

Scottish Law Commission

(SCOT. LAW COM. No. 68)

REPORT ON BANKRUPTCY AND RELATED ASPECTS OF INSOLVENCY AND LIQUIDATION

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by the Lord Advocate
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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:

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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"

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

CHAPTER 12

GIFTS AND PREFERENCES

Introduction

12.1 In Scots law both the rules relating to the reduction of gifts and those relating to the reduction of preferences were developed before the introduction of sequestration and may still operate where a debtor's estates have not been sequestrated.¹ Ideally, these rules should cohere with one another. There are, however, differences between the conditions for reduction of gifts and those for the reduction of preferences. Under the common law these differences are marginal, since the crucial factor in both cases is the insolvency (in an absolute sense) of the debtor. The differences are more striking under the rules respectively of the 1621 and 1696 Acts which utilise different criteria. The reduction of gifts under the 1621 Act requires the insolvency of the debtor at the time of challenge and a relationship between the debtor and the recipient of the gift. The reduction of preferences under the 1696 Act requires that the preference should have been given within a short period before the date of constitution of the debtor's "notour bankruptcy".²

12.2 There are, as we shall explain, other differences in detail which tend to make the law confusing for those who have to apply it. We consider that a greater measure of consistency could now be introduced into this branch of the law. The statutory provisions relating to the reduction of gifts and preferences, in our view, could be substantially improved and to a considerable extent assimilated if the period of challenge were ascertained in each case by reference to sequestration or its equivalent. We discuss these matters in detail below.

Gifts

The present law

Scottish rules

12.3 There is always a risk that a debtor, appreciating that his affairs are becoming embarrassed and that he may be insolvent, may seek to put assets out of the reach of his creditors by transferring them to other persons, particularly to friends and relations. The common law of Scotland recognises this risk. Following the principle of the *actio Pauliana* of Roman law, the common law allows challenge of a gift made by an insolvent donor on the ground that such a gift amounts to a fraud upon his creditors. Indeed, the common law extends the principle of the *actio Pauliana* by allowing successful challenge of a voluntary alienation by a debtor, irrespective of proof of intention to defraud, where it can be shown that—

¹This, of course, is also the case as regards equalisation of diligence under s. 10 of the 1913 Act.

²The 1696 Act (as amended by s. 115(3) of the Companies Act 1947 (c. 47)) selects a period of six months preceding the constitution of notour bankruptcy.

- (a) the debtor was insolvent at the time of the challenge and was either insolvent at the time of the alienation or was made insolvent by it; and
- (b) the alienation was made without onerous consideration; and
- (c) the alienation was to the prejudice of the challenging creditor.

12.4 The common law challenge may be made by any creditor, whether his debt was contracted before or after the alienation.³ Challenge may also be made by a trustee in sequestration,⁴ but by a trustee under a trust deed only, it is thought, where the trust deed confers a power to challenge and creditors having a title to challenge accede to it.⁵

12.5 Insolvency in the context of the common law challenge means the debtor's absolute insolvency in the sense that his overall liabilities are greater than his assets. Such insolvency is difficult for a creditor to establish in any event, but is especially difficult in relation to a point of time in the past. The common law, therefore, was strengthened by the 1621 Act. It is still in force, and provides that, when a debtor makes an alienation to "anye coniunct Or confident persoun⁶ without trew Just and necessarie causes and without a Just pryce realie payit the same being done efter the Contracting of lauchfull dettis frome trew creditoures", the latter may challenge the gift. The Act has received a very liberal construction and, if it can be established that the debtor was insolvent at the date of the challenge, it is presumed (a) that he was also insolvent at the date of the alienation, and (b) that the alienation was made without onerous consideration. It is not wholly clear whether, if the debtor was solvent at the date of the alienation, the gift will be set aside where it can be shown that its effect was to render the debtor insolvent.⁷ If, however, it is established that the debtor was or became solvent after the date of the alienation, the right of challenge disappears.

12.6 The 1621 Act provides that the person making the challenge may be "any trew creditour". This has been construed to mean only creditors whose debts were contracted before the alienation. Challenge under the 1621 Act is therefore more restricted than under the common law. But a trustee in sequestration may make the challenge under statute "whether representing prior creditors or not".⁸ A trustee under a trust deed may challenge under the Act of 1621 only where a trust deed gives him this power and prior creditors accede to it.⁹

12.7 The 1621 Act applies only where the alienation is to a "coniunct Or confident" person and the preamble to the Act refers to the "wyiffes

³Goudy, p. 33 and cases cited there. See in particular *Wink v. Speirs* (1867) 6 M. 77, per Lord Justice Clerk Patton at 79.

