred in the original petition for sequestration.

#### ***Notice and advertisement***

8.6 Notice of petitions for recall of sequestration under section 30 must at present be advertised in the *Gazette* and be served on the parties who petitioned or concurred in the petition for sequestration, and on the trustee, if appointed. In petitions under section 31, there must be published in the *Gazette* notice of the Lord Ordinary's deliverance "requiring all concerned to appear within fourteen days from the date of publication to show cause why the sequestration should not be recalled". We propose rather that petitions for recall should be served upon the bankrupt, upon the parties who petitioned or concurred in the petition for sequestration, and on the interim trustee or (where he has been appointed) the permanent trustee excluding, of course, any person presenting or concurring in the petition for recall. We also recommend that any other person with an interest to oppose the petition should be given an opportunity to do so, and that there should be a notice in the *Gazette* requiring any such person to lodge answers.

#### ***Grounds of recall***

8.7 In one case the present law does not require the establishment of grounds for recall. Where nine-tenths in number and value of the creditors have presented a petition for recall under the proviso to section 31 of the

1913 Act, that fact alone suffices unless a person opposing recall satisfies the court that it should not be granted, on the view that such a large majority creates a *prima facie* case for recall.<sup>10</sup> We consider, however, that the petitioners—whatever the majority of the creditors they represent—should be obliged to satisfy the court that the sequestration ought to be recalled.

8.8 We consider that the law should recognise, in addition to certain specified grounds of recall, the right of the court to recall a sequestration whenever it considers that, in the light of all the circumstances, the sequestration ought to be recalled. The situations which may arise in a sequestration are so various that we consider a general power of recall of this nature indispensable. Section 30 of the 1913 Act, like its predecessor, does not specify the relevant grounds for the recall of a sequestration. As Lord Justice-Clerk Hope has remarked:<sup>11</sup>

“It is not provided in that section—and, in fact, could not be—on what ground the Court are bound to recall a sequestration; the matter is left entirely to the discretion of the court.”

This discretion, however, is subject to the qualification that:

“... where there is no nullity *ex facie* of the proceedings, though nullity be made out on investigation, the Court may exercise its discretion as to recalling or not recalling the sequestration; but where an objection founded on the statute appears *ex facie* of the proceedings the Court cannot exercise any discretion, but is bound to recall.”<sup>12</sup>

The distinction hardly takes account of the practicalities of sequestration proceedings. A defect, although patent, may be of little or no consequence, whereas a latent defect might have constituted an insuperable barrier to the award of sequestration. We consider, for those reasons, that there is no justification for continuing to exclude the discretion of the court where the ground of recall is some *ex facie* defect in the proceedings. It may be objected that an award of sequestration may be attended with serious consequences as regards the reduction of preferences and the reduction or equalisation of diligences, and that it is wrong in principle that it should be allowed to remain effective notwithstanding defects in the proceedings. The precise effect, however, of an award in any particular case is a matter which will inevitably be taken into account by the court when it considers whether, in the exercise of its discretion, it should recall or refuse to recall the sequestration. The legislation, therefore, should state a very general basis for recall of an award of sequestration, namely, that in the light of all the facts, including those arising after the award of sequestration, it ought to be recalled (the court, however, not being bound to recall an award in any case). This rule should be supplemented by a provision allowing the court to sist the proceedings and to subject the sist to such conditions as the court may think fit.

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<sup>10</sup>See *Livingstone's Creditors v. Livingstone's Trustee* 1937 S.L.T. 391 at 394.

<sup>11</sup>*Ure v. McCubbin* (1857) 19 D. 758 at 760.

<sup>12</sup>*Ballantyne v. Barr* (1867) 5 M. 330 at 334.

8.9 To leave the matter, however, to a general discretion of this nature without further specification would not always be helpful to practitioners. In particular, there are three cases to which we consider express reference should be made, the first of these being the case where the debtor has paid his debts in full or has given sufficient security for their payment. The justification for a discretion in this case is possibly less apparent than in other situations, but without a discretion there might be an abuse of the sequestration process.<sup>13</sup>

8.10 It would also be helpful to refer specifically to the case envisaged in section 43 of the 1913 Act, which provides that the court may recall a sequestration on the ground that "a majority of the creditors in number and value reside in England or in [Northern] Ireland, and that from the situation of the property of the bankrupt or other causes his estate and effects ought to be distributed under the bankrupt or insolvent laws of England or [Northern] Ireland". This is a useful provision, but, in our view, it should be extended to cover cases where the majority in number and value of the creditors reside in *any* country outside Scotland. It should also be amended to refer to the appropriate forum rather than to the appropriate system of law.<sup>14</sup>

8.11 Finally, there is the case where a petitioner seeks the recall of a competing award of sequestration. The possibility of competing awards being made by different courts cannot be entirely excluded despite our proposals for notice.<sup>15</sup> Existing law relies to a great extent upon priority in time in resolving conflicts between awards of sequestration,<sup>16</sup> but in our view it is preferable that the matter should be regulated in recall proceedings. We therefore recommend that where a petition is presented to the Court of Session for recall of a competing award (or competing awards) of sequestration, the court should have the power to recall *any* of the competing awards, whether or not it is the subject of the petition for recall, after such further intimation or service that it considers to be necessary. This is in accordance with our stated principle that the Court of Session should have a wide discretion to determine in the light of all the circumstances whether an award of sequestration should be allowed to stand or should be recalled.

8.12 To summarise the immediately preceding discussion, we consider and recommend that the court (1) should have power to recall any award of sequestration where it appears that in the light of all the facts, including those disclosed or occurring after the award, the award ought to be recalled, but (2) should not necessarily be bound to recall an award. Particular instances where the court should be entitled to recall an award of sequestration are as follows—

- (a) where the debts have been paid in full or sufficient security has been given for their payment in full;

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<sup>13</sup>*Cf. Re Burnett* (1894) 1 Mans. 89.

<sup>14</sup>See paras. 6.29–6.31.

<sup>15</sup>See paras. 6.26–6.27.

<sup>16</sup>1913 Act, s. 17.

- (b) where a majority in number and value of the creditors reside in any country outside Scotland and it appears to the court that because of the situation of the property of the bankrupt or for some other reason the affairs of the bankrupt should be administered in that country; and
- (c) where one or more awards of sequestration of the estate or analogous remedies have been granted.<sup>17</sup>

In all cases the court should have the power to sist the proceedings before it and to make the sist or recall subject to such conditions as the court may think fit.

### ***Time-limits in petitions for recall***

8.13 It will have been observed that there are a variety of time-limits for presentation of a petition for recall of a sequestration. It must be presented within a period of 40 days after the date of the award in the usual case, that is, where it is at the instance of a debtor, or the successors of a deceased debtor (except where a successor has been edictally cited), or a creditor.<sup>18</sup> In a case where there has been an award of sequestration of the estate of a deceased debtor and his successor has been edictally cited in the process, it is competent for the successor or any person having an interest to present a petition for recall at any time before the advertisement for payment of the first dividend.<sup>19</sup> Again, in the case of a petition under section 43 of the 1913 Act (which relates to recall on the ground of *forum non conveniens*) the period for presentation of the petition is three months from the date of sequestration. Finally, a petition for recall by nine-tenths in number and value of the creditors may competently be presented at any time.<sup>20</sup>

8.14 Our Working Party recommended that the existing period of 40 days from the date of the award of sequestration within which a petition for recall may in the usual case be presented should be reduced to 30 days.<sup>21</sup> While we are wholly persuaded of the need for finality in connection with awards of sequestration, we consider that—against the background of our proposals for alteration of the law—such a period would be too short. The period should be sufficiently long to enable the permanent trustee to conduct proper investigations before presenting a petition for recall. We propose, therefore, that a petition for recall should be competent in the normal case until the expiry of a period of 10 weeks from the date of sequestration (that is, a period which will allow the permanent trustee some four to six weeks to carry out investigations). We recommend accordingly. We consider, however, that there might be departures from this principle in special cases where it should be possible to bring a petition for recall at any time. The three cases are where the grounds of recall are either (a) that the bankrupt has paid his debts in full or has given sufficient security for their payment in full, (b)

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<sup>17</sup>See paras. 6.28 and 6.31.

<sup>18</sup>1913 Act, s. 30.

<sup>19</sup>s. 30.

<sup>20</sup>s. 31.

<sup>21</sup>Memo. No. 16, p. 65.

*forum non conveniens*, or (c) that there is a competition of awards of sequestration. We do not consider that further exceptions to the general time-limit of 10 weeks from the date of the sequestration are required. Under the present law, notwithstanding the expiry of the time-limits for recall, an action of reduction or recourse to the *nobile officium* of the Court of Session may remain competent. As we explain below,<sup>22</sup> we consider that no departure in this respect from the present law should be made. Accordingly, we consider that further exceptions to the general time-limit are unnecessary.

### ***Effect of existing proceedings***

8.15 Where a petition for recall of a sequestration is presented it may or may not result in recall of the sequestration. It is for consideration, therefore, whether, in the interval between presentation of a petition for recall and its determination, the proceedings in the sequestration should continue as if no petition for recall had been presented or should be stayed. Existing law requires the proceedings to be continued,<sup>23</sup> and on balance we think that this course is to be preferred. We recommend accordingly. The 1913 Act also provides that where a creditor who has petitioned for recall of a sequestration, or appeared to oppose a petition for recall, or lodged an objection, "shall withdraw ... or die, any other creditor may be sisted in his place and follow out the proceedings".<sup>24</sup> This is a useful provision, but we consider that it should be expanded so as to provide that where any person who has presented a petition for recall or who has opposed such a petition withdraws or dies, any other person who would have been qualified to present or, as the case may be, to oppose the petition may be sisted in his place. We recommend accordingly.

### ***General effects of recall***

8.16 Section 105 of the 1913 Act provides that the recall of an award of sequestration shall not affect the interruption of prescription or the suspension of any statute of limitations in England or [Northern] Ireland caused by the presenting of, or concurring in, a petition for sequestration or the lodging of a claim in the hands of the trustee. The Act does not specify the effects of the recall of a sequestration in other respects. The principal aim should clearly be to restore, as far as possible, the parties concerned to the status quo, in particular that the debtor should recover the possession of his estate and, where he has been divested of it, be re-invested in it as its owner. The interests of third parties with whom the interim trustee or permanent trustee has had dealings must also be protected. It will be necessary, moreover, to ensure that preferences or alienations cut down by the sequestration should, so far as possible, be restored as if no award had been made. Since the circumstances of petitions for recall may vary so considerably we do not think that the legislation to follow on this Report

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<sup>22</sup>Para. 8.18.

<sup>23</sup>1913 Act, s. 32.

<sup>24</sup>See s. 33.

should attempt to make exhaustive provision for the effects of recall of a sequestration. We recommend, however, that, in addition to retention of the existing provision relating to prescription and limitation, it should be provided—

- (a) that the effect of recall of an award of sequestration should be, so far as practicable, to re-invest the bankrupt in the sequestrated estate<sup>25</sup> and to restore any other person to the position he would have been in if the sequestration had not been awarded; but
- (b) that the recall should not invalidate any transaction entered into before such recall by the interim trustee or the permanent trustee with a person acting in good faith.

It should also be provided that the court has power to make such further order as it may consider to be necessary or reasonable in the circumstances to secure those results, including orders relating to the payment out of the estate of the outlays and remuneration of the interim and permanent trustee.

### ***Recall and legal expenses***

8.17 There is old authority for the view that a successful petitioner cannot recover from the estate the expenses of the petition for recall on the ground that the petition “was a proceeding required by the statute, whether the respondent appeared or not”.<sup>26</sup> We think it undesirable, however, that the discretion of the court in this matter should in any way be restricted, since there will be wide variations in the circumstances and equities of particular cases. We recommend, therefore, that the court should have a complete discretion in the award of expenses in petitions for recall and that this should be clarified in the legislation implementing this Report. It should be made clear, however, that the court has a discretion to require any party to the petition for sequestration to pay the whole or any part of the fees and outlays of the interim trustee or of the permanent trustee.

### ***Actions of reduction***

8.18 While they have discouraged the bringing of actions for reduction of awards of sequestration<sup>27</sup> the courts have accepted with some hesitation that where a petition for recall is not competent, an action for reduction may be.<sup>28</sup> Lord Mackenzie has said:

“I agree with the passage cited from Goudy on Bankruptcy, (3rd ed.) p. 164: ‘When recall has become incompetent, owing to lapse of time, it is possible that in some circumstances a reduction of the sequestration proceedings might be brought—as for example where the award has been obtained by forgery or gross fraud.’”<sup>29</sup>

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<sup>25</sup>We envisage that if the permanent trustee has completed title to any property, an extract of the decree for recall could be used to make up a title in the name of the debtor as provided by s. 5 of the Conveyancing (Scotland) Act 1924 (c. 27).

<sup>26</sup>*Smith v. Rostron* (1860) 23 D. 140.

<sup>27</sup>See, e.g., *Gibson v. Munro* (1894) 21 R. 840, per Lord Young at 846; *Central Motor Engineering Co. v. Galbraith* 1918 S.C. 755, per Lord President Strathclyde at 765.

<sup>28</sup>See *Gibson and Central Motor Engineering Co.*, above; *Whitlie v. Gibb* (1898) 25 R. 412.

<sup>29</sup>*Central Motoring Engineering Co.*, above at 770.

We have considered whether, having regard to the decision in *Watt v. Lord Advocate*,<sup>30</sup> it would be desirable to state with precision the circumstances in which a reduction may be competent. We consider that it would be preferable not to do so and to leave this matter to the general law. Accordingly, it should be made clear that nothing in the legislation proposed by us will affect the competency of an action of reduction of a sequestration. Recourse to the *nobile officium* of the Court of Session will, of course, remain for the rare case where neither recall nor reduction is competent.<sup>31</sup>

### ***Occupancy rights***

8.19 Finally, we must refer to our recent Report on Occupancy Rights and Domestic Violence.<sup>32</sup> That Report recommended<sup>33</sup> that where one spouse only is entitled or permitted to occupy a matrimonial home the other spouse should, by virtue of marriage, have a statutory right of occupancy. This new right of occupancy would terminate on the entitled spouse's sequestration, so that, in order to minimise the risk of occupancy rights being defeated, the Report recommended<sup>34</sup> that where the Court of Session is satisfied "that the purpose of the application for sequestration was wholly or mainly to defeat the spouse's occupancy rights in the matrimonial home, it should have power to recall the sequestration or make such other order as it considers appropriate". Clause 10 of the Matrimonial Homes (Family Protection) (Scotland) Bill (at present before Parliament) implements the above recommendation, and the draft Bill annexed to this Report does not deal with this recommendation.

### **Termination by deed of arrangement**

8.20 The 1856 Act adopted from English law a procedure by which a sequestration might be terminated by a deed of arrangement,<sup>35</sup> and this procedure was subsequently extended to include settlements or arrangements by way of composition.<sup>36</sup> Those provisions were re-enacted with minor amendments by the 1913 Act.<sup>37</sup>

8.21 At the meeting for the election of the trustee or at any subsequent meeting called for that purpose, a majority in number and three-fourths in value of the creditors may resolve that the estate be wound up by deed of arrangement and that application be made to the court to sist procedure. It is not competent to decide at this stage the precise form which the deed of arrangement should take. The resolution must be reported to the court within four days and the court, after hearing any party having interest and finding that the application is reasonable, may grant the sist and make arrangements for the interim management of the estate.

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<sup>30</sup>1979 S.L.T. 137.

<sup>31</sup>*e.g. Anderson* (1866) 4 M. 577.

<sup>32</sup>(1980) Scot. Law Com. No. 60.

<sup>33</sup>para. 2.13.

<sup>34</sup>para. 2.97.

<sup>35</sup>ss. 35-40.

<sup>36</sup>Bankruptcy (Scotland) Amendment Act 1860 (c. 33), s. 5.

<sup>37</sup>ss. 34-39.

8.22 During the period of sequestration, which may extend to two months, the creditors may present to the court a deed of arrangement signed by a majority of them in number and three-fourths in value. After notice to non-concurring creditors, hearing parties having an interest (presumably including the bankrupt) and making such inquiry as it may think necessary, the court considers whether the deed of arrangement has been duly entered into and executed and is reasonable. If so, it issues a deliverance approving of it and declaring the sequestration to be at an end.

8.23 No statutory provision is made for the discharge of the bankrupt under such deeds of arrangement, though the debtor may, and usually would, stipulate for his discharge in the deed.

8.24 From the bankrupt's point of view the advantages of a deed of arrangement are that the sequestration is at an end, that he is free of the disabilities attaching to an undischarged bankrupt, and that he may immediately set up in business again. From the creditor's standpoint the attractions of such a deed lie in avoiding the expenses incidental to a sequestration and in the prospect that they may obtain a larger dividend by the debtor's return to business under supervision.

8.25 Deeds of arrangement have not taken root in Scottish practice. The reasons for this may include the complexity of the procedure and the risk that the deed may not in the end secure the court's approval. The procedure requires two applications to the court determined ultimately by a test of reasonableness. The cases on the question whether the terms of the deed are reasonable indicate wide differences in the approach to the test of reasonableness. In one case the mere prospect of a small dividend for creditors was held to suffice:<sup>38</sup> in another the arrangement was thought to be unreasonable despite the fact that the prospect of payment in full was offered.<sup>39</sup> It has been held, moreover, by the Court of Session that, in applying the test of reasonableness, regard must be had to the public interest in the proper investigation of the causes of the bankruptcy before the sequestration is declared to be at an end.<sup>40</sup>

8.26 Another reason for the unpopularity of deeds of arrangement may be the availability of the more familiar procedure of discharge on composition.

8.27 In any event, for those or for other reasons, deeds of arrangement are virtually unknown in current practice, and the Accountant of Court has suggested to us that if the present procedures for discharge on composition were improved the facility for recourse to deeds of arrangement could be safely withdrawn. We entirely agree. We propose in Chapter 19 a revised procedure for discharge on composition which, though simple in character, should afford better protection to the private and public interests involved

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<sup>38</sup>*Hunter's Sequestration* (1931) 47 Sh. Ct. Rep. 51.

<sup>39</sup>*Fraser's Sequestration* (1935) 51 Sh. Ct. Rep. 225.

<sup>40</sup>*Stone v. Woodhouse Hambly & Co.* 1937 S.C. 824.

than deeds of arrangement in their present form.<sup>41</sup> We recommend, therefore, that the facility for recourse to deeds of arrangement should be withdrawn.

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<sup>41</sup>Paras. 19.27–19.38.

## CHAPTER 9

### THE PERMANENT TRUSTEE: HIS ELECTION, RESIGNATION AND REMOVAL

#### Introduction

9.1 The trustee in a sequestration is at present elected by the creditors<sup>1</sup> and may be removed by them.<sup>2</sup> The permanent trustee's role in the sequestration process (which we describe in Chapter 10) suggests that the basic principles of the present law may appropriately be retained. The introduction, however, of an interim trustee in every sequestration permits of some modifications to the election procedure. Moreover, the procedures for the trustee's election and removal are somewhat cumbersome and we have sought, so far as consistent with maintaining essential safeguards, to simplify those procedures.

#### Election of the trustee

9.2 We have considered elsewhere<sup>3</sup> the qualifications for office of the permanent trustee and have recommended that he should possess such professional or other qualifications and fulfil such conditions as may be prescribed. We also recommend that there should continue to be excluded from the office of permanent trustee those persons at present excluded from office by virtue of section 64 of the 1913 Act.

#### Existing election law and procedure

9.3 The existing law and procedure for election of the trustee is set out in sections 63 to 70 of the 1913 Act. The meeting for election of the trustee must be held:

“not earlier than six nor later than twelve days from the date of the appearance in the *Gazette* of the notice of the award of sequestration”<sup>4</sup>

and at a convenient place within the sheriffdom. The meeting should be held in a public place.<sup>5</sup> The qualified creditors (or their mandatories) assembled at the time and place fixed for the election, and presided over either by the sheriff or by a chairman of their own choosing, constitute the meeting. The meeting may be adjourned provided that there is no adjournment beyond the limit of the statutory period. In practice it would appear that the sheriff does not usually attend meetings for the election of a trustee, though he will where questions of exceptional difficulty or importance are likely to arise. Where the sheriff does not attend, the creditors elect from their number a preses or

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<sup>1</sup>To entitle a creditor to vote he must produce a notice of claim and account at the meeting for the election of the trustee: 1913 Act, s. 45, as substituted by s. 5 of the Insolvency Act 1976 (c. 60). For form of notice of claim see the Notice of Claim (Scotland) Regulations 1977 (S.I. 1977/1495).

<sup>2</sup>1913 Act, s. 71.

<sup>3</sup>See paras. 4.20 and 4.21.

<sup>4</sup>1913 Act, s. 63. It is, of course, desirable under existing law that the trustee should be appointed as soon as possible—see Goudy, p. 194.

<sup>5</sup>*A v. B* (1847) 10 D. 245.

chairman (who has no privilege in voting beyond that of an ordinary creditor). Except where the sheriff clerk or his depute is present, the creditors must also appoint a clerk. The notices of claim<sup>6</sup> and documents of debt of the creditors are initialled by the sheriff clerk or his depute or (where neither of them is present) by the preses, and it is the duty of the sheriff clerk or his depute or, as the case may be, the clerk appointed by the creditors to write out the minutes in the presence of the meeting and enter therein the names and designations of the creditors and mandatories present and the amounts for which they claim. That completed, the qualified creditors or their mandatories "shall then and there elect a fit person to be trustee, or two or more trustees, to act in succession ..."<sup>7</sup>

9.4 Where there is a competition between two or more candidates for the office of trustee, there is the possibility of objections in respect of (1) the voting rights of any creditor, (2) the qualifications (or disqualification) of a candidate, or (3) the regularity of the proceedings. Objections under the first head are, perhaps, unlikely where there is no competition but objections under the second or third head may, of course, arise even in the absence of a competition. All objections must be stated before the election takes place. Where a disqualification of a person elected as trustee is afterwards found to exist, there must be a new election.<sup>8</sup>

9.5 Section 64 makes provision for the election of two or more trustees to act in succession. There is an apparent contradiction, however, between that section and section 71, which provides that where a trustee:

"shall have been discharged, die, resign ... any creditor ... may apply to the Lord Ordinary or the sheriff for an order to hold a meeting for devolving the estate on the trustee next in succession, or electing a new trustee".

The effect of this provision is apparently that the substitute trustee will succeed to the office of trustee only if creditors choose to approve his appointment and not to elect a new trustee.<sup>9</sup> The substitute trustee apparently succeeds automatically:

"only in cases where the failure of the first-named trustee has arisen, from non-acceptance, etc. prior to the sheriff's declaration".<sup>10</sup>

9.6 Although the 1913 Act speaks of the election of the trustee by the creditors, the election must be declared and confirmed by the sheriff and the trustee's appointment is essentially a judicial appointment. Accordingly,

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<sup>6</sup>s. 64 of the 1913 Act refers to the *oaths* of the creditors, and does not appear to have been amended by the 1976 Act; but under s. 45 of the 1913 Act as substituted by s. 5 of the 1976 Act creditors generally now submit notices of claim. See also Notice of Claim (Scotland) Regulations 1977 (S.I. 1977/1495).

<sup>7</sup>The procedure at the meeting for the election of the trustee is set out in s. 64 of the 1913 Act.

<sup>8</sup>*Wilson v. Thomson* 14th Dec. 1811 F.C.; *Mann v. Dickson* (1857) 19 D. 942.

<sup>9</sup>*McLaggan v. Dewar* (1851) 13 D. 1394. Lord Cockburn noted the contradictions between the two sections of the Act, and Lord Murray stated that the substitute trustee had merely a *spes successionis*.

<sup>10</sup>Goudy, pp. 203-204.

section 66 of the 1913 Act provides that where the sheriff is not present at the meeting for election of the trustee, the preses shall forthwith report the proceedings to the sheriff, and send the notices of claim to the sheriff clerk to be retained by him until the final appointment of the trustee. If there is no competition for the office and no objections to any vote or to the candidate, the sheriff is directed to declare as trustee the person elected by the creditors. Where there is a competition or an objection the sheriff, where he is present at the meeting, may either forthwith decide the matters at issue or, if he chooses, make *avizandum*. Where the sheriff is not present, he must hear the objecting parties and thereafter give his decision.<sup>11</sup> The statute contemplates that the procedure for disposal of objections and the making of a decision will be carried out with the minimum of delay.<sup>12</sup> The judgment of the sheriff is final,<sup>13</sup> and the expenses of any competition must be paid by the unsuccessful party.<sup>14</sup> The sheriff's declaration of a person as trustee is not of itself sufficient to confirm the person in that office. He is confirmed by the sheriff as trustee only after he has lodged a bond of caution.

### ***Proposals for reform***

9.7 The presence in every sequestration of an interim trustee (who will be appointed at or even before the date of the award) diminishes the urgency for appointment of a permanent trustee, and there is not the same compelling need as under existing law for the holding of a meeting of creditors for the election of a trustee as soon as possible after the award of sequestration.<sup>15</sup> Indeed, the interim trustee should be allowed sufficient time to examine the debtor's statement of affairs and to send a summary thereof and observations thereon to creditors before the meeting for the election of a permanent trustee. Subject to this, the debtor's affairs and control of the sequestration should be placed in the hands of a permanent trustee without undue delay. We recommend, therefore, that the meeting of creditors for the election of the permanent trustee should be convened within 28 days, or such longer period as the sheriff on cause shown may allow, after the date of award of sequestration. We further recommend that it should be open to the creditors to continue the statutory meeting to a date not later than the end of the period of 28 days referred to above or such longer period as may be allowed by the sheriff.

9.8 We propose that not later than seven days before the date of the meeting, the interim trustee should take whatever steps are reasonable in the circumstances of the case to notify the creditors, and that at the same time he should also notify the Accountant in Bankruptcy, of the date, time and place of the meeting. The precise manner in which the interim trustee discharges his duty of notification would be a matter for his judgment: in

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<sup>11</sup>1913 Act, ss. 65, 66.

<sup>12</sup>*e.g.* s. 66 provides that notes of objections will be submitted within four days of the meeting and "the sheriff shall forthwith hear parties thereon".

<sup>13</sup>1913 Act, s. 67.

<sup>14</sup>*Ibid.* s. 68.

<sup>15</sup>The meeting must under existing law be held within 6 to 12 days from the date of the appearance in the *Gazette* of notice of the award of the sequestration. 1913 Act, s. 63.

some cases individual notification may be appropriate, whereas in others (as where there are a large number of creditors) advertisement in the *Gazette* may suffice. The interim trustee would also send to every creditor known to him and to the Accountant in Bankruptcy, and that not later than four days before the date of the meeting, a summary of the bankrupt's statement of affairs along with any observations which the interim trustee may wish to make on the statement.<sup>16</sup>

9.9 As we have pointed out, under existing law the first meeting of creditors is presided over either by the sheriff or by a chairman appointed by the creditors, and the sheriff's functions in connection with the election of a trustee may therefore be partly administrative and partly judicial or (in a case where he is not present at the meeting) wholly judicial. We think that this is confusing and untidy, and that the proper function of the sheriff is to adjudicate in any disputes arising from the election proceedings and to confirm the appointment of the permanent trustee. Accordingly, we recommend that the sheriff should not preside at the statutory or any other meeting nor should the sheriff clerk act as clerk to any such meeting.

9.10 The main business of the meeting will be to receive the bankrupt's statement of affairs, to consider the interim trustee's report thereon, and to elect the permanent trustee and fix the amount of his caution. While the simplest approach would be for the interim trustee to act as chairman throughout the meeting, it would be anomalous for him to so occupy the chair without the consent of the creditors, especially if he is himself a candidate for the office of permanent trustee. We propose, therefore, that, while the interim trustee should initially take the chair at the meeting, it would be for limited purposes only. He would verify from the claims submitted by the creditors their right to attend at meetings and the extent of their voting rights as appearing from the documents submitted by them.<sup>17</sup> He would then preside over the proceedings for the election by the creditors of one of their number or of one of their representatives as chairman, to whom the interim trustee would surrender the chair. In default, however, of the election by the creditors of a chairman, the interim trustee would remain in the chair throughout the proceedings.

9.11 Nor do we think it necessary to make provision for the formal appointment of a clerk. It will suffice to provide that the interim trustee should arrange for the making of a record of the proceedings at the meeting. We so recommend.

9.12 The course of the proceedings after the election of the chairman should in our view be as follows. The statement of affairs itself along with the interim trustee's observations would be laid on the table and be available for inspection. The interim trustee would then answer to the best of his

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<sup>16</sup>Where the interim trustee considers that the assets are unlikely to be sufficient to pay any dividend, he will include a statement to that effect in his observations. For a further discussion on this point see para. 7.33.

<sup>17</sup>For the determination of voting rights see paras. 17.14-17.17.

ability any questions, and consider any representations, put to him by the creditors regarding the debtor's business or financial affairs or his conduct in relation thereto. Unless the interim trustee had determined that the debtor's assets were unlikely to be sufficient to pay a dividend (and remained satisfied that his determination was correct)<sup>18</sup> the creditors would then proceed to elect a permanent trustee. All the creditors whose claims had been admitted by the interim trustee would be entitled to vote except (a) any creditor in a debt acquired by him (otherwise than by succession) after the date of the sequestration,<sup>19</sup> and (b) any postponed creditor. In the event of failure by the creditors to elect a permanent trustee, the interim trustee would be deemed to be elected as permanent trustee. Against the background of our proposal that the interim trustee should fill any vacancy in the office of permanent trustee, and having regard also to the very limited usefulness of the facility, we recommend that the facility<sup>20</sup> for the election of a substitute trustee to act in succession to the permanent trustee should cease to be available.

9.13 We have already proposed that the existing requirement for the finding of caution by the trustee elected by the creditors (or deemed to be elected by them) should be retained.<sup>21</sup> Accordingly, after the election or deemed election of the permanent trustee, the creditors would fix a sum which he should be required to find as caution for the performance of his duties. In the event of the creditors failing to fix a sum, this would be done by the Accountant in Bankruptcy.<sup>22</sup>

9.14 The existence of the interim trustee, we consider, makes unnecessary any provision for the transmission of claims to the sheriff clerk. These should be retained by the interim trustee and in due course handed over by him to the permanent trustee. The interim trustee should, however, be required to make an immediate report of the proceedings at the meeting and submit it to the sheriff.<sup>23</sup> If no notice of objection is lodged by any person within four days of the meeting, the sheriff should declare to be permanent trustee the person elected, or deemed to be elected, to that office. Where there is an objection, the existing procedure for the disposal of objections in a case where the sheriff is not present should be followed.<sup>24</sup> We considered, but reject, a proposal by our Working Party<sup>25</sup> that the period for lodging a note of objections should be extended to seven days. It seems important that the trustee should be confirmed in office as soon as practicable after the meeting for his election.

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<sup>18</sup>In which event the interim trustee would become permanent trustee without election.

<sup>19</sup>*Cf.* 1913 Act, s. 60.

<sup>20</sup>See para. 9.5.

<sup>21</sup>See paras. 4.22-4.23.

<sup>22</sup>We deal in paras. 9.16 and 9.17 with the more general aspects of the requirement of caution.