⁴1913 Act, s. 9.

⁵*Cf. Fleming's Trs. v. McHardy* (1892) 19 R. 542.

⁶The meaning of this expression is discussed in para. 12.7.

⁷Contrast *McLay v. McQueen* (1899) 1 F. 804 with *Abram Steamship Co. v. Abram* (O.H.) 1925 S.L.T. 243.

⁸1913 Act, s. 9.

⁹*Cf. Fleming's Trs. v. McHardy* (1892) 19 R. 542.

Childrene Kynnismen alleis and vther confident and Interposed persoues". Case law has interpreted the expression conjunct persons to include those who are closely related to the debtor, such as a spouse, parents, children, brothers, sisters, uncles, and sons-in-law. It has construed the expression confident person to include those in a confidential relationship with the debtor, such as business partners, clerks, servants etc. There is no explicit rule to the same effect in the common law, but Bell suggests that:

"where the connection between the parties has been very close and intimate, the Court has raised a presumption to the effect of throwing the *onus probandi* of solvency on the holder of the deed."¹⁰

There is no recent authority, however, to support this proposition.

12.8 Though the 1621 Act declares that the alienations, dispositions, etc. to which it refers "to have bene frome the beginning and to be in all tymes Cuming null and off nane avaiill force nor effect", it also extends protection to "anye of his Maiesties gude subiectis (no wayis pertakeris of the saidis fraudis) [having] lauchfullie purchesit anye of the saidis bankruptis Landis or guidis by trew barganis". A third party, therefore, receiving the subject matter of the alienation for value and in good faith is protected. The donee, however, is liable to make good to the bankrupt's creditors the price he receives.

12.9 It is not a condition of any challenge under the common law or under the Act of 1621 that the alienation was entirely gratuitous: it suffices that there was a materially inadequate consideration in money or in money's worth. Where there is a material inadequacy, the transaction is held to be gratuitous to the extent of the inadequacy and may be reduced.¹¹ It is a defence that the alienation implemented a prior legal obligation and for this reason gifts made in antenuptial contracts of marriage have been sustained.¹² It may also be a defence under the Act of 1621 that an alienation was made in pursuance of a natural obligation, as where a husband makes a reasonable postnuptial provision for a wife or child.¹³ The words "trew Just and necessarie causes" though in terms conjunctive, have always been construed disjunctively.¹⁴ Accordingly, a challenge under the Act of 1621 can be defeated where it can be shown that the alienation was made for a "trew" or "Just" cause even if strict necessity is absent. The court, therefore, has declined to invalidate a gift of money by a prospective husband to his future

¹⁰*Comm. ii. 184*, citing *Crs. of Marshall v. his children* (1709) Mor. 48 Note; *Inglis v. Boswell* (1676) Mor. 11567; *McChristian v. Monteith* (1709) Mor. 4931.

¹¹*Glencairn v. Brisbane* (1677) Mor. 1011; *Miller's Tr. v. Shield* (1862) 24 D. 821; *Gorrie's Tr. v. Gorrie* (1890) 17 R. 1051; *Tenant v. Miller* (1897) 4 S.L.T. 318; *Abram Steamship Co. v. Abram* (O.H.) 1925 S.L.T. 243.

¹²*Bell, Comm. ii. 176*; *McLay v. McQueen* (1899) 1 F. 804.

¹³*Bell, Comm. ii. 178*: the court, however, will scrutinise such arrangements with particular care. *Robertson's Trustee v. Robertson* (1901) 3 F. 359; cf. also *Kemp v. Napier* (1842) 4 D. 558; *Rust v. Smith* (1865) 3 M. 378; *Dunlop v. Johnston* (1867) 5 M. (H.L.) 22; *McManus's Tr. v. McManus* 1978 S.L.T. 255 and 1979 S.L.T. (Notes) 71.