<sup>23</sup>And also to the Accountant in Bankruptcy where the caution has not been fixed by the creditors.

<sup>24</sup>See para. 9.6.

<sup>25</sup>Memo. No. 16, p. 78.

9.15 A difficulty arises under the present law in relation to appeals from the sheriff's interlocutors relating to the confirmation in office of the trustee. Section 67 of the 1913 Act provides that:

"The judgment of the sheriff declaring the person or persons elected to be trustee or trustees in succession, shall be given with the least possible delay; and such judgment shall be final, and in no case subject to review in any court or in any manner whatever."

That section must, however, be read with section 166, which provides that it shall be competent to bring under review in the Court of Session any deliverance of the sheriff except where the same is declared not to be subject to review. Accordingly, the courts have held that any judgment of a sheriff, although it may be directly concerned with the validity of an election or the eligibility of a trustee, is subject to review if it does not expressly declare a person to be trustee. The competency of an appeal has thus been sustained where the sheriff allowed production and amendment of claims<sup>26</sup> or called upon a competitor for the office of trustee to lead further evidence in support of a voting entitlement<sup>27</sup> or allowed proof as to the suitability of a person elected as trustee.<sup>28</sup> In those cases, however, there were expressions of dislike for the admissibility of appeals from interlocutory judgments of the sheriff, and the judges appear to have been of opinion that the sheriff's decision should be final in all questions touching upon the appointment of the trustee. We agree with that opinion and recommend that the provision to replace section 67 should make it clear that the judgment of the sheriff will be final in any question in so far as it relates to, or affects in any way, the election or deemed election of the trustee. Section 68 of the 1913 Act declares not only that no part of the expense of any competition for the office of trustee shall be paid out of the estate, but that all such expense shall be paid by the unsuccessful to the successful party. The latter part of this provision has not been applied literally by the courts.<sup>29</sup> Since this appears to deprive the court of their usual discretion in relation to expenses we recommend that it should not be re-enacted.

#### ***Finding of caution by the trustee and his confirmation in office***

9.16 In Chapter 4<sup>30</sup> we proposed that the requirement for a trustee to find caution should be retained. We recommend, additionally, that to avoid inquiries into the sufficiency of bonds of caution, they should be accepted only where issued by a guarantee company approved by the Court of Session under section 27 of the Judicial Factors (Scotland) Act 1849.<sup>31</sup> Though we are advised that bonds of caution are normally obtainable on the day of application,<sup>32</sup> there may be cases where unusual circumstances may give rise to delay, and we suggest that the sheriff should have a power

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<sup>26</sup>*Tennent v. Crawford* (1878) 5 R. 433.

<sup>27</sup>*Galt v. Macrae* (1880) 7 R. 888.

<sup>28</sup>*Moncur v. Macdonald* (1887) 14 R. 305.

<sup>29</sup>*Dyce v. Paterson* (1847) 9 D. 1161; *Menzies v. Duff* (1851) 13 D. 1044.

<sup>30</sup>Paras. 4.22 and 4.23.

<sup>31</sup>c. 51.

<sup>32</sup>Memo. No. 16, p. 31.

to extend the present period of seven days. We recommend, therefore, that the person elected or deemed to be elected as permanent trustee should be required to lodge his bond of caution within a period of seven days after the date of the deliverance declaring his election or deemed election or within such longer period as the sheriff might, on cause shown, allow. This deliverance should not be subject to review. The premium on a bond of caution would, as under existing law, form part of the expenses of the permanent trustee.

9.17 When the trustee has lodged his bond of caution, the sheriff will confirm him in office and the sheriff clerk will issue an act and warrant in his favour in a manner to be prescribed by Act of Sederunt. The confirmation by the sheriff should not be subject to review. The effect of the act and warrant, as under the present law,<sup>33</sup> should be to vest the bankrupt's estate in the permanent trustee and to authorise him to perform the duties of that office. A copy of the act and warrant in favour of the permanent trustee bearing to be authenticated by the sheriff or one of the judges of the Court of Session shall be evidence of the trustee's title in any part of the United Kingdom outside Scotland.

### **Resignation and removal of the trustee**

#### ***Existing law***

9.18 Sections 71, 157 and 158 of the 1913 Act make provision for the removal or resignation of the permanent trustee (a) where a majority in number and value of the creditors present at any meeting called for that purpose resolve that he be removed or that his resignation be accepted, (b) where the Lord Ordinary or the sheriff, on petition by one-fourth in value of the creditors, is satisfied that "sufficient reason has been shown", (c) by the Lord Ordinary or the sheriff, at the instance of any creditor or of the Accountant of Court, where the trustee fails to make an annual return to the sheriff clerk, or (d) by the Lord Ordinary or the sheriff following upon a report as to the trustee's conduct (or misconduct) by the Accountant. Section 71 also makes provision for the consequential succession or election of a new trustee if a trustee "shall have been discharged, die, resign, or be removed, or remain at any one time for three months furth of Scotland".

9.19 Where a trustee is removed by a majority in number and value of the creditors, it is not necessary for the creditors to give any reason for their decision.<sup>34</sup> Accordingly, there is no appeal on the merits but there is, of course, appeal on questions such as the regularity of the proceedings.<sup>35</sup> There may be a small doubt as to whether appeal against removal is competent only at the instance of the removed trustee or at the instance of any other person who may be thought to have an interest, for example, a creditor who voted against removal of the trustee.

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<sup>33</sup>1913 Act, s. 70.

<sup>34</sup>*Wallace v. Gibson* (1824) 3 S. 73; *Walker v. Walker* (1835) 13 S. 428.

<sup>35</sup>1913 Act, ss. 165, 166.

9.20 Where a trustee is removed by the Lord Ordinary or the sheriff for "sufficient reason", there must be some real neglect or misconduct in the exercise of the trustee's duties.<sup>36</sup> Slight irregularities will not justify the removal of the trustee in circumstances which inevitably carry a stigma.<sup>37</sup> The petition may be presented by a single creditor, provided that he represents at least one-fourth in value of the creditors.<sup>38</sup>

9.21 Sections 157 and 158 also make provision for the removal of the trustee for failure to make an annual return and for failure in the performance of his duties respectively. Section 157 is in fact inoperative and our Working Party recommended that it should not be re-enacted in any new bankruptcy statute.<sup>39</sup>

9.22 A trustee in sequestration cannot resign against the wishes of the creditors. But section 71 enables him to do so with the consent of a majority in number and value of the creditors present at a meeting called for the purpose of accepting the resignation, although it is competent for a creditor opposed to the giving of consent to appeal against it.<sup>40</sup>

### ***Proposals for reform***

9.23 It has been suggested to us that the permanent trustee should be entitled to resign office whenever he wishes. Our own view, however, is that the existing law is reasonably satisfactory. The trustee has implicitly undertaken to the creditors and to the court to perform statutory duties, and his release from those duties should require the acceptance of his resignation by a majority in number and value of the creditors at a meeting called for that purpose. We appreciate that a liquidator may resign at will<sup>41</sup> and that the Blagden Report recommends that a trustee in bankruptcy under English law should be entitled to resign on his giving 14 days' notice of his intention to do so.<sup>42</sup> Nevertheless, we consider that the importance of continuity in the administration of a bankruptcy process demands that resignation by trustees should be discouraged and so far as possible avoided. In order, therefore, to secure continuity of the administration, any resignation by a trustee, even if acceptable to the creditors, should not take effect unless at the same meeting they elect a new permanent trustee. That apart, we would modify existing law to the extent of permitting a trustee to demit office with the authority of the sheriff and subject to such conditions as he might impose (*e.g.* he might make the resignation conditional upon the election of a new permanent trustee). This provision will permit the abolition of a right of appeal against a decision of the creditors—since we regard it as unnecessary and inappropriate that there should be a right of appeal against their *acceptance* of the trustee's resignation.

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<sup>36</sup>Bell, *Comm.* ii. 317; *Aytoun v. Macculloch* (1824) 3 S. 80.

<sup>37</sup>*Ewing v. Lawrie* (1824) 3 S. 234; *Lowden v. Christie* (1835) 13 S. 389.

<sup>38</sup>*Henderson v. Bulley* (1849) 11 D. 1470.

<sup>39</sup>Memo. No. 16, p. 103.

<sup>40</sup>Bell, *Comm.* ii. 317; see also *Brown v. Burt* (1848) 11 D. 338.

<sup>41</sup>1948 Act, s. 242.

<sup>42</sup>pp. 55–56. English law is at present not clear as to the trustee's entitlement to resign.

9.24 We do not propose any change in the existing law whereby a majority in number and value of the creditors present at a meeting called for that purpose may remove the trustee without giving any reason therefor. It seems to us to be clear that if a trustee no longer commands the confidence of a majority of creditors, they should be entitled to remove him, and appeal on the merits should (as at present) be excluded. The meeting could be called by a commissioner or, where there are no commissioners, by the Accountant in Bankruptcy. It should be mandatory upon the creditors, if they do in fact decide to remove the trustee, to elect another permanent trustee in his place. The existing doubts as to rights of appeal against removal should also be removed, that is, it should be made clear that appeal against removal is competent at the instance of not only the removed trustee but also any creditor who did not vote for removal.

9.25 We see no reason to alter existing law for the judicial removal of the trustee, beyond proposing that an application for the removal of the permanent trustee should always be made in the first instance to the sheriff, and that an application for removal may be made by the Accountant in Bankruptcy on the more general ground that cause has been shown for the trustee's removal from office. "Cause shown" would embrace failure by the trustee to perform the duties to which reference is made in section 158 of the 1913 Act. But it would extend to the removal of the trustee where there has been no misconduct, as where the trustee acquires some interest which is adverse to the interests of the general body of creditors. The court would order any application for removal of the permanent trustee to be served upon him and intimated in the *Gazette* and would, of course, give the permanent trustee an opportunity of being heard before disposing of the application. The court, whether or not it orders the removal of the trustee, should be entitled to make any further or other order as it thinks fit, including an order as to expenses. There would be a right of appeal against the sheriff's decision.

9.26 There has been some doubt as to whether the bankrupt may petition for removal of the trustee. He has no power under statute to do so, but in one case the court appears to have recognised an indirect right in the bankrupt by instructing the trustee to call a meeting of creditors to express their opinion on the grounds of removal stated by the bankrupt.<sup>43</sup> We consider that the bankrupt should have no entitlement to petition for removal. It seems to us that the appropriate remedy is for the bankrupt to complain to the Accountant in Bankruptcy, who would take whatever action was appropriate in the circumstances.

9.27 Section 71 of the 1913 Act provides:

"If the trustee shall have been discharged, die, resign, or be removed, or remain at any one time for three months furth of Scotland, any commissioner, or any creditor ranked or claiming and entitled to be ranked on the estate, may apply to the Lord Ordinary or the sheriff for

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<sup>43</sup>*Robertson v. Mitchell* (1871) 9 M. 741.

an order to hold a meeting for devolving the estate on the trustee next in succession, or electing a new trustee”.

In a clear-cut case, however, such as when the trustee has died or has resigned office, it should be possible to convene a meeting for the purpose of appointing a new trustee without the need for an application to the court. Moreover, section 71 makes no provision for a number of cases, notably where there is simply a hiatus, as where a person elected as trustee fails to take up the office,<sup>44</sup> or is found to be disqualified,<sup>45</sup> or where the creditors simply fail to elect a trustee.<sup>46</sup>

9.28 In cases where the position is clear, such as the case where the trustee has resigned or has died or has been removed from office by the court, the commissioners or, if there are no commissioners, the Accountant in Bankruptcy should be required to convene a meeting for the election by the creditors of a new trustee. In a case of doubt as, for example, where the trustee is thought to be incapacitated, it should be open to any commissioner, the bankrupt, any creditor or the Accountant in Bankruptcy to apply to the sheriff—

- (1) to declare the office of permanent trustee to have become vacant;
- (2) to make any consequential orders necessary to enable the sequestration to proceed or to safeguard the estate pending the election of the new permanent trustee.

In the event of the sheriff so declaring the commissioners or, if there are no commissioners, the Accountant in Bankruptcy shall call a meeting of creditors for the election by them of another permanent trustee. In the exceptional case where a meeting is held but no trustee is elected, a person nominated by the Accountant in Bankruptcy will succeed to the office of permanent trustee.<sup>47</sup> In cases where a trustee has been removed from office by the court, we envisage that the court will at the same time make orders under heads (1) and (2) above.

9.29 The procedure for the finding of caution and for the confirmation in office of a new trustee is the same as in the case of the original trustee. An act and warrant in favour of the new trustee is issued after he has lodged a bond of caution and the sequestrated estate is then vested in him.<sup>48</sup> Section 71 of the 1913 Act contains certain supporting provisions including the imposition of a duty on the new trustee to call his predecessor to account. In our view those purposes would be better achieved by provisions empowering the new trustee to require the delivery to him of all papers relating to the sequestration other than the principal copy of the accounts of the former trustee, of which he shall be entitled to obtain only a certified copy, and requiring the permanent trustee who has been removed from office or, if he

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<sup>44</sup>See *Jeffrey v. Kerr* (1828) 6 S. 968.

<sup>45</sup>*Mann v. Dickson* (1857) 19 D. 942.

<sup>46</sup>*Stewart v. Chalmers* (1864) 2 M. 1216.

<sup>47</sup>The person appointed would be required to be eligible for election as permanent trustee and to find caution for the performance of his duties.

<sup>48</sup>See 1913 Act, s. 97.

has died, his representatives to submit accounts of his intromissions with the estate to the Accountant in Bankruptcy for audit and the fixing of the amount of his remuneration. The remuneration so fixed and the expenses, with any modification authorised by the court, shall be paid by the new permanent trustee.

## CHAPTER 10

### POWERS AND DUTIES OF THE PERMANENT TRUSTEE

#### Introduction

10.1 As we explained in Chapter 4, the implementation of the proposals in this Report would give to the interim trustee a significant role in the sequestration process, but at a stage before the permanent trustee enters upon his functions. The permanent trustee<sup>1</sup> would remain the linch-pin of the Scottish system of bankruptcy administration. It is the purpose of this Chapter to describe and examine his powers and duties in so far as these are not specifically dealt with in the remaining Chapters of this Report.<sup>2</sup>

10.2 One general point, however, may be made at the outset. The trustee must perform his duties personally and cannot share them with others to the effect of making such persons responsible for the performance of those duties.<sup>3</sup> He may appoint agents, including solicitors, to assist him in the performance of his duties, but the trustee's personal responsibility remains. A trustee is not entitled to employ, for example, a solicitor to do work which is properly the responsibility of the trustee. If he does so, the expense incurred will not be accepted as a charge on the estate.<sup>4</sup> We have no evidence of dissatisfaction with the primary rule that the trustee must perform his duties personally, and in this respect we propose no change in the law.

#### Taking possession of the estate

10.3 We discuss in Chapter 11 the vesting of the bankrupt's estate in the permanent trustee, and we need refer here only to certain rules relating to the trustee's entitlement to take possession of that estate and of documents relating to the estate. Section 76 of the 1913 Act requires the trustee:

“... as soon as may be after his appointment, [to] take possession of the bankrupt's estate and effects, and of his title deeds, books, bills, vouchers, and other papers and documents.”

We consider that no substantial changes are required in the law in so far as it relates to the trustee's power to take possession of the bankrupt's estate. In so far as it relates to the trustee's power to take possession of title deeds, bills and other documents, we propose certain modifications in the following paragraphs.

10.4 The direction in section 76 of the 1913 Act that the trustee shall take possession of the bankrupt's estate and of his title deeds and other

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<sup>1</sup>In the remainder of this Chapter, except in cases where possible confusion might arise, we will refer to the permanent trustee simply as “the trustee”.

<sup>2</sup>See, in particular, Chapter 14 relating to the examination of the bankrupt; Chapter 16 relating to the valuation of claims; Chapter 17 relating to the submission, recording and adjudication of claims; Chapter 18 on the distribution of the estate; and Chapter 22 relating to registration, gazetting, and advertisement.

<sup>3</sup>See *MacTaggart's Representatives v. Watson* (1834) 12 S. 332; (1835) 1 Sh. & McL. 553.

<sup>4</sup>*Gourlay v. Straton* (1827) 5 S. 804; *Wilson's Trustee v. Wilson's Creditors* (1863) 2 M. 9.

documents must be read subject to the provision in section 97 of the Act that the estate vests in the trustee "subject always to such preferable securities as existed at the date of the sequestration". The reference to securities includes a reference to rights of lien.<sup>5</sup> It is well settled, however, despite the terms of section 97, "that a person holding documents over which he claims a right of lien cannot withhold them from the trustee in bankruptcy, but must produce them under reservation of the right of lien; and the effect of such reservation is that if in the end a valid lien is found to have existed, the person delivering the documents will have a preference over the estate".<sup>6</sup> A lien over documents is principally invoked in the context of a solicitor's lien over his client's title deeds, and this lien is now of less value because of the ease with which extracts of deeds are obtainable and of the enhanced evidential status of such extracts. Nevertheless, we do not propose any material change in the law, merely proposing that it should be expressly stated that the trustee's right to require delivery and to take possession of the debtor's title deeds and other documents is not excluded by a claim to a lien over them, but the holder of the lien would retain any preference to which he may be entitled.

10.5 The recovery of the estate may require the bankrupt's co-operation and section 77 of the 1913 Act provides that the bankrupt:

"shall at all times give every information and assistance necessary to enable the trustee to execute his duty; and, if the bankrupt fail to do so, or to grant any deed which may be requisite for the recovery or disposal of his estate, the trustee may apply to the sheriff to compel him to give such information and assistance, and to grant such deeds ...".

The principle that the bankrupt should at all times give the trustee such information and assistance as may be necessary for the performance of his duties should be retained, and the power of the court to order the bankrupt to grant deeds should be extended to cover the execution of any document. Failure by the bankrupt to give information or assistance to the trustee should also continue to constitute an offence but, to avoid unnecessary recourse to the sanctions of the criminal law, we recommend that, where the bankrupt fails to comply with an order of the sheriff to execute a deed or other document, the sheriff clerk should be authorised to sign it on the bankrupt's behalf.

10.6 Difficult problems are also presented when information relevant to the bankrupt's estate is contained in books, deeds or documents belonging to, or at least in the possession of, a third party. This is particularly true when the documents are of a confidential nature. Our Working Party,<sup>7</sup> considering one aspect of this problem, endorsed a suggestion by the Institute of Chartered Accountants that the trustee should have power to call upon the Inland Revenue to make available copies of the bankrupt's records, returns of income and assessments to income tax for a period of six years

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<sup>5</sup>1913 Act, s. 2. See also *Garden Haig Scott & Wallace v. Stevenson's Trustee* 1962 S.C. 51, per Lord Sorn at 62 and Lord Guthrie at 65.

<sup>6</sup>*Train & McIntyre v. Forbes* 1925 S.L.T. 286, per Lord Constable at 288.

<sup>7</sup>Memo. No. 16, p. 81.

preceding the sequestration. This proposal was opposed on the grounds that it breaches a confidentiality rule applying to the tax affairs of every person and that in most instances the bankrupt will himself authorise the Inland Revenue to disclose information which he himself has furnished. It seems difficult, however, to justify the application of any principle of confidentiality to a trustee in sequestration, who in all other relevant respects stands in the shoes of the bankrupt. Where the bankrupt refuses to co-operate, bankruptcy law should facilitate the adequate investigation of his affairs, if possible, without recourse to the sanctions of the criminal law. In our view, however, the problem is a more general one and we note that it is so treated in the Canadian Bill S-11.<sup>8</sup> We consider, therefore, that the trustee should be entitled to have access to all papers sent to another person by or on behalf of the bankrupt and relating to his assets, to his dealings with them or otherwise to his business or financial affairs, and that the trustee should have the right to copy such records. The sheriff should have the power to order that person to allow the trustee to have access to those papers and to make copies of them. We so recommend.

10.7 Section 187 of the 1913 Act provides, to state its effect in general terms, that the Lord Ordinary or sheriff may order that for a period not exceeding three months from the date of the order all letters addressed to the bankrupt shall be delivered to the sheriff clerk or trustee, to be opened in the presence of the sheriff, after written notice to the bankrupt to attend if within Scotland. This provision, we understand, is seldom used. Though it is inconsistent with current emphasis on personal privacy, we would be disposed to leave it undisturbed if we thought that it would materially assist the trustee in the recovery of the bankrupt's estate. At a time, however, when letters are by no means the only method of transmitting confidential information or confidential instructions, we doubt whether this provision remains of material assistance to trustees. We recommend, therefore, that it should not be re-enacted.

#### **Management and realisation of the estate**

10.8 Section 78 of the 1913 Act requires the trustee, apart from recovering the bankrupt's estate, to manage and realise the bankrupt's estate:

“... and convert the same into money, according to the directions given by the creditors at any meeting, and, if no such directions are given, [to] do so with the advice of the commissioners.”

Though the emphasis in this provision is on the trustee's duty to realise the estate and convert it into money, there is no obligation upon the trustee to effect an immediate realisation where this would entail a serious loss, and he may continue for a time the bankrupt's business.<sup>9</sup> His position, however, is one of some delicacy because he will normally incur personal liability in respect of contracts adopted or made by him, though he will have a right of recourse against the estate unless he has acted without any necessary consent or authorisation.

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<sup>8</sup>s. 200.

<sup>9</sup>See Goudy, p. 303.

10.9 Sections 78 and 92 of the 1913 Act envisage that the trustee should act subject to the directions of the creditors given at any meeting of creditors. In practice, however, we understand that the creditors rarely give more than general instructions to the trustee. It was partly for this reason that we proposed in Chapter 4<sup>10</sup> that in the administration of the estate the trustee should no longer require to act subject to the directions of the creditors as a body but only to those of the commissioners, and that the permanent trustee should be required as soon as may be after his appointment to consult with the commissioners or, where none are appointed, with the Accountant in Bankruptcy as to his administration of the bankrupt's estate. Apart from complying with any general or specific directions which the commissioners or, as the case may be, the Accountant may give to the trustee as to the exercise of his functions, the trustee, if he considers that this would be beneficial for the administration of the estate, should be entitled to exercise certain special powers with the consent of the commissioners (if any) or, in small assets cases, of the Accountant in Bankruptcy. These are the powers—

- (a) to carry on any business of the debtor;
- (b) to bring, continue or defend any legal proceedings relating to the estate of the bankrupt;
- (c) to create a security over any part of the estate; and
- (d) to exercise in relation to any property a power of appointment or other power which might have been exercised by the debtor for his own benefit.

Furthermore, with the consent of the commissioners (if any) he should have the power to refer to arbitration or to compromise any question or claim relating to the estate.<sup>11</sup>

### *Sale of moveables*

10.10 The 1913 Act contains few special provisions relating to the method of sale of the bankrupt's moveable property. We consider that, subject to the directions (if any) given by the commissioners, or if there are no commissioners by the Accountant in Bankruptcy, this should be a matter for the trustee. Where delay might adversely affect their sale, the trustee should be entitled to sell perishable goods at any time without complying with any such directions. The 1913 Act envisages the case where a trustee wishes to realise the bankrupt's non-vested, contingent rights. For this purpose, section 78 enables the trustee to effect an insurance on the life of the bankrupt and to this end to require him to submit to medical examination.<sup>12</sup> Like our Working Party,<sup>13</sup> we consider that this provision is excessive, and that it should be discarded. Another special provision relates to cases where the trustee proposes to sell the copyright in a work or any

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<sup>10</sup>See para. 4.18.

<sup>11</sup>*Cf.* 1913 Act, s. 172.

<sup>12</sup>1913 Act, s. 78.

<sup>13</sup>Memo. No. 16, p. 82.

interest therein. Section 102 of the Act contains provisions to safeguard the interest of the author of the work. These provisions should be retained.

10.11 Section 116 of the 1913 Act declares that it is lawful for a creditor to purchase the estate of the bankrupt, but only when it is sold "publicly". Our Working Party<sup>14</sup> considered that a right on the part of creditors to purchase the estate privately would not be detrimental to the interests of other parties to the sequestration. We agree, and recommend that the legislation to follow on this Report should not preclude creditors from purchasing the estate by private bargain. Section 116 declares that the trustee, commissioners, any law agent employed by the trustee in the sequestration and any partner of such law agent should not be entitled to purchase the estate. We consider that this safeguard is an important one, and that the prohibitions should be retained and modified to include any person standing in a family or business relationship to the trustee. We so recommend.

10.12 The Scottish authorities have regarded it as outwith the powers of trustees to sell book debts (that is, to assign for a consideration the right to recover book debts), their duty being rather to enforce such debts by action and diligence.<sup>15</sup> The legislature, however, intervened, in a provision now embodied in section 133 of the 1913 Act, to permit, with the authority of the creditors, the sale of book debts by auction, presumably on the view that the private sale of such debts would be open to abuse. Such sale is permissible, moreover, only on the lapse of 12 months from the deliverance actually awarding sequestration. The reason for this provision has been succinctly stated by Lord President Dunedin:

"The policy is obvious—not to allow sequestration to be indefinitely protracted simply because the assets of the bankrupt are hard to realise."<sup>16</sup>

We consider that, with the growth of efficient systems for the factoring of book debts, including invoice discounting, this provision is over-cautious. It certainly seems unduly cautious to permit of the realisation of book debts only after the lapse of a year since, after such a period, they may become virtually unrealisable. It seems unnecessarily restrictive too, to permit of such sales only with the authority of the creditors. The commissioners' approval, tacit or express, should suffice. We therefore recommend that the trustee should be expressly empowered to sell, with or without recourse against the estate, debts owing to the estate, in such manner and subject to such directions (if any) as may have been given to him by the commissioners or, if there are no commissioners, by the Accountant in Bankruptcy.

10.13 Section 133, in addition to authorising the sale of outstanding debts, permits of the sale by auction of the remaining assets, heritable and moveable, of the bankrupt estate. In the light of our own proposals for the realisation of the estate we see no reason for retaining this provision and suggest that it should not be re-enacted.

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<sup>14</sup>Memo. No. 16, p. 91.

<sup>15</sup>See *Stewart v. Crookston—Galbraith v. Stewart* 1910 S.C. 609.

<sup>16</sup>*Stewart v. Crookston* above, at 613.

### *Sale of heritage*

10.14 The present law, however, contains a series of detailed and complicated provisions relating to the sale of the bankrupt's heritage.<sup>17</sup> It may be convenient to deal first with the simplest case, where the heritage is unencumbered with any security.

10.15 In relation to sales by public auction of the bankrupt's heritable estate, the 1913 Act envisages that the trustee should obtain a resolution by the creditors to dispose of the estate by public sale at an upset price and in a manner fixed by the trustee with the consent of the commissioners.<sup>18</sup> Sale by private bargain is competent only with the concurrence of a majority of the creditors in number and in value, of the heritable creditors (if any) and the Accountant of Court, and on such terms as the trustee with the concurrence of the same parties may fix.<sup>19</sup>

10.16 The main issue is whether, without special consents, the trustee should be entitled to sell the heritable estate by private bargain. On consultation reference was made to the wide powers of a liquidator to sell the property of a company, including any heritable property or real estate belonging to it, by public auction or by private bargain without the authority of the court or that of the Committee of Inspection.<sup>20</sup> Although our Working Party proposed that the trustee should be entitled to sell heritable property only with the consent of the commissioners,<sup>21</sup> we consider that the trustee should have the right to sell the estate by public auction unless he is otherwise directed by the commissioners. We also considered whether, as our Working Party proposed, the consents of the commissioners should be required. We decided against such a requirement. Some protection is afforded by the proposed rule that the trustee and various persons associated with him<sup>22</sup> should not be entitled to purchase any part of the debtor's estate. It should be sufficient, in our view, to impose (as we now recommend) a duty upon the trustee to consult with the commissioners in relation to the performance of his statutory duties; and in the sale of heritage by private bargain, as in other sales, to comply with the directions (if any) of the commissioners or, if there are no commissioners, with those of the Accountant in Bankruptcy.<sup>23</sup> Like our Working Party,<sup>24</sup> we considered, but rejected proposals for obtaining professional valuations as a preliminary to the sale of heritage. In many classes of property, the value is well-established. It would, of course, be the duty of the trustee to ensure that the price is the best that can reasonably be obtained and this could sometimes require him to obtain a professional valuation of the property.

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<sup>17</sup>1913 Act, ss. 108–116.

<sup>18</sup>s. 110.

<sup>19</sup>s. 111.

<sup>20</sup>1948 Act, s. 245(2)A.

<sup>21</sup>Memo. No. 16, p. 88.

<sup>22</sup>See para. 10.11.

<sup>23</sup>Para. 4.30.

<sup>24</sup>Memo. No. 16, p. 90.

10.17 Where the bankrupt's estate is subject to heritable securities, it was generally agreed on consultation that the right of the heritable creditor to sell in terms of his security must remain. Section 108 expressly provides for the sale of heritage by a heritable creditor in terms of his security maintaining, however, the creditor's obligation to account for any reversion to the trustee and any posterior creditor. Since it merely empowers or requires the heritable creditor to do what, apart altogether from section 108, he is entitled or (as the case may be) bound to do,<sup>25</sup> section 108 would appear to be redundant. We recommend that it should not be re-enacted in the legislation to follow on this Report.

10.18 Section 109 makes provision for the public sale of heritage belonging to the bankrupt estate by the trustee with the concurrence of heritable creditors. Its detailed rules relating to the method of sale and disposal of the price appear to us to conduce to expense and to be unnecessary. We recommend, therefore, that the trustee's normal powers of sale should be exercisable either with the concurrence of any heritable creditor or, if he sells at a price which is sufficient to discharge any heritable securities, without such concurrence. Where a heritable creditor has intimated to the trustee that he intends to commence<sup>26</sup> the procedure for the sale of that part of the bankrupt's estate which is subject to the heritable security, the trustee should be precluded from exercising his power of sale in relation to that part of the estate. Similarly, once the trustee has intimated to a heritable creditor that he intends to exercise his power of sale the heritable creditor should be precluded from taking steps to enforce his security. In the event of the heritable creditor or the trustee (as the case may be) thereafter delaying in the sale, the trustee or the creditor (as the case may be) should be entitled to apply to the court for authority to sell the property. We recommend accordingly.

10.19 When the trustee sells an estate which is subject to heritable securities, section 112 of the 1913 Act requires him to make up a scheme of ranking and division of the claims of the heritable creditors and other creditors on the price of the heritable estate sold. This scheme must be reported by the trustee to the court, and the court's judgment is a necessary warrant for payment out of the price against the purchaser.<sup>27</sup> Since this procedure is somewhat drawn out, special provision is made for interim warrant by the Lord Ordinary or the sheriff for payment of preferable claims.<sup>28</sup> In our view these provisions are unnecessary. In a case of any complexity the trustee would prepare a scheme of ranking and division as

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<sup>25</sup>The Conveyancing and Feudal Reform (Scotland) Act 1970 (c. 35), s. 27 makes detailed provision for the application of the proceeds of sale by a creditor in a standard security.

<sup>26</sup>We would regard a heritable creditor as having "commenced" the exercise of a power of sale when he first takes an action that is directed solely at the sale of the security subjects, as, for example, where the holder of a standard security advertises a sale of the subjects under s. 25 of the Conveyancing and Feudal Reform (Scotland) Act 1970 (c. 35).