¹⁴*Bell, Comm. ii. 176*, citing *Grant v. Grant of Tullifour* (1748) Mor. 949 at 952.

wife for the purchase by her of the matrimonial home.¹⁵ There is, however, no certainty as to the precise circumstances in which the court will uphold a disposition made in implementation of a natural obligation or made for an allegedly "trew" or "Just" cause.¹⁶

12.10 The common law of Scotland does not usually regard a postnuptial settlement as having been granted for an onerous consideration, but section 2 of the Married Women's Policies of Assurance (Scotland) Act 1880¹⁷ protects from challenge as gratuitous alienations policies of assurance effected by a married person or a person contemplating marriage on his or her own life for the benefit of his or her spouse or prospective spouse and/or children. Section 2, however, provides that if it is established;

"that the policy was effected and the premiums thereon paid with intent to defraud creditors, or if the person upon whose life the policy is effected shall be made bankrupt within two years from the date of such policy, it shall be competent to the creditors to claim repayment of the premiums so paid from the trustee of the policy out of the proceeds thereof."

12.11 Under the common law donations from husband to a wife during the subsistence of their marriage were revocable even where the husband was solvent and, accordingly, fell to the husband's creditors on his sequestration. This rule was changed by the Married Women's Property (Scotland) Act 1920,¹⁸ and now such donations when completed within a year and a day of the sequestration of the donor's estates are revocable at the instance of the creditors of the donor. The solvency or insolvency of the donor at the time of the donation is immaterial.

12.12 The common law rules relating to gratuitous alienations as well as those of the 1621 Act are thought to apply to companies (including limited liability companies) as well as to individuals, and the concept of "confident person" has been held to include the manager of such a company.¹⁹ There is, however, some doubt as to whether section 320(1) of the 1948 Act refers to gratuitous alienations as well as to fraudulent preferences. Section 320(1) provides that any conveyance or certain other deeds or acts made or done by a company within six months before the commencement of its winding-up which, if made or done by an individual within six months before his bankruptcy, would be deemed a fraudulent preference in the bankruptcy should be deemed a fraudulent preference in relation to the company's creditors and be invalid accordingly. "Fraudulent preference", however, is defined in section 320(3) as including "any alienation or preference which is voidable by statute or at common law on the ground of insolvency or notour bankruptcy". Despite this definition it seems more probable that section 320

¹⁵*Armour v. Learmonth* 1972 S.L.T. 150.

¹⁶*Drummond v. Swayne* (1834) 12 S. 342; *Jones' Tr. v. Jones* (1888) 15 R. 328.

¹⁷c. 26, as amended by s. 1 of the Married Women's Policies of Assurance (Scotland) (Amendment) Act 1980 (c. 56).

¹⁸(c. 64) s. 5, proviso (b).

¹⁹*Abram Steamship Co. v. Abram* 1925 S.L.T. 243. A gift by a company might also be challengeable as being *ultra vires* the company.

is directed only at preferences in favour of creditors.²⁰ This question need not concern us further because we propose below that gratuitous alienations created by companies should be challengeable under the same rules and subject to the same conditions as apply in sequestrations.

English rules

12.13 So far as English law is concerned, we think it sufficient to refer to two enactments. The first is section 42(1) of the 1914 Act, which deals with the effect of bankruptcy upon certain "settlements". This term includes "any conveyance or transfer of property".²¹ It would seem, nevertheless, that an outright gift is not included and that the settlement must take the form of "dispositions of property by a person to be held and preserved for the enjoyment of some other person".²² The settlement is to be void against the trustee in the bankruptcy²³ if the settler becomes bankrupt within two years of making it. It is to be similarly void if he becomes bankrupt within 10 years of making it, unless the beneficiaries can establish that the settler would have been solvent at the time of making the settlement even if he had disposed of the property comprised in the settlement. There are excluded *inter alia* settlements made in favour of a purchaser or encumbrancer in good faith and for valuable consideration, and settlements made before and in consideration of marriage.

12.14 Quite apart from bankruptcy law and operating independently of the debtor's bankruptcy, section 172 of the Law of Property Act 1925²⁴ provides that any conveyance of property made with intent to defraud creditors will be voidable at the instance of any person prejudiced by it. There are specifically excepted—at least where there is good faith:

"... any estate or interest in property conveyed for valuable consideration and in good faith or upon good consideration and in good faith to any person not having, at the time of the conveyance, notice of the intent to defraud creditors."

Proposals for reform

General structure of the law

12.15 Our Working Party examined the rules of the common law and those of the 1621 Act relating to gratuitous alienations and argued that the differences between these rules were a source of confusion and that they should be rationalised and harmonised. They proposed, therefore, *inter alia* that—

²⁰This is its effect under English law and D. G. Antonio argues that it has a similarly restricted effect in Scots law. See "Fraudulent Preferences in Bankruptcy and Liquidation" 1965 S.L.T. (News) 145. The opposite view is taken in Palmer, *Company Law* 22nd ed. (London, 1976), p. 996.