<sup>27</sup>s. 112. For the operation of the corresponding provision of the 1856 Act, see *Callum v. Goldie* (1885) 12 R. 1137.

<sup>28</sup>s. 113.

part of his normal duties of accounting, and his accounts will be subject to audit and review in the usual way. We propose, therefore, that sections 112 and 113 should not be re-enacted in the legislation to follow on this Report.

### *Protection of purchasers*

10.20 The scheme proposed above in relation both to heritage and to moveable property requires the trustee to conduct sales (other than sales of perishable goods) subject to the directions of the commissioners or, if there are no commissioners, of the Accountant in Bankruptcy. In the sale of heritage, moreover, the trustee or a heritable creditor cannot exercise his power of sale after notice by the other that he intends to commence a sale. It would be unreasonable to expect a purchaser to have to concern himself with these procedural matters and we recommend, therefore, that the validity of the title of a purchaser should not be challengeable on the ground that there has been a failure to comply with such procedural requirements. We contemplate that the purchaser's title would be open to challenge when, for example, he knew or had reason to suspect that there had been a failure to comply with the requirements.

### *Contractual powers of the trustee*

10.21 The contractual powers and duties of the trustee are not closely regulated by the 1913 Act, and merely arise from his duty to manage, realise and recover the bankrupt's estate.<sup>29</sup>

10.22 In general, the trustee has a right, subject to the directions of the creditors or commissioners, to elect to adopt the bankrupt's contracts on behalf of the estate or to repudiate those contracts.<sup>30</sup> What constitutes adoption of a contract is a question of circumstances, but it is not necessarily inferred from limited intromission with the subject matter of a contract.<sup>31</sup> Where the trustee adopts a contract concluded by the bankrupt he will incur personal liability for the bankrupt's obligations thereunder,<sup>32</sup> though he will normally have a right of recourse against the estate.<sup>33</sup> It is open, of course, to a trustee who proposes to fulfil a bankrupt's contract to arrange with the other contracting party that he (the trustee) should not be subject to personal liability.

10.23 It was suggested to us that a trustee who adopts the bankrupt's contracts should not be personally liable in relation to them. Our Working Party rejected this proposal *inter alia* on the view that:

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<sup>29</sup>1913 Act, s. 78.

<sup>30</sup>The right is restricted where the terms or the nature of the contract exclude transmission to the trustee (Gloag, pp. 425-427), as where the performance of the contract requires the personal skills or services of the bankrupt (*Anderson v. Hamilton & Co.* (1875) 2 R. 355 at 363).

<sup>31</sup>See Goudy, p. 346; *Sturrock v. Robertson's Trustee* 1913 S.C. 582.

<sup>32</sup>*Mackessack v. Molleson* (1886) 13 R. 445.

<sup>33</sup>*Kirkland v. Cadell* (1838) 16 S. 860. Where the trustee acts without any necessary consent or authorisation he will lose the right of recourse, although he may have a right of relief against individuals.

“... the [other] contracting party should not be obliged to risk the continuation of the contract by someone who may not have the knowledge, experience, labour and capital, limited as it would be to the funds of the estate, to carry out the contract to a satisfactory conclusion without some form of undertaking.”<sup>34</sup>

We have reached the same conclusion. Although the opinion has been expressed in textbooks<sup>35</sup> that a liquidator who continues a contract of a company in liquidation and makes it clear that he is acting on behalf of the company does not make himself personally liable, it is unclear whether this accurately represents Scots law.<sup>36</sup> It is certainly at variance with the relevant rule relating to trustees under private trust deeds for creditors and that applicable in England to trustees in bankruptcy.<sup>37</sup> In our view it is undesirable that the other party to a contract with a trustee in a sequestration (or, indeed with the liquidator of a company in liquidation) should be bound, in the absence of any agreement to the contrary, to the performance of obligations for which the trustee (or the liquidator) is not prepared to accept personal responsibility. We make, therefore, no recommendation for the alteration of the existing law, except that the trustee's power to adopt or to refuse to adopt a contract should be controlled, not by the directions of the creditors or commissioners, but solely those of the commissioners.

10.24 It is, of course, open to the trustee, subject to the directions (if any) of the creditors and the advice of the commissioners, to enter into contracts in the course of his management of the estate. If he does not expressly exclude personal liability, such liability will be presumed.<sup>38</sup> In accordance with the policy advocated above,<sup>39</sup> we propose that the trustee should be entitled to enter into new contracts where he considers that to do so would be beneficial for the administration of the estate, subject only to any directions given to him by the commissioners (if there are any). Where he enters into a contract in accordance with such directions, he would under the common law be personally liable (in the absence of any contractual stipulation to the contrary) though with a right of recourse against the bankrupt estate.<sup>40</sup> Any further indemnification of the trustee would be a matter between him and individual creditors.

10.25 The trustee, on the other hand, has a right to decline to adopt any contract to which the bankrupt was a party and, in that case, the remedy of

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<sup>34</sup>Memo. No. 16, p. 58.

<sup>35</sup>Gloag, p. 135; Palmer, *Company Law* (22nd ed.), p. 908.

<sup>36</sup>The matter was expressly left open in *Gray's Trustees v. Benhar Coal Co. Ltd.* (1881) 9 R. 225 and in *Crown Estate Commissioners v. Liquidators of Highland Engineering Ltd.* 1975 S.L.T. 58, per Lord Keith at 60. See also *Smith v. Lord Advocate* 1979 S.L.T. 233 per Lord President Emslie at 241.

<sup>37</sup>1914 Act, s. 54(2).

<sup>38</sup>*Mackessack v. Molleson* (1886) 13 R. 445, especially Lord Shand at 452.

<sup>39</sup>Para. 10.9.

<sup>40</sup>*Cf.* s. 17(2)-(4) of the Companies (Floating Charges and Receivers) (Scotland) Act 1972 (c. 67).

the other party is a claim for damages in the sequestration.<sup>41</sup> A trustee may be held, however, to have repudiated a contract if he does not positively declare<sup>42</sup> his intention to adopt it within a reasonable period.<sup>43</sup> What is a reasonable period may depend on the nature of the contract and the circumstances of the case,<sup>44</sup> but the cases suggest that a short period is envisaged. Three weeks was regarded as too long in an executory contract.<sup>45</sup> Scots law, however, does not require the trustee to make up his mind within any fixed period of time whether to adopt or to repudiate the contract.

10.26 It was put to our Working Party that the relative uncertainty of his position under Scots law might place the other contracting party in a difficult position, certainly in a position very different from that of his analogue under English law. Section 54 of the 1914 Act requires a trustee who wishes to disclaim onerous contracts and, indeed, onerous property generally to do so by a written disclaimer within a specified period. The Report of our Working Party contained a description of the relevant rules of Scots and English law and an analysis of their respective advantages and disadvantages.<sup>46</sup> The Working Party provisionally concluded that the English approach should not be adopted. We received little comment on this question, though the Law Society of Scotland favoured the English approach. In relation to commercial contracts the principal problem in the present law of Scotland is the possible uncertainty of the other contracting party as to his position. We consider that this problem would be largely cured if a provision, suggested by section 54(4) of the 1914 Act, were adopted, namely that any party to a contract entered into with the bankrupt should be entitled to require the trustee to elect whether to adopt or refuse to implement the contract within 28 days of the receipt by him of a request in writing, or such longer period as the court, on application by the trustee within such period of 28 days, may allow. If the trustee does not reply within the period of 28 days or the period fixed by the court, he should be deemed to have refused to adopt<sup>47</sup> the contract. This provision should be without prejudice to the power of the court, in appropriate circumstances, to infer repudiation within a lesser period.

### *Investment and banking practice*

10.27 The latter part of section 78 of the 1913 Act provides that the trustee should lodge all monies which he receives in the course of the administration of the estate in "such bank as the majority of the creditors in number and value at any general meeting shall appoint", and failing such

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<sup>41</sup>*Kirkland v. Cadell* (1838) 16 S. 860 at 881; Gloag, p. 426; *Asphaltic Limestone Concrete Co. v. Glasgow Corporation* 1907 S.C. 463; *Crown Estate Commissioners v. Liquidators of Highland Engineering Ltd.* 1975 S.L.T. 58; *Gibson v. Hunter Home Designs Ltd.* 1976 S.L.T. 94.

<sup>42</sup>*Crown Estate Commissioners* above, per Lord Keith at 59-60.

<sup>43</sup>*Ibid.*

<sup>44</sup>Gloag, p. 426; Rankine, *The Law of Leases in Scotland* (3rd ed.), p. 698.

<sup>45</sup>*Anderson v. Hamilton & Co.* (1875) 2 R. 355.

<sup>46</sup>Appendix D, pp. 141-147.

<sup>47</sup>Under English law the trustee is deemed to have adopted the contract if he fails to reply—1914 Act, s. 54(4).

appointment (under certain provisions) in any joint stock bank of issue in Scotland. We consider that directions by creditors on this matter are unnecessary, and that the trustee should be required to lodge the monies he receives in a bank or other institution currently exempted from the prohibition in section 1(1) of the Banking Act 1979<sup>48</sup> on the acceptance of deposits.

10.28 Our Working Party,<sup>49</sup> again following a recommendation by the Law Society of Scotland, proposed that the sum of £50 which the trustee was then entitled to keep in his own hands without incurring the penalties prescribed by section 79 of the 1913 Act should be raised to £250. The figure of £50 was increased to £100 by the Insolvency Act 1976,<sup>50</sup> and power was given to vary this amount from time to time by statutory instrument.<sup>51</sup> We suggest that the sum should now be increased to £200 and that a power to amend be included in the legislation to follow on this Report. We do not consider, however, that it is necessary to retain the special provision for the dismissal from office of a trustee who unlawfully retains funds in his hands. This should be left to the general rules sanctioning breach of their statutory duties by trustees.

#### **Meetings of the creditors and commissioners**

10.29 Under the present law an important function of the trustee is to convene and to act as clerk to the meetings of the creditors and of the commissioners. The leading provision relating to meetings of creditors is section 93 of the 1913 Act which provides that:

“The trustee, or any commissioner with notice to the trustee, may at any time call a meeting of the creditors, and the trustee shall call such meeting, when required by one-fourth in value of the creditors ranked on the estate, or by the accountant.”

A similar provision should find a place in the legislation to follow on this Report, though amended to require the permanent trustee to convene a meeting of creditors when required by the court, by one-tenth in number and value of the creditors, by a commissioner, or by the Accountant in Bankruptcy.<sup>52</sup> The trustee will arrange for a record to be made of the proceedings at meetings of creditors and will insert in the sederunt book the minutes of the meeting. He will take the chair at any such meeting until the meeting elects its own chairman.

10.30 The 1913 Act has no provision for the convening of meetings of commissioners. It is merely provided in section 81 that they may assemble at any time to ascertain the situation of the bankrupt estate. The flexibility of this provision is admirable but it should be made clear that the trustee may convene a meeting of the commissioners at any time, and shall do so when

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<sup>48</sup>c. 37.

<sup>49</sup>Memo. No. 16, p. 83.

<sup>50</sup>s. 1 and Sched. 1.

<sup>51</sup>s. 1(2).

<sup>52</sup>Cf. 1914 Act, s. 79(2).

directed by the court or when requested to do so by the Accountant in Bankruptcy or by any commissioner. The trustee will in practice require to convene such a meeting not later than 28 weeks from the date of the sequestration for the examination and approval of the trustee's accounts for the first accounting period, and thereafter at intervals of not less than 26 weeks until the estate has been exhausted.<sup>53</sup> The trustee should be required to act as clerk to the meetings of commissioners and to record their deliberations in the sederunt book. He may be asked to withdraw, however, when they are considering matters relating to his functions. When a commissioner has resigned office, is removed from office, dies, becomes incapacitated from acting, or declines to act, the trustee should be required to call a meeting of creditors for the election of a new commissioner. We envisage that the trustee should continue to be subject to these duties. In terms of section 73 of the 1913 Act,<sup>54</sup> a majority in value of the creditors assembled at any meeting called for that purpose may remove a commissioner and elect another in his place. We propose to retain this provision with the substitution of a majority in number and value of the creditors for a majority in value.

### **Investigatory powers and duties**

10.31 Under the present law the trustee has a duty to furnish a report upon the conduct of the bankrupt in connection with petitions by the latter for his discharge,<sup>55</sup> and we propose to retain a similar requirement where the debtor's petition is presented prior to the date of his discharge by operation of law. Section 180, moreover, of the 1913 Act imposes a duty on the trustee:

“... if he has reasonable grounds to suspect that the bankrupt has been guilty of any offences under this Act, to report the same to the Lord Advocate.”

It is not wholly clear whether under these provisions the trustee has a positive duty to investigate the conduct of the debtor. We have concluded, however, that it would be inappropriate to confer on the trustee a positive duty to investigate possible criminal conduct on the part of the bankrupt. It would be sufficient, in our view, to provide that where the permanent trustee has information in his possession which leads him to suspect the commission of an offence by the bankrupt or by any other person in connection with the administration of the estate, he shall report the facts to the Accountant in Bankruptcy.

### **Duty to maintain records and to account**

10.32 The trustee may be said to combine the functions of clerk and accountant in the sequestration. He is required by section 80 to keep a sederunt book, in which he must record:

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<sup>53</sup>See paras. 18.21–18.22. These periods may be altered, however, where the trustee invokes the procedures for the acceleration or postponement of payment of dividends.

<sup>54</sup>As read with s. 96.

<sup>55</sup>1913 Act, s. 143.

“... all minutes of creditors and of commissioners, states of accounts, reports, and all the proceedings necessary to give a correct view of the management of the estate.”

He is also required to keep regular accounts of the affairs of the estate. In our view, these should remain central duties of the trustee.

10.33 The sederunt book is a public document, and it is required to be open to inspection by the commissioners and by the creditors or their agents at all times. In consequence, the trustee is not bound to insert within it documents of a confidential nature. These need only be exhibited to the commissioners or the Accountant.<sup>56</sup> The entries which must be recorded in the sederunt book, in addition to those prescribed in section 80 of the Act, include entries relating to the oaths of creditors,<sup>57</sup> to the recall of the mandate of a commissioner,<sup>58</sup> to the bankrupt's state of affairs,<sup>59</sup> to the bankrupt's oath following his public examination,<sup>60</sup> and to balances due to or by the trustee in his accounts with the estate.<sup>61</sup> The trustee before his discharge is required to transmit the sederunt book to the Accountant. Entries in the sederunt book constitute *prima facie* evidence in matters relating to the estate except when founded upon by the trustee in his own favour.<sup>62</sup> It is, therefore, a document of importance. The trustee must retain it in his hands and is said to be personally responsible for its loss.<sup>63</sup> We see no reason to alter these rules except where required consequentially by other proposals in this Report.

10.34 Under section 76 of the 1913 Act the trustee, in addition to taking possession of the bankrupt's estate and effects, is required to:

“... make up an inventory of such estate and effects and a valuation showing the estimated value and annual revenue thereof, and shall forthwith transmit copies of such inventory and valuation to the accountant.”

It seems unnecessary for the trustee to make an estimate of the annual value of the estate, but otherwise we propose that this duty should be retained.

10.35 The trustee is also required to keep regular accounts of the affairs of the estate, which are also to be open to inspection by the commissioners and by the creditors or their agents at all times.<sup>64</sup> This duty should be retained and expressly stated in the legislation to follow on this Report. We would add, however, that the right to inspect the accounts should be extended to the bankrupt. The duty of the trustee to make up specific

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<sup>56</sup>s. 80.

<sup>57</sup>s. 46.

<sup>58</sup>s. 72.

<sup>59</sup>s. 77.

<sup>60</sup>s. 91.

<sup>61</sup>ss. 121, 127 and 129.

<sup>62</sup>Goudy, p. 340.

<sup>63</sup>*Ibid.*

<sup>64</sup>s. 80.

accounts is related to the accounting periods prescribed by the present law,<sup>65</sup> which in turn are dictated by the prescribed dates for the payment of dividends. We propose, as we later explain in Chapter 18,<sup>66</sup> to retain the principle of accounting periods related to the dates of payment of dividends and to introduce more flexible provisions for the acceleration or postponement of such dates of payment. The trustee, we recommend, should submit his accounts to the commissioners within two weeks after the end of each accounting period. With the accounts the trustee would submit to the commissioners a scheme of division of the available funds and proposals for the payment of a dividend. These accounts would be audited by the commissioners, who would also fix the trustee's remuneration. Under the present law the trustee is required, before each of the periods assigned for the payment of a dividend, to transmit to the Accountant a copy of those accounts.<sup>67</sup> Though the Law Society suggested that this duty should be removed, we agree with our Working Party that it should be retained. Such transmission is clearly required to enable the Accountant to supervise the administration of bankruptcy in Scotland. We would indeed fortify the Accountant's right to be kept fully informed of progress and developments in any sequestration, by empowering him to require any trustee to supply him (the Accountant) with such further or supplementary information relating to the bankrupt or his estate as the Accountant may consider necessary for the discharge of his statutory functions. We recommend accordingly.<sup>68</sup>

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<sup>65</sup>1913 Act, ss. 121, 127 and 129.

<sup>66</sup>Paras. 18.16–18.18.

<sup>67</sup>s. 80.

<sup>68</sup>*Cf.* 1913 Act, s. 159.

## CHAPTER 11

### VESTING OF THE BANKRUPT'S ESTATE IN THE TRUSTEE

#### Introduction

11.1 When the process of sequestration was introduced in 1772, only the bankrupt's moveable estate could be claimed by the factor. The anomalies so occasioned led in 1783 to the bankrupt's heritable estate being made available to the factor<sup>1</sup> and under the present law the principle is that the whole estate of the bankrupt attachable by diligence, of whatever kind, vests in the trustee *tantum et tale* as it stood in the person of the bankrupt. The historical justification for this principle is that sequestration is a species of collective diligence by the creditors in which the surrender by the debtor of his estate is the counterpart of his right to a discharge. None of our consultees suggested any fundamental alteration of the law in this respect. We recommend, therefore, the retention of the principle that the bankrupt's whole estate, except in so far as it is specifically exempted, should fall under the sequestration and vest in the trustee.

11.2 The main issues discussed in this Chapter relate to the qualifications to the principle of universal attachment and to how legislative effect should be given to the principle and its qualifications. For example, the provisions of the 1913 Act relating to the vesting of heritable estate are now unnecessarily complicated, and we consider that they should be restated in a briefer and more direct way.

11.3 From the standpoint of social policy, perhaps the most important question is the extent to which the property and income of the bankrupt should be excluded from vesting in order that he may maintain himself and his family. This question is closely connected with that of exemptions in diligence. Section 97(1) of the 1913 Act provides that the bankrupt's moveable property vests in the trustee "so far as attachable for debt, or capable of voluntary alienation". The reference to voluntary alienation is inappropriate since certain goods and earnings are and should be excluded from sequestration because they are not attachable for debt. Yet they are capable of voluntary alienation.<sup>2</sup> While the phrase "attachable for debt" is appropriate as a general principle, it presents certain problems. Earnings, for example, attract two different types of exemption from diligence—the statutory limitation rule exempting half the balance over £4 of the weekly wage<sup>3</sup> and the common law exemption fixed by the court in its discretion

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<sup>1</sup>Payment of Creditors (Scotland) Act 1783 (c. 18), ss. 19–23.

<sup>2</sup>The reference to voluntary alienation enables the trustee to claim moveable property which is owned by the bankrupt in common with a third party though such property could not be attached by poinding for a bankrupt's debts. We think that this rule should be preserved but by other drafting.

<sup>3</sup>Wages Arrestment Limitation (Scotland) Act 1870 (c. 63) as amended by Small Debt (Scotland) Act 1924 (c. 16), s. 2 and Wages Arrestment Limitation (Amendment) (Scotland) Act 1960 (c. 21), s. 1.

which may be a higher sum (known as the *beneficium competentiae*). While the former is invariably applied to arrestments in modern practice, it is the latter which is applied in sequestrations, in cases where the court determines under section 98(1) to what extent the bankrupt's earnings during sequestration should vest in the trustee.<sup>4</sup> Again, the reference to "attachable for debt" does not take account of the fact that the exemptions from diligence do not apply to certain classes of privileged creditors.<sup>5</sup> Moreover, while cash in the debtor's hands is generally thought not to be poindable in law and is not poinded in practice,<sup>6</sup> it can be claimed by the trustee in a sequestration.<sup>7</sup> In the light of these remarks, we think that the provisions vesting moveable property in the trustee should be amended and clarified. We recommend that the general exemptions from poinding designed to protect the debtor and his family should continue to apply in sequestrations: thus the necessary clothing of the bankrupt and his family, necessary household furniture and plenishings, and his tools of trade, should not vest in the trustee. Any alterations to these exemptions made in the context of the reform of the law of diligence should apply also in sequestrations.<sup>8</sup> We also recommend that the bankrupt's earnings, and income arising from any estate not vested in the trustee, during the sequestration should not automatically vest in the trustee. We later propose,<sup>9</sup> however, that the trustee should be entitled to apply to the court for an order requiring payment to him of the bankrupt's income (from whatever source) in excess of what is required for a suitable aliment for the bankrupt and his family. This approach seems to reflect actual practice better than the existing law which somewhat artificially regards personal income arising during sequestration as in theory vested in the trustee though no vesting declarator has been made under section 98(1) of the 1913 Act<sup>10</sup> and though, in the absence of such a declarator, the theory has no substantial practical consequence.

11.4 Under the present law, the property which vests in the trustee or is recoverable by him comprises (1) the bankrupt's moveable property at the date of sequestration, "so far as attachable for debt, or capable of voluntary alienation by the bankrupt";<sup>11</sup> (2) the bankrupt's heritable property in Scotland and immoveable property situated elsewhere; (3) property alienated before the sequestration but recoverable for the general body of creditors under the law relating to gratuitous alienations and fraudulent preferences; (4) rights and powers exercisable by the bankrupt which may result in funds being made available to the creditors, such as rights of action, general powers of appointment and claims for legal rights in succession; (5) property

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<sup>4</sup>*Caldwell v. Hamilton* 1919 S.C. (H.L.) 100.

<sup>5</sup>e.g. alimentary and rates creditors using arrestments, and Exchequer diligence for Crown debts (assuming that such diligence has not been rendered incompetent by s. 26 of the Crown Proceedings Act 1947 (c. 44)).

<sup>6</sup>See our Memo. No. 48 on *Poindings and Warrant Sales* (October, 1980), para. 4.11.

<sup>7</sup>This is made clear by the 1913 Act, s. 15.

<sup>8</sup>In our Memo. No. 48 above, paras. 4.13-4.40, we discuss exemptions from poindings in detail and advance provisional proposals for reform.

<sup>9</sup>See paras. 11.33-11.35.

<sup>10</sup>*Caldwell v. Hamilton* 1919 S.C. (H.L.) 100.

<sup>11</sup>1913 Act, s. 97(1).

which is for the purposes of sequestration regarded as the property of the bankrupt such as funds belonging to his wife that have been lent to him or inmixed with his own funds, and (6) after-acquired property and contingent rights to property.

### **Vesting of the estate**

#### ***Moveable Property***

11.5 Section 97(1) of the 1913 Act vests in the trustee as at the date of the sequestration:

“the moveable estate and effects of the bankrupt, wherever situated, so far as attachable for debt, or capable of voluntary alienation by the bankrupt, to the same effect as if actual delivery or possession had been obtained, or intimation made at that date, subject always to such preferable securities as existed at the date of the sequestration, and are not null or reducible.”

The effect of this provision is, therefore, to complete the title of the trustee to the corporeal moveables of the bankrupt and to those incorporeal moveables whose transfer requires assignation followed by intimation to the debtor in the obligation. Where, on the other hand, the incorporeal moveable is of a kind that requires the formality of registration for completion of title, the act and warrant operates as an assignation or transfer but it is apparently necessary for the trustee to effect registration in order to make his title complete.<sup>12</sup> The act and warrant of confirmation in favour of the trustee has also the effect of transferring to and vesting in him “any non-vested contingent right of succession or interest in property conceived in favour of the bankrupt ... to the same effect as if an assignation of such right or interest had been executed by the bankrupt and intimation thereof made at the date of the sequestration ...”.<sup>13</sup>

11.6 We were asked to consider whether it was appropriate for the debtor's corporeal moveables to vest immediately in the trustee (as the present law provides) without actual delivery or transfer of possession. This is inconsistent with the general law relating to transfer of property in moveables and with the presumption of ownership which the common law infers from actual possession. In many sequestrations, however, the trustee would be placed in an extremely difficult position if he were required to complete his title to the debtor's corporeal moveables by taking delivery, and to the bankrupt's debts by making intimation to the debtors. It would usually be impracticable for the trustee to take actual delivery of all the bankrupt's corporeal moveables (for example, the contents of a shop or the bankrupt's dwellinghouse) and difficult questions as to whether there had been constructive delivery could arise. A requirement upon the trustee to make intimation to all the bankrupt's debtors, in addition to creating time-consuming and expensive additional work (as, for example, where the bankrupt had a large number of book debtors), could extend the

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<sup>12</sup>*Morrison v. Harrison* (1876) 3 R. 406.

<sup>13</sup>1913 Act, s. 97(4).

opportunities for fraud and widen the range of protected transactions. This would detract from the principle of equality in misfortune among the bankrupt's creditors, and this is one of the major principles of the legislation that we propose. It can be argued that it is anomalous that the act and warrant should confer upon the trustee a completed or real right to the bankrupt's corporeal moveables and to certain classes of his incorporeal moveables (namely, those to which title is completed by intimation) but not to those classes of incorporeal moveables (such as company shares and patents) where registration is necessary to complete the title of the transferee or assignee. But there are in our view practical reasons for the distinction. Where the assets are of a kind whose ownership is recorded in a public register, the need to maintain the accuracy of the register makes it undesirable to give the trustee a completed title to the assets without registration in the appropriate manner. Accordingly, subject to certain exceptions and qualifications discussed below,<sup>14</sup> we recommend the retention of the principle embodied in section 97(1) of the 1913 Act that the trustee should succeed to the debtor's moveable estate "to the same effect as if actual delivery or possession had been obtained, or intimation made".

### ***Immoveable property***

#### ***Heritable property in Scotland***

11.7 The heritable estate of the bankrupt in Scotland vests in the trustee:

"to the same effect as if a decree of adjudication in implement of sale, as well as a decree of adjudication for payment and in security of debt, subject to no legal reversion, had been pronounced in favour of the trustee, and recorded at the date of sequestration, and as if a poiding of the ground had then been executed."<sup>15</sup>

The reference to the recording of the decree of adjudication is to recording in the Register of Inhibitions and Adjudications rather than in the Register of Sasines.<sup>16</sup> The effect of that complex provision is therefore to give the trustee only a personal right or title to subjects where registration in the Register of Sasines or in the Land Register for Scotland is necessary to complete the right, as in the case of feudal subjects, heritable securities and real burdens, and also in the case of a registered lease.<sup>17</sup> The trustee may, of course, readily complete title by recording a notice of title (the act and warrant providing the link).

11.8 These provisions for vesting the bankrupt's heritable estate in the trustee are supplemented or fortified by section 100 of the 1913 Act which provides that:

"the bankrupt shall, if required, grant all deeds necessary for recovering his property and feudally vesting his heritable estate in the trustee ...".

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<sup>14</sup>See paras. 11.22 and 11.32–11.36.

<sup>15</sup>1913 Act, s. 97(2).

<sup>16</sup>*Melville v. Paterson* (1842) 4 D. 1311, per Lord Ivory at 1315; Goudy, p. 256.

<sup>17</sup>Registration of Leases (Scotland) Act 1857 (c. 26), s. 10 as amended by Conveyancing (Scotland) Act 1924 (c. 27), s. 24.

The reasons for importing into the statutory scheme both an adjudication and an order upon the bankrupt to convey are historical.<sup>18</sup> Whatever the past justification for the complications of the existing scheme, there is no impediment today to a straightforward transfer of the bankrupt's heritable estate to the trustee by force of the act and warrant without anything more.<sup>19</sup> The provision in section 100 that the bankrupt must grant all deeds necessary for the vesting of the heritable estate in the trustee can also be dispensed with—although it would be desirable to retain the facility created by that section for the completion of title in an appropriate case in name of the bankrupt.<sup>20</sup> We recommend accordingly.

11.9 Section 101 of the 1913 Act makes detailed provision for the transfer to the trustee of heritable property of a deceased debtor to which his successor has made up title. The provision will presumably operate only where the existence of the successor's title is discovered after the award of sequestration. The procedure of section 101 is unnecessarily cumbersome, and there also seems to be no reason for the restriction of its scope to the recovery of *heritable* property. We propose, instead, that in any case where the executor of a deceased debtor or any heir, beneficiary or legatee has a completed title to, or is in possession of, any part of the deceased debtor's estate, the trustee should by virtue of his act and warrant be entitled to demand a conveyance or delivery of such estate. If the executor or other person refuses to comply with the demand, it should be competent for the court, on application by the trustee and after giving the executor or other person an opportunity to lodge answers, to order him to deliver or convey the estate to the trustee unless cause is shown for the order not being made.

#### *Immoveable property outwith Scotland*

11.10 Section 97(3) of the 1913 Act provides for the act and warrant vesting in the trustee:

“All real estate situated in England, [Northern] Ireland, or in any of His Majesty's dominions, belonging to the bankrupt, and all interest in or regarding such real estate, which the bankrupt held, or to which he was entitled, to the same extent as would have happened if the bankrupt had been adjudicated bankrupt in England or [Northern] Ireland, or in any of His Majesty's dominions respectively.”

This provision remains entirely appropriate for England and Wales and for Northern Ireland. It should, therefore, be retained for these parts of the United Kingdom, as should the provision in section 97(3) which relates to

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<sup>18</sup>See Goudy, p. 247.

<sup>19</sup>For example, s. 5 of the Conveyancing (Scotland) Act 1924 (c. 27) provides that in a clause of deduction of title it is competent “to specify as a title or as a midcouple or link of title, any statute, conveyance, deed, instrument, decree or other writing whereby a right to land or to any estate or interest in or security over land is vested in or transmitted to any person ...”

<sup>20</sup>The facility could be useful in, for example, the possible case where there is an unrecorded feu charter in favour of the bankrupt, where it could be convenient or might even be necessary (for example, if there is an exclusion of assignees before infeftment) for infeftment to be taken in name of the bankrupt.

registration, enrolment or recording of the act and warrant of the trustee in accordance with the laws of the country where the bankrupt's real estate is situated. There is a doubt, however, about the effect of the act and warrant in relation to the vesting of any immoveable estate of the bankrupt situated outside the United Kingdom or other British territory. The essence of the doubt is whether, on a true construction, section 97 of the 1913 Act does or does not extend the trustee's right to any such immoveable estate.<sup>21</sup> Where immoveable property is situated within a foreign country, it is, of course, for the law of that country, as the *lex situs*, to determine the effect of a Scottish sequestration upon that property. But the legislation to follow on this Report should state in unambiguous terms<sup>22</sup> that the effect of the act and warrant under Scots law is to vest in the trustee the whole property of the bankrupt of whatsoever kind and wheresoever situated.