²¹1914 Act, s. 42(4).

²²*Re Tankard ex parte the Official Receiver* [1899] 2 Q.B. 57 at 59.

²³The effect of this provision is that the settlement is avoided only from the date when the trustee obtains title. See Williams, p. 338.

²⁴c. 20.

“(a) Gratuitous alienations should not be challengeable at common law;

(b) Any alienation made by a debtor during the year preceding his public insolvency²⁵ to any person should be reducible unless the debtor or such person prove (1) that the alienation was onerous, or (2) that the debtor was solvent at the date of the alienation;

(c) Any alienation made by a debtor during the second and third years preceding his public insolvency to any person should be reducible if the person challenging the alienation proves that the debtor was insolvent at the date of the alienation, unless the debtor or the alienee prove that the alienation was onerous.”²⁶

12.16 The proposals of the Working Party attracted a variety of comments on consultation. We cannot accept their proposal (a) to abandon the challenge of gratuitous alienations at common law. The common law offers the possibility of challenge over a much longer period of time than would be possible under the Working Party's proposal (c). It gives scope for the challenge both of cases where there is evidence of an intention to deceive or to prejudice creditors and of cases where, although intention to deceive may have been present, it cannot or cannot easily be established. The principle on which the common law proceeds is that, from the moment of his insolvency, the debtor's estate constitutes a fund for division among the creditors, so that any gratuitous alienation by him is considered to be a breach of the creditors' rights.²⁷ Insolvency in this context means that, if his property were then realised, the debtor's overall liabilities would exceed his assets. We consider that this principle is a sound one: a person who is insolvent in this sense should be paying his creditors and not making gifts to others. The right of challenge, moreover, at common law should continue to be available not only to creditors and to the trustee in the debtor's sequestration as their representative, but also to a trustee under a protected trust deed irrespective of the terms of the deed and to a judicial factor on the estate of a deceased debtor where the estate is insolvent.

12.17 Nor can we accept the Working Party's proposal (c). It was in contemplation by the Working Party that public insolvency (like notour bankruptcy) might be constituted and re-constituted on a number of occasions, perhaps over a long period of time. The proposal would lay open to challenge any gift to any person up to three years before *any* constitution of the debtor's public insolvency (or notour bankruptcy). Accordingly, the trustee would require to examine whether at any time in the past the debtor had become publicly insolvent and whether he had made gifts during the three years prior to such public insolvency and during any period after that event until his solvency was re-established. This would be unduly burdensome.

²⁵An expression suggested by the Working Party to replace the term “notour bankruptcy”.

²⁶Memo. No. 16, p. 13.

²⁷Goudy, pp. 22–24.

12.18 The Working Party's proposal (*b*) is based on the sound principle that a heavy onus of proof should be laid on *any* recipient of a gift made within a short period before the donor's insolvency. This would be an improvement upon the existing law, which, on the one hand, places by the Act of 1621 a heavy burden of proof upon a recipient who is conjunct or confident with the donor in the event of the latter's insolvency, no matter how distant the gift from the insolvency—and, on the other hand, places the entire onus of proof of insolvency and non-onerosity according to the strict rules of the common law upon the challenger of a gift to a stranger even when it is made on the very eve of the donor's insolvency. The Working Party's proposal (*b*) would remove this anomaly but is open to the same objection in one respect as proposal (*c*), that is, it adopts as the reference point for the determination of the period when a gift should be open to question the public (or apparent) insolvency of the donor. We consider that this is inappropriate and that the point of reference should be one which indicates that the debtor's insolvency is not merely public but likely to be irretrievable. The relevant reference point should be the date of the debtor's sequestration or of the commencement of a similar process for the division of an insolvent debtor's estate among his creditors generally.

12.19 We recommend, therefore, that when a debtor alienates any *significant* part of his estate during a specified period preceding²⁸ the date of the sequestration of his estate, the alienation should be challengeable in an action at the instance of the trustee in the debtor's sequestration. On such a challenge being brought, the court should be entitled to grant decree of reduction or for such restoration of property to the debtor's estate or such other redress as it may consider appropriate, unless the person seeking to uphold the alienation demonstrates either that the alienation was made for adequate consideration or that the debtor was solvent immediately after the alienation or became solvent at any time thereafter. A similar right of challenge should be open to a trustee under a protected trust deed, the relevant date being the date when it was granted. In the case of the sequestration of the estate of a deceased debtor or of the appointment of a judicial factor on his insolvent estate, the relevant date—in consonance with the existing law—would be the deceased's date of death, but the right of challenge would be available only if sequestration was awarded, or a judicial factor was appointed within seven months of that date. This proposal is intended to supersede the 1621 Act, which we recommend should be repealed.

Time within which alienations should be open to challenge

12.20 The next question that arises is the length of the relevant period or periods before sequestration (or the commencement of a similar process) for the purpose of the statutory challenge of alienations. The periods of one year and of three years suggested by the Working Party were regarded by some

²⁸Although we refer to a period preceding the date of the sequestration, we recommend that our proposals should extend to the case where the alienee completes his title (and thereby completes the alienation) *after* the date of sequestration.

consultees as being too short. A debtor may see the possibility of financial embarrassment resulting from liabilities which will emerge in the future (notably tax liabilities) and may plan to place his estate beyond the reach of prospective creditors in the event of his failure. In the case of a gift to a stranger a period of two years²⁹ strikes us as being an appropriate choice. In the case of relatives and close business associates of the debtor there is a still greater risk of transactions which may take the form of a gratuitous alienation but which are designed in reality to provide a fund for the donor in the event of his sequestration. We consider, therefore, that in the case of a gift to a "conjunct or confident" person³⁰—or as we propose to say, a person who has a family or business relationship with the insolvent—the period during which a gift may be open to statutory challenge should be longer. The choice of the period is not an easy one and it would clearly be unfair to permit the statutory challenge to operate when a considerable period may have elapsed between the making of the gift and the donor's insolvency. We consider, however, that a period of five years would be appropriate and so recommend. The 1621 Act did not precisely define the range of persons to whom it applied although this has been clarified to some extent by case law. We consider that it would be desirable to introduce a greater degree of certainty into the law and suggest that a person who has a family or business relationship with the debtor should refer to a person who in relation to the debtor—

- (a) is the wife or husband, a parent or child, a grandparent or grandchild, or a brother or sister (whether of full blood or half-blood or by affinity) and "child" includes an illegitimate child and the wife or husband of an illegitimate child;³¹ or
- (b) is a partner, employer or employee or a person otherwise standing in a position of trust or confidence in relation to the debtor's business or financial affairs.

Who may make the statutory challenge?

12.21 We have already noted³² that challenge under the 1621 Act may be made by any creditor whose debt was contracted before the date of the alienation. It might be suggested that a requirement of sequestration or its equivalent before the statutory challenge can be made would remove the need for individual creditors to retain their right of challenge, because the creditors will *ex hypothesi* be represented by a trustee in sequestration or a person similarly empowered to make the challenge. The reported cases show, however, that there may be circumstances where an individual creditor is the person mainly interested in the reduction of an alienation³³ or has an

²⁹This is similar to the period under English law, but our proposed scheme is less strict than that of English bankruptcy law, which does not admit solvency at the date of the "settlement" as a defence. See para. 12.13.

³⁰See para. 12.7.

³¹*Cf.* Sex Discrimination Act 1975 (c. 65), s. 82(5).

³²See para. 12.6.

³³See, e.g. *Bell v. Gow* (1862) 1 M. 183.

interest in the reduction adverse to that of the trustee.³⁴ Accordingly, it would be unsafe to exclude an individual creditor from the benefits of the statutory challenge. We recommend, therefore, that the statutory challenge should be available to any creditor in respect of a debt incurred by the debtor at any time before the date of the latter's sequestration or the equivalent events referred to in paragraph 12.19.

Married Women's Property (Scotland) Act 1920

12.22 The proviso to section 5 of the Married Women's Property (Scotland) Act 1920 permits donations between a man and his wife to be revocable by creditors of the donor when completed within a year and a day of sequestration. This provision (unlike the 1621 Act) does not admit proof of solvency of the donor at the date of the alienation as a relevant defence to an action by the creditors. We consider that this speciality is unjustified and recommend that in the interests of consistency and equality the proviso to section 5 should be repealed.

Gifts of money

12.23 We are not dissatisfied with the broad approach of Scots law to the specification of the transactions which may be challenged as gratuitous alienations. The dispositions, however, struck at by the Act of 1621 do not include cash payments³⁵ and we recommend that it should be made clear that gratuitous alienations include any form of transfer of property, including payments in cash. Cash payments were presumably originally exempt out of favour to donees, because they were likely to have been small in amount and to have been spent by the donee. In principle, however, it should make no difference whether a donee has received shares to the value of £1,000, or the sum of £1,000 to purchase shares of that value.