### ***Property recoverable under the law relating to gratuitous alienations and unfair preferences***

11.11 The rights to property recoverable for the benefit of the general body of creditors under the law relating to gratuitous alienations and unfair preferences are examined in Chapter 12 of this Report and our proposals for alteration of the law are set out in that Chapter.

### ***Rights and powers exercisable by the bankrupt***

#### ***Actions for recovery of debts and damages***

11.12 It is competent for the trustee to take over or to initiate actions for recovery of property or debts belonging or due to the bankrupt and actions of damages for breach of contract or in respect of certain delictual claims. The action may either be raised by the trustee initially or, if it has already been commenced by the bankrupt, be continued by the trustee by sisting himself in the action.<sup>23</sup> Where, however, the ground of action arises from injury to the person or to the feelings or reputation of the bankrupt, different considerations apply. The trustee has no right to institute proceedings for *solatium* for personal injuries suffered by the bankrupt,<sup>24</sup> and it is likely that the same result would follow where the ground of action is injury to the feelings or reputation of the bankrupt.<sup>25</sup> The general principle of the law is, therefore, to recognise that there are certain rights of action with which the bankrupt is so intimately connected that he, and he alone, should have the

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<sup>21</sup>For a discussion of the doubt see Anton, *Private International Law* (Edinburgh, 1967), pp. 438–440 and Dicey and Morris, *Conflict of Laws* 8th ed. (London, 1967), p. 677; 10th ed. (London, 1980), p. 714, n. See also *Murphy's Trustee* 1933 S.L.T. 632.

<sup>22</sup>*Cf.* 1914 Act, s. 167.

<sup>23</sup>Goudy, p. 266.

<sup>24</sup>*Muir's Trustee v. Braidwood* 1958 S.C. 169. The trustee might, however, be permitted to continue such an action after it has been commenced by the bankrupt—see *Neilson v. Rodger* (1853) 16 D. 325; *Thom v. Bridges* (1857) 19 D. 721.

<sup>25</sup>*Bern's Executor v. Montrose Asylum* (1893) 20 R. 859, a case where opinions were expressed that the reasons for excluding an executor from raising an action for injury to the person, feelings or reputation of the deceased applied also in the case of a trustee in bankruptcy: See Lord McLaren at 863 and Lord Young at 870. See also the opinion of the Lord Ordinary (Walker) in *Muir's Trustee* above at 171 and *Scott v. Johnston* (1885) 12 R. 1022, *per* Lord Young at 1024.

right to say whether or not proceedings should be instituted. But if he does choose to institute proceedings it would seem that his creditors can reach any sum received by him as damages.<sup>26</sup> We make no recommendation for any change in the law.

### *Powers and faculties*

11.13 A general power of appointment in the bankrupt may be exercised in favour of his creditors on the ratio that, since the power is unrestricted and so could be exercised by the bankrupt for his own benefit, it is an asset under his control which should be utilised for the benefit of his creditors.<sup>27</sup> The right of a bankrupt to claim legal rights in the estate of a deceased person, where the claim would benefit the creditors, is also exercisable by his trustee.<sup>28</sup> These rules have been evolved by case law and are not dealt with in the 1913 Act. In England there is specific statutory provision to the effect that the capacity to exercise powers in or over or in respect of property which might have been exercised by the bankrupt for his own benefit is comprised in the property of the bankrupt available to his creditors.<sup>29</sup> We do not suggest any change in the law, but, in order to make the legislation as comprehensive as possible, we recommend that this principle should be a matter of express provision.

### *Special kinds of property*

#### *Property of the bankrupt's spouse*

11.14 Where a married man becomes bankrupt the Married Women's Property (Scotland) Act 1881 (c. 21) declares that any money, or other estate of his wife, lent or entrusted to him, or inmixed with his funds, is to be treated as an asset of his estate in bankruptcy under reservation of the wife's claim to a dividend as a postponed creditor after the claims of all other creditors for valuable consideration have been satisfied.<sup>30</sup> While the 1881 Act abolished the husband's proprietary right in his wife's moveable assets, it did not restrict his right to administer them and there was a risk that, although the spouses' moveables were now legally separate, they would in fact be inmixed. "The provision [was] intended to prevent fictitious claims by a wife upon property which truly belongs to the husband, so as to defraud his creditors."<sup>31</sup> When the husband's *jus administrationis* was abolished by section 1 of the Married Women's Property (Scotland) Act 1920 (c. 64), the 1881 Act provision was retained, presumably on the view that there was still a risk of fraud in situations where the spouses' funds are inmixed.

11.15 We accept that this risk remains but consider that if, on the sequestration of a husband's estate, provision should be made for cases

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<sup>26</sup>*Jackson v. McKechnie* (1875) 3 R. 130, where an award of damages for defamation to an undischarged bankrupt was held to fall under the sequestration.

<sup>27</sup>Goudy, pp. 298-299.

<sup>28</sup>*Aikman* (1893) 30 *Scottish Law Reporter* 804.

<sup>29</sup>1914 Act, s. 38(b).

<sup>30</sup>s. 1(4).

<sup>31</sup>Goudy, p. 289.

where the wife's funds have become inmixed with those of her husband, corresponding provision must be made for cases where, when a wife's estate has been sequestrated, her husband's funds are found to be inmixed with hers.<sup>32</sup> Section 1(4) of the 1881 Act refers to "any money, or other estate of the wife". It is not wholly clear whether the phrase "or other estate" includes corporeal moveables, but it is difficult to see how such moveables can become inmixed with the husband's "funds".<sup>33</sup> Indeed, where the asset is a corporeal moveable, or incorporeal moveable other than money, the separate identity of the asset is not generally a point at issue and its ownership is susceptible of proof. We consider, therefore, that the provision should be limited to cases where one spouse's monies have become inmixed with the monies or funds of the other. Moreover, since the provision is designed to deal with cases of possible fraud, we consider that it should not apply where the loan or trust has been constituted by a contract in writing signed by the parties.<sup>34</sup> If such a contract is itself a fraud on creditors it will be otherwise open to reduction. We considered also whether the relevant provision should be limited, as is the corresponding English provision,<sup>35</sup> to cases where the funds have been lent or entrusted by one spouse to the other for the purpose of any trade or business carried on by the latter. The problem of fraud on creditors, however, exists whether or not the monies concerned have been lent or entrusted for business purposes and we do not consider that any such limitation should be introduced into Scots law.

11.16 We recommend, therefore, that any monies lent or entrusted by his or her spouse to a bankrupt debtor which have become inmixed with his or her funds and are so inmixed as at the date of the sequestration should be treated as assets of the bankrupt estate and that the amount of such monies should be a postponed debt on the distribution of that estate. This provision, however, should not apply where it can be shown that the monies have been lent or entrusted under a contract in writing signed by both spouses.<sup>36</sup>

### *Copyright*

11.17 Section 102 of the 1913 Act regulates the position where the property of a bankrupt comprises the copyright, or any interest in the copyright, in any work, and the bankrupt is liable to pay to the author of the work royalties or a share of the profits. In any such case the trustee is not entitled to sell copies of the work or authorise its performance or dispose of the copyright except on terms that safeguard the interest of the author of the work. These provisions are entirely appropriate. But the great expansion of specialised knowledge and expertise of all kinds that has taken place over

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<sup>32</sup>Cf. 1914 Act, s. 36, which provides for both cases.

<sup>33</sup>See Clive and Wilson, *Husband and Wife* (Edinburgh, 1974), p. 338; *Adam v. Adam's Trustee* (1894) 21 R. 676; and the learned judgment of Sheriff Guthrie Smith in *Daniel's Trustee v. Cruikshank* (1894) 10 Sh. Ct. Rep. 201 at 203.

<sup>34</sup>Cf. Partnership Act 1890 (c. 39), s. 2(3) (d).

<sup>35</sup>1914 Act, s. 36.

<sup>36</sup>We are aware that Article 1 of the Uniform Law annexed to the draft E.E.C. Bankruptcy Convention proposes that all modes of proof should be admissible to rebut such a presumption. We consider that this would be inadvisable.

recent decades makes it possible that protection against bankruptcy should be extended to many kinds of intellectual property and know-how. It seems to us that each of these matters (including the protection of an author) would more appropriately be regulated in its own legislative code than in a general bankruptcy statute. Accordingly, we make no recommendation beyond the re-enactment of the provisions of section 102 of the 1913 Act.

#### *After-acquired property and contingent rights to property*

11.18 The provisions of the 1913 Act in relation to the vesting in the trustee of after-acquired property of the bankrupt are contained in sections 28, 29 and 98 of the 1913 Act. Section 28 (which relates to the award of sequestration on a petition by a debtor)<sup>37</sup> provides that on the presentation of a petition the Lord Ordinary or the sheriff is to award:

“sequestration of the estates which then belong or shall thereafter belong to the debtor before the date of the discharge, and declare the estates to belong to the creditors for the purposes of this Act.”

Sections 28 and 29 are complemented by section 98, which provides that any estate acquired by the bankrupt after the date of sequestration and before his discharge “shall *ipso jure* fall under the sequestration”. That does not mean, however, that such estate vests in the trustee immediately on its acquisition by the bankrupt in the same way as property belonging to the bankrupt at the date of sequestration and vesting in the trustee by virtue of his act and warrant under section 97. Section 98(1) requires the trustee first to obtain a declarator that the interest in the acquired property vests in him. The effect of the provision has been explained as follows:

“[Section 98] vests in the trustee *ipso jure* a right to the *acquirenda*, but that is only a personal right, which to be fully effectual requires to be made real by certain statutory procedure. It is the duty of the trustee when he comes to the knowledge of such acquisitions to apply to the Lord Ordinary to ‘declare all right and interest in such estate which belongs to the bankrupt to be vested in the trustee at the date of the acquisition thereof, to the same effect as is hereinbefore enacted in regard to the other estates’. The estate dealt with in this section, therefore, cannot be practically brought under the sequestration without the intervention of the Court. It follows that till this is done earnings which are not vested by a declarator of the Lord Ordinary to the effect set out in the section remain open to the diligence of creditors whose debts have been incurred after the sequestration, and if any such creditor has made his right effectual by diligence before the trustee has made the right of prior creditors real by the statutory procedure, the right first made effectual must prevail.”<sup>38</sup>

The declaratory procedure of section 98 has therefore the dual purpose of providing a mechanism for transforming the personal right of the trustee to *acquirenda* into a real right and of providing through advertisement and the

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<sup>37</sup>s. 29 relates to a petition by a creditor and is not materially different from s. 28 as regards the question under discussion.

<sup>38</sup>*Grant v. Green's Trustee* (1901) 3 F. 1016, per Lord Kinnear at 1019.

intervention of the court a safeguard for persons who might have a legitimate interest to object to the estate falling under the sequestration.

11.19 This declaratory procedure applies to all the bankrupt's *acquirenda* during the course of the sequestration. It applies to gifts and testamentary bequests, where it is a cumbersome but not inappropriate method of securing the vesting of the estate in the trustee. But it applies also to the earnings of the bankrupt under a contract of employment<sup>39</sup> and presumably to other sums of a like nature which may be received periodically by him. We discuss below<sup>40</sup> our proposal for a qualified exclusion of such income from vesting in the trustee. In relation to other *acquirenda*, such as gifts and testamentary bequests, we recommend simply that they should *ipso jure* fall under the sequestration during its subsistence, and that any person who holds such property should have a duty to hand it over to the trustee on the production of his act and warrant, subject to the rules which we propose below for the protection of persons acquiring in good faith and for value.

11.20 If our scheme is to operate satisfactorily, it is important that the permanent trustee should receive notice of any accretion to the bankrupt's estate and that any person who would, if it were not for the sequestration, be obliged to deliver or convey some item of property to the bankrupt should be informed of the sequestration. Accordingly, the bankrupt should be required, immediately on his learning of some addition or proposed addition to his estate, to notify the permanent trustee of that fact and to intimate the fact of the sequestration to any person who would otherwise be obliged to deliver or convey the additional item to the bankrupt. Failure by the bankrupt to comply with the requirement should be an offence. But if a person such as a testamentary trustee has transferred an item of property to the bankrupt or, on the instructions of the bankrupt, to some other person, he should incur no liability to the trustee in sequestration (except to account for any monies in his hands) if he acted in good faith and without knowledge of the sequestration. Again, the trustee should not be entitled to challenge a title to any interest in, or security over, the property where the title to that interest has been acquired in good faith and for value.

11.21 The alteration of law proposed by us makes it necessary to consider how to reconcile the proposed new scheme with section 44(4)(b) of the Conveyancing (Scotland) Act 1924 (c. 27) as amended by section 7(1)(a) of the Conveyancing Amendment (Scotland) Act 1938 (c. 24). That provision requires the trustee, in a case where any land, lease or heritable security is judicially declared to be vested in him under section 98 of the 1913 Act, "within one month after such land or lease or heritable security shall have been declared to be vested in him, to record in the appropriate Register of Sasines with regard to such land or lease or heritable security a memorandum" in a prescribed form. Under the scheme that we propose there would, of course, be no judicial declaration and the trustee would in

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<sup>39</sup>*Caldwell v. Hamilton* 1919 S.C. (H.L.) 100.

<sup>40</sup>See para. 11.34.

the usual case acquire a title to any heritable estate from a person such as an executor or trustee. In view of the protection that we propose to extend both to such persons and to acquirers in good faith and for value, we do not think it necessary or appropriate to impose any duty upon a trustee in sequestration to record a memorandum or to record a conveyance in his favour within any specified period. As a matter of good practice, recording should and usually will immediately follow the granting of a conveyance. If there is delay in recording, the person principally at risk would be the trustee in sequestration himself. We propose, therefore, simply that section 44(4)(b) of the 1924 Act be repealed.

### **Exclusions from and qualifications of the trustee's right**

#### ***The tantum et tale principle***

11.22 The property of the bankrupt which vests in his trustee is subject to certain exclusions and qualifications, generally expressed in the maxim that the trustee takes the property *tantum et tale* as it stood in the person of the bankrupt. The principle—which is amply vouched by authority—rests upon the common law. It is an equitable principle. Accordingly, save in respect of matters where the trustee has a title superior to that of the bankrupt (for example, under the rules relating to gratuitous alienations and fraudulent preferences), the property which vests in the trustee does so vest subject to any qualifications or rights which affect it or which have arisen from the conduct of the bankrupt. So where property has been acquired or dealt with fraudulently by the bankrupt, the property vests in the trustee subject to the rights of the persons who have suffered from the fraud.<sup>41</sup> Likewise, rules of law which regulated the rights of creditors of the bankrupt *inter se* prior to the sequestration are applicable in a question with the trustee when the property of the bankrupt vests in him.<sup>42</sup> It would, we think, be unwise to put the adaptability of the principle at risk by attempting to make it the subject of express statutory statement.

#### ***Rights of superiors***

11.23 The 1913 Act specifically provides that the vesting of the bankrupt's heritable estate in the trustee shall have no effect upon the rights of the superior.<sup>43</sup> We do not propose any alteration of the law in that respect, but the express provision of the 1913 Act can, we think, be omitted. The rights of a superior must remain unaffected by a sequestration in the absence of provision to the contrary.

#### ***Landlord's right of hypothec***

11.24 Section 115 of the 1913 Act provides that nothing in the Act shall affect the landlord's right of hypothec. It would seem to be reasonable that

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<sup>41</sup>*Colquhoun's Tr. v. Campbell's Trs.* (1902) 4 F. 739. But it should be noted that the trustee, being an adjudger, is not bound by contractual obligations relating to the heritable property of the bankrupt—see *Gibson v. Hunter Home Designs Ltd.* 1976 S.L.T. 94.

<sup>42</sup>e.g. the rules applicable to catholic and secondary creditors *Littlejohn v. Black* (1855) 18 D. 207.