Prior obligation without consideration

12.24 In Scots law a promise to make a donation in the future creates a binding legal obligation on the promisor. To avoid the risk of evasion, we recommend that a transaction in implement of a prior obligation should be deemed to be without consideration to the extent that the prior obligation was itself undertaken for no consideration or for an inadequate consideration.

Protection for certain gifts

12.25 In some systems dispositions made in fulfilment of a moral obligation are exempt from challenge³⁶ and in others ordinary or customary gifts are protected from challenge. We have recommended that the statutory

³⁴See *Brown & Co. v. McCallum* (1890) 18 R. 311, a case concerned with the title of an individual creditor to reduce an illegal preference under the 1696 Act.

³⁵*Armour v. Learmonth* 1972 S.L.T. 150. According to the strict terms of the Act, the alienation must be constituted in writing.

³⁶There is authority in Scots law—Goudy, pp. 25, 49—for a similar exemption expressed in terms of gifts made in fulfilment of a natural obligation.

rules should apply only where “a significant part” of the donor’s estate is transferred:³⁷ this should effectively prevent the unfair challenge of conventional gifts of the usual kind. We also recommend that the protection afforded to the policies to which the Married Women’s Policies of Assurance (Scotland) Acts 1880³⁸ and 1980³⁹ apply should be retained.⁴⁰

Protection of third parties

12.26 Both under the common law and under the Act of 1621 a third party who takes from the donee in good faith is protected. The 1621 Act, however, provides that:

“... the ressaver off the pryce of the saidis Landis guidis and vtheris frome the buyer salbe haldin and obleisit to mak the same furthcuming to the behuiff of the bankruptis trew creditouris in payment of thair Lauchfull dettis.”

We make no recommendation for alteration of the substance of these provisions.

Forum of challenge

12.27 Section 8 of the 1913 Act provides that:

“Deeds made void by this Act, and all alienations of property by a party insolvent or notour bankrupt which are voidable by statute or at common law, may be set aside either by way of action or exception, and a decree setting aside the deed by exception shall have the like effect, as to the party objecting to the deed, as if such decree were given in an action at his instance: and this section shall apply as well in the sheriff court as in the Court of Session.”

It was assumed by Lewis,⁴¹ and apparently assumed by the Committee on the Sheriff Court (the Grant Committee)⁴² that section 8 extends the jurisdiction of the sheriff court to actions of reduction of the deeds to which it refers. This assumption is understandable, since otherwise section 8 would appear largely to duplicate Rule 50 of the sheriff court rules, but the assumption nevertheless appears to be incorrect. Section 8 is a mere restatement of the rules embodied in section 10 of the 1856 Act and in section 9 of the Bankruptcy and Real Securities (Scotland) Act 1857, and it was held in *Dickson v. Murray*⁴³ that these enactments did not render an action of reduction competent in the sheriff court, but merely enabled a party to object to such a deed by way of exception. This decision was followed in subsequent cases.⁴⁴ These cases, we take it, would still be in point because it

³⁷See para. 12.19.

³⁸c. 26.

³⁹c. 56.

⁴⁰See para. 12.10.

⁴¹*Sheriff Court Practice* 8th ed. (Edinburgh, 1939), p. 33.

⁴²Cmnd. 3248 (1967), paras. 119–120.

⁴³(1866) 4 M. 797.

⁴⁴*Moroney v. Muir and Sons* (1867) 6 M. 7; *Mackenzie v. Calder* (1868) 6 M. 833; *Brown's Trustees v. Fraser* (1870) 8 M. 820.

is generally accepted that the statutory jurisdiction of a court is not to be extended by implication.⁴⁵

12.28 It is a different question, however, whether the sheriff court ought to be conceded jurisdiction in actions to reduce alienations which are alleged to be voidable under the common law or under statutory bankruptcy rules. The Grant Committee, as explained above, assumed that the sheriff court did have such jurisdiction, and saw no objection to its retention, although otherwise it thought that reductions should continue to be exclusive to the Court of Session.⁴⁶ Though we consider that the sheriff court should continue to be the primary forum in matters of bankruptcy we have come to the conclusion that there are reasons of policy why actions of reduction, including an action for the reduction of a deed granting a gratuitous alienation, should remain a matter for the exclusive jurisdiction of the Court of Session. In our view, the legislation to follow on this Report should not disturb the present rules relating to the competence of either the Court of Session or the sheriff court. The sheriff court, therefore, would continue to exercise its jurisdiction where the issue of the validity of the alienation arises in an action which is not in form an action of reduction.

Application of proposals to companies registered under the Companies Acts

12.29 We have already referred to the doubts as to the construction of section 320 of the Companies Act 1948.⁴⁷ We see no reason why the liquidator of a company which is being wound up on account of insolvency should not enjoy exactly the same powers to challenge gratuitous alienations (whether under statute or at common law) as a trustee in sequestration. Nor do we see why, as in a sequestration, an individual creditor should not have the right to challenge a gratuitous alienation prejudicial to his own interests. We recommend, therefore, that the liquidator of a company which is being wound up on account of insolvency should have (with all necessary modifications) a right to challenge gratuitous alienations, whether at common law or under our proposals, similar to that of a trustee in a sequestration and that an individual creditor of such a company should have a similar right when his debt was contracted before the date of the sequestration.

Recall of orders for payment of capital sums on divorce

12.30 In our Memorandum No. 22 on "Aliment and Financial Provision" we considered⁴⁸ the effects of bankruptcy on orders for financial provision and, in particular, the problem created where an order by the court is subsequently shown to be unjustifiable having regard to the financial circumstances of the spouse against whom the order had been made. We expressed the view that such an order would not be challengeable under

⁴⁵Goudy, p. 34 summarily dismisses the idea that such actions are competent in the sheriff court.

⁴⁶Report, para. 120.

⁴⁷See para. 12.12.

⁴⁸Vol. 2, para. 3.94.

existing law as a gratuitous alienation or as a fraudulent preference. Our tentative conclusion was that the position was unsatisfactory and that:

“a transfer of property between spouses should not be immune from challenge as a gratuitous alienation at common law by reason only of the fact that the transfer has been made by or under an order of the court on divorce, but the Bankruptcy Act 1621 (under which alienations to ‘conjunct and confident persons’ are presumed in certain circumstances to be gratuitously made by an insolvent) should not apply to such a transfer.”

12.31 This proposal was accepted by those who offered comments upon it, though one well qualified commentator suggests that the question would rarely arise in practice and should be left, in effect, to be dealt with by the remedy of reduction available in the case of decrees impetrated by fraud. On re-examining the problem we are persuaded that it would not be appropriate to permit an order for the payment of a capital sum (or, should the law be amended to this effect, an order for the transfer of property between spouses) to be challenged as a gratuitous alienation. An alienation is not treated as being gratuitous in Scots law if it is made for a true, just, or necessary cause,⁴⁹ and it is at least arguable that, where the court has made an order for the payment of a capital sum by one spouse to the other, the cause (apart from cases where the court decree is reducible on the ground of fraud) must have been true, just or necessary. For this reason, it would be inappropriate to apply directly to such orders the ordinary rules for the reduction of gratuitous alienations.

12.32 The fundamental question in this context is whether the interests of the creditors on bankruptcy are to be given priority over the interests of the bankrupt's former spouse. Where, at the time the order was made, the paying spouse was insolvent or was rendered insolvent by the payment, it seems to us that priority should be given to the interests of the creditors whether or not the alienation would be regarded as a gratuitous one under the present law. Without prejudice to the powers of the Court of Session to reduce such decrees, it should be competent for the persons aftermentioned to challenge an order for the payment of a capital sum on divorce on the ground that the person against whom the order was made was insolvent at the time or was rendered insolvent by its implementation. Such a challenge should be competent only where the order was made within five years of the date of the sequestration (or its equivalent) or, in the case of a deceased debtor, his date of death. It should be open to the court to order the repayment of sums paid under the order. Such a challenge should be open to (1) a trustee in sequestration (including a trustee on the sequestrated estate of a deceased debtor when sequestration is awarded within the period of seven months after the date of death); (2) a trustee under a protected trust deed irrespective of its terms; or (3) a judicial factor appointed on the insolvent estate of a deceased debtor when the appointment is made within the period of seven months after the date of death.

⁴⁹See para. 12.9.