<sup>43</sup>s. 97(2).

the landlord's right of hypothec, if and for so long as it remains available to a landlord, should be unaffected by a sequestration as its whole purpose is to provide security for rent. We recommend, therefore, the retention of a provision to a similar effect.

### ***Property held in trust***

11.25 Property held by the bankrupt in trust does not vest in his trustee. That is the legal position both in Scotland and in England, the distinction being that in Scotland the proposition relies upon judicial interpretation of the provision now contained in section 97 of the 1913 Act,<sup>44</sup> whereas in England there is an express statutory statement.<sup>45</sup> We recommend that the rule should be expressly stated in the legislation that we propose.

### ***Property agreed to be sold or sold by the bankrupt***

11.26 Where a seller of heritable property becomes bankrupt after having contracted to sell the property, the property vests in the trustee (or, in the case of an insolvent company, in the liquidator) free of the contractual obligation of the seller.<sup>46</sup> This is so even where the buyer, although he has not taken delivery of the conveyance,<sup>47</sup> has paid the price. The position under English law is quite the reverse: the property of a bankrupt vests in the trustee subject to the equitable right of the purchaser to have the estate conveyed to him if he has paid or makes payment of the purchase price.<sup>48</sup>

11.27 The hardship to the purchaser in the case of *Gibson v. Hunter Home Designs Ltd.* prompts the question whether there should be any alteration of the law where a person who has contracted to sell heritable property becomes bankrupt before delivery of the disposition to the purchaser. Our conclusion is that there should be no change in the law. This was the view of the great majority of the persons (including the Law Society of Scotland) who responded to a Consultation Paper on the question that we issued in 1979. Existing law keeps faith with the principle of equality among the creditors, and, as many of our consultees pointed out, the unfortunate situation that arose in *Gibson* can be avoided by the exercise of due care and the taking of any advisable safeguards.

11.28 A different question is whether there should be any change of law where the bankrupt has delivered a disposition or other conveyance or assignation of property (whether heritable or moveable) to the acquirer where some further step such as registration of the deed is required to complete the acquirer's title, and sequestration and the appointment of a

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<sup>44</sup>*Heritable Reversionary Co. Ltd. v. Millar* (1892) 19 R. (H.L.) 43 and earlier authorities there cited.

<sup>45</sup>1914 Act, s. 38(1).

<sup>46</sup>*Heritable Reversionary Co. Ltd. v. Millar* (1892) 19 R. (H.L.) 43; *Gibson v. Hunter Home Designs Ltd.* 1976 S.L.T. 94.

<sup>47</sup>See *Gibson v. Hunter Home Designs Ltd.* above.

<sup>48</sup>*Re Pooley, ex parte Rabbidge* (1878) 8 Ch.D. 367, C.A.; *Re Scheibler, ex parte Holthausen* (1874) 9 Ch. App. 722. The trustee may, however, "disclaim" the property if the contract is onerous, and in that event he has neither rights nor liabilities in the property—see 1914 Act, s. 54.

trustee have supervened before the acquirer has done so. It is still an undecided question whether a trustee in sequestration, by the earlier completion of his title, can defeat the title of a bona fide acquirer for value whose title is incomplete at the date of sequestration. In none of the cases relating to a competition in heritable property<sup>49</sup> did that precise question arise, and in *Gibson v. Hunter Home Designs Ltd.*<sup>50</sup> (where there had been no delivery of a disposition to the purchaser) there is at least the suggestion of a possibly different result in a case where a disposition had in fact been delivered.<sup>51</sup> The position regarding the moveable estate is also unclear. The case law is not easily reconcilable<sup>52</sup> and seems uncertain whether to accord precedence to the general creditors of the bankrupt or to the acquirer for value.

11.29 We consider that in any case where the trustee obtains a completed title by force of statute he should prevail over an acquirer for value whose title remains incomplete at the date of the sequestration. To provide otherwise would expose the estate of the bankrupt to possibly widespread and latent dangers. But where the trustee does not obtain a completed title by force of statute to any property (and this will usually be the case where registration in the Register of Sasines or some other public register is necessary for the completion of title), he should not be entitled at his own hand to defeat the right of a person who has in good faith and for value acquired the property from the bankrupt, notwithstanding that the title of that person is still uncompleted at the date of entry. In any such case the bankrupt is, in practice, likely to have divested himself of property that is specific and defined, and it would seem to be equitable that the trustee should be excluded from asserting a title to the property. Accordingly, we recommend that in any such case the property should be excluded from vesting in the trustee.

#### ***Exclusions for the maintenance of the bankrupt and his dependants***

11.30 During sequestration a bankrupt must be permitted to retain certain rights to property and income for his protection and that of his family. It is convenient if we discuss these rights with reference to (a) the bankrupt's heritable property, (b) his moveable property, and (c) income that accrues to him after the date of sequestration.

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<sup>49</sup>See e.g. *Melville v. Paterson* (1842) 4 D. 1311; *Lindsay v. Giles* (1844) 6 D. 771; *Smith v. Frier* (1857) 19 D. 384.

<sup>50</sup>1976 S.L.T. 94.

<sup>51</sup>*Ibid.* at 96. See also Goudy at p. 251 (footnote (c)) and "The Unconstructive Trust" by Dr. R. Burgess 1977 *Juridical Review* 200 at p. 211 where he comments upon the Lord President's opinion and argues that a constructive trust arises on delivery of the disposition. *The Encyclopaedia of the Laws of Scotland* (Vol. 13 at p. 404) also contains the assertion, unsupported by any citation of authority, that there does not pass to the trustee "estate originally belonging to a debtor in beneficial ownership, but which he has, prior to his sequestration, onerously conveyed or assigned by delivered disposition or assignation, although the disponee has not completed his title by infeftment or intimation before completion of the title of the trustee".

<sup>52</sup>See e.g. *Tod's Trustees v. Wilson* (1869) 7 M. 1100 and the adverse comments upon that case in *Watson v. Duncan* (1879) 6 R. 1247, per Lord Deas at 1252.

### *The bankrupt's heritable property*

11.31 The bankrupt has no right under existing law to retain any part of his heritable property in a question with the trustee, and any house owned by him will pass to the trustee for the benefit of his creditors.<sup>53</sup> We do not propose any alteration of the law in this respect. If a house is owned by the bankrupt it may well be the most valuable asset in his estate and it would be unjustifiable to allow the bankrupt to retain it at the expense of his creditors.<sup>54</sup>

### *The bankrupt's moveable property*

11.32 We have already recommended<sup>55</sup> that there should vest in the trustee the whole moveable property of the bankrupt as at the date of sequestration with the exception of those items of corporeal moveable property which are exempted from poinding for the protection of the debtor and his family.<sup>56</sup> We also stated that any alterations to those exemptions made in the context of the reform of the law of diligence should apply also in sequestrations. We have, therefore, employed in our draft Bill a form of words that is sufficiently general to achieve this effect.

### *The bankrupt's income*

11.33 The fact that a debtor's estate has been sequestrated will not necessarily affect, or immediately affect, his receipt of income. Where the income is derived from estate to which the trustee has title it must pass to him for the benefit of the creditors. But there may be a period before the trustee completes title to the estate when interest or dividends may have been paid directly to the debtor. He may also receive income from a variety of other sources. It may come, for example, from a wage or salary, from fees or earnings from a profession, trade or business, from an alimentary fund or a pension, or from social security benefits. The issue arises, therefore, as to whether and to what extent that income should be retained by the debtor or fall to the sequestrated estate.

11.34 In the case of a salary or wages (and probably in the case of earnings from a trade or profession), we have noted<sup>57</sup> that under existing law instalments of salary or wages as they accrue from time to time may be claimed by the trustee as *acquirenda* of the bankrupt under section 98(1) of the 1913 Act (but only in so far as they exceed what is required for the reasonable maintenance of the bankrupt). From the standpoint of the trustee there are, however, certain disadvantages in section 98(1) of the 1913 Act as a means of reaching part of the bankrupt's income. While the court has

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<sup>53</sup>*White v. Stevenson* 1956 S.C. 84.

<sup>54</sup>In our Memo. No. 41 (Occupancy Rights in the Matrimonial Home and Domestic Violence (1978) Vol. 2, paras. 6.46-6.48) we suggested that a spouse's right of occupancy should not prevail against the claims of creditors. Cf. the (English) Matrimonial Homes Act 1967 (c. 75), s. 2(5).

<sup>55</sup>See paras. 11.3 and 11.6.

<sup>56</sup>The exempted items are the necessary clothing of the bankrupt and of his family, necessary household furniture and furnishings, and his tools of trade.

<sup>57</sup>See para. 11.19, and *Caldwell v. Hamilton* 1919 S.C. (H.L.) 100.

interpreted the provision as enabling them to make an order vesting appropriate proportions of future payments of wages or salary in the trustee, the order is directed against the bankrupt and not the person paying the wages or salary.<sup>58</sup> There would be obvious advantage to the creditors in providing for the payments to be remitted direct to the trustee by the person responsible for making payment. This is the position under existing law when the bankrupt is the beneficiary under an alimentary provision. The trustee's right in such a case is regulated by section 98(2) of the 1913 Act, which provides as follows:

“Where the bankrupt is in right of an alimentary provision, it shall be competent to the Lord Ordinary, or the sheriff, upon a petition by the trustee, to determine whether the amount of such provision is in excess of a suitable aliment to the bankrupt, in view of his existing circumstances, and, if he shall determine that it is, to fix the amount of the excess, and to order the same to be paid to the trustee as part of the property of the bankrupt falling under the sequestration.”

A provision akin to section 98(2) seems to us to be the logical and satisfactory way both to resolve the question whether the bankrupt's income yields any excess over his alimentary needs, and to regulate the payment of any excess to the trustee.<sup>59</sup> We recommend, therefore, that it should be competent to the sheriff, on the application of the permanent trustee, to determine whether the amount of any income of the bankrupt is in excess of what is required for a suitable aliment for him and his family; and that if the sheriff so determines, he should fix the amount of the excess and order it to be paid to the trustee by the bankrupt or by the person responsible for making payment. Any such order should be revocable or variable in the event of a change of circumstances, on the application of the trustee, the bankrupt or any other interested party.

11.35 Section 148 of the 1913 Act makes special provision in connection with the payment to the trustee of part of the pay or pension of persons who are or have been engaged in the service of the Crown. In any such case the court may make an order for payment to the trustee of a portion of the pay or pension only where the Government department concerned consents to the payment. The provision (which also appeared in the 1856 Act) was no doubt intended to safeguard both the public interest and the personal interests of Crown servants, but it has become increasingly inappropriate with the passage of time. This was recognised by the Blagden Committee, who saw “no reason to perpetuate this requirement [of consent] as a condition precedent to an order”<sup>60</sup> although they proposed that the court should still consider the views of the bankrupt's superior officer. We would

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<sup>58</sup>See *Caldwell v. Hamilton*, above and our Memo. No. 49 on *Arrestment and Judicial Transfer of Earnings* (October 1980), paras. 3.3 and 3.4.

<sup>59</sup>We have suggested for consideration that if earnings transfer orders are introduced, there is a case for making them available to a trustee in sequestration—see Memo. No. 49 above, paras. 3.3 and 3.4. In the context of earnings transfer orders we suggested that jurisdiction should be exclusive to the sheriff court and we make the same proposal in this context—see Memo. No. 49 above, para. 3.28.

<sup>60</sup>Blagden Report, para. 130, discussing s. 51 of the 1914 Act.

go further and simply dispense with the provision entirely, with the result that a servant (or ex-servant) of the Crown would be in no different position from that of any other person. It would seem to be entirely just that there should be a universal rule that the bankrupt is entitled to retain sufficient income for a suitable aliment for himself and his family and that anything beyond that should pass to the trustee.

11.36 The Blagden Report recommended<sup>61</sup> that there be excluded from vesting in the trustee any refund of tax attributable to the income of a bankrupt's wife, even although the refund might in law be the property of the husband. This recommendation has been overtaken by section 22 of the Finance Act 1978 (c. 42), which makes provision for repayment of any tax deducted from the earned income of a wife to be made to her.

### **Protection of persons transacting with the bankrupt**

11.37 Section 107 of the 1913 Act, which renders of no effect acts and payments by the bankrupt after sequestration of his estate, gives protection in certain instances to persons who transact with the bankrupt in ignorance of the sequestration, but the protection extends mainly to transactions in moveable property. Nevertheless, we do not think that any change is necessary as regards conveyances or assignments of heritable property where recording in the Register of Sasines is necessary. An abbreviate of sequestration (which has the effect of an inhibition and of a citation in an adjudication of the estate of the debtor at the instance of the creditors) must be recorded in the Register of Inhibitions and Adjudications after the issue of the first deliverance,<sup>62</sup> and no deed by the bankrupt relating to the sequestrated estate will receive effect so long as the recorded abbreviate remains effective. Should that effect be allowed to expire, a subsequent deed by the bankrupt relating to the sequestrated estate will not be ineffective because of the sequestration.<sup>63</sup> Accordingly, a search of the Register of Inhibitions and Adjudications will disclose whether an abbreviate of sequestration or a memorandum of renewal has been recorded there: if either has been so recorded the interested person will know that he must transact with the trustee in sequestration, whereas if it has not he will know that he need not concern himself with a possible sequestration. There are, of course, transactions and payments in relation to heritable property that do not involve a search of registers, and in those cases a person transacting with a bankrupt may or may not become aware of the sequestration during the course of the transaction.<sup>64</sup>

11.38 There is greater uncertainty with regard to the moveable estate. A person who makes a payment in the ordinary course of business to the

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<sup>61</sup>At para. 104.

<sup>62</sup>1913 Act, s. 44.

<sup>63</sup>1913 Act, s. 44 as read with Conveyancing (Scotland) Act 1924 (c. 27), s. 44(4) (c).

<sup>64</sup>If it is simply a case of making a payment (as of rent) a person making payment in good faith to the bankrupt will be protected by s. 107 of the 1913 Act, and by the provision to replace that section that we propose.

bankrupt or who purchases goods from the bankrupt will have no occasion to search the Register of Inhibitions and Adjudications. Accordingly, he may well have no opportunity to discover, or indeed no reason to suspect the existence of, the sequestration, at least until notice of publication of the award of sequestration in the *Gazette*. A person may, of course, remain ignorant of the sequestration even after publication of that notice, but it must nevertheless be regarded as notice to the world of the sequestration. Accordingly, we consider that, while the protective provisions to replace those in section 107 should be expressed in rather wider terms, the protection should not continue indefinitely but only until the date of notice of publication of the award of sequestration in the *Gazette*. The case is, of course, different where the trustee has acquiesced in the bankrupt's dealings, has abandoned the property that is in issue to the bankrupt, or is otherwise personally barred from challenging a transaction. The transaction would in that event be protected, whether it took place before or after notice of publication of the award of sequestration.

11.39 We recommend, therefore, that any dealing of or with the bankrupt relating to the sequestrated estate (including any act done or deed granted by the bankrupt or any other person) after the date of the sequestration shall be of no effect in a question with the trustee unless the person seeking to uphold the dealing demonstrates either—

- (a) that the trustee has abandoned to the bankrupt the property to which the dealing relates, has expressly or impliedly authorised the dealing, or is otherwise personally barred from challenging the dealing, or
- (b) that the dealing occurred between the date of sequestration and the date of publication of the notice of the award of sequestration in the *Gazette* and comes within one of the following descriptions—
  - (i) the performance of an obligation undertaken before the sequestration, by a person obliged to the bankrupt in the obligation;
  - (ii) the purchase from the bankrupt of goods for which the purchaser has given value to the bankrupt or is willing to give value to the trustee; or
  - (iii) a banking transaction in the ordinary course of business between the banker and the bankrupt,

and that the person dealing with the bankrupt was at the time of the dealing unaware of the sequestration.