Preferences

Existing law

12.33 The law of Scotland, in addition to allowing the challenge of gratuitous alienations by insolvent debtors, permits a creditor to challenge voluntary transactions by which after the insolvency of a debtor, another creditor receives a preference. Mere threats on the part of a creditor to enforce payment by diligence do not make the transaction involuntary. Such a preference typically includes the payment of a debt not yet due or a transference of property in security (or further security) of an existing debt. Such a payment or transfer is not struck at as lacking onerosity, or on any literal application of the principle that on insolvency a debtor becomes a trustee for his creditors as a whole,⁵⁰ but rather on the view that it disturbs the principle of the fair treatment of the creditors *inter se* where there is insolvency.

12.34 For a challenge to be successful under the common law a creditor must establish that the payment or transference was voluntary and that at the time the debtor was absolutely insolvent and was aware of this. This might suggest that the challenging creditor must establish the awareness by the debtor of his insolvency, but the courts have readily permitted such awareness to be inferred from circumstances. Knowledge of the debtor's insolvency or collusion on the part of the preferred creditor need not be established.⁵¹ On the other hand, the creditor's knowledge of the debtor's absolute insolvency does not transform the payment of a debt into an unfair preference where the payment would not otherwise be so regarded.⁵² It is not wholly clear whether prior creditors alone have a title to challenge a preference under the common law, but it may be that there is no such restriction.⁵³ Such challenges as may still be made under the common law—and they are rare—are likely to be made in the course of a sequestration or liquidation, and here the trustee⁵⁴ or liquidator⁵⁵ is empowered to make the challenge. A trustee under a private trust deed for creditors may have a right of challenge deriving from that of the acceding creditors.⁵⁶

12.35 Experience of the operation of the common law rules showed that proof of the debtor's absolute insolvency at the date of the transaction was difficult to establish. In an attempt to cure this deficiency the 1696 Act, referring to the prevalence of frauds and abuses to the prejudice of creditors, declared that:

“... all and whatsoever voluntar dispositions assignations or other deeds which shall be found to be made or granted directly or indirectly

⁵⁰*Nordic Travel Ltd. v. Scotprint Ltd.* 1980 S.L.T. 189.

⁵¹*McCowan v. Wright* (1853) 15 D. 494; see also *Whatmough's Trustee v. British Linen Bank* 1932 S.C. 525 and 1934 S.C. (H.L.) 51.

⁵²*Nordic Travel*, above, per Lord President Emslie at 198.

⁵³*Bell, Comm.* ii. 195; Goudy, p. 42.

⁵⁴1913 Act, s. 9.

⁵⁵By inference from the 1948 Act, s. 245(5) and s. 320(1), (3). For the doubts as to the construction of s. 320 of the 1948 Act, see para. 12.12.

⁵⁶*Fleming's Trs. v. McHardy* (1892) 19 R. 542.

be the forsaid dyvor or Bankrupt either at or after his becoming Bankrupt or in the space of sixty days of befor in favors of any of his Creditors either for their satisfaction or farther Security in preference to other Creditors to be voyd and null.”

The period of 60 days was extended to six months by the Companies Act 1947,⁵⁷ but it should be noted that in the case of a deceased debtor, section 106 of the 1913 Act provides:

“When the sequestration of the estates of a deceased debtor is dated within seven months after his death ... any preference or security acquired for a prior debt by any act or deed of the debtor which has not been lawfully completed for a period of more than sixty days before his death ... shall ... be of no effect in competition with the trustee.”

Section 106 and the period of 60 days within it have been left unchanged by the 1947 Act.

12.36 The term “bankrupt” is used in the 1696 Act in the sense of notour bankrupt, an expression which that Act and subsequent bankruptcy Acts have defined.⁵⁸ Although the estate of a company registered under the Companies Acts is not liable to be sequestered,⁵⁹ the company may be rendered notour bankrupt to the effect of permitting the equalisation of diligence under section 10 of the 1913 Act and the reduction of preferences struck at by the 1696 Act.⁶⁰

12.37 It is not necessary under the Act of 1696 to establish intention on the part of the debtor to favour the creditor in fact preferred, or collusion on the part of the latter.⁶¹ It was early decided, however, that a title to challenge under the 1696 Act was restricted to creditors whose debts subsisted at the date when the preference was granted, although a trustee in sequestration has a title to challenge, whether representing prior creditors or not.⁶² A liquidator has a title to challenge⁶³ probably even where he does not represent prior creditors.⁶⁴ A trustee under a trust deed for creditors may challenge only if the trust deed confers a power of challenge and creditors having a title to challenge accede to the deed.⁶⁵ Though the 1696 Act refers only to “dispositions assignations or other deeds”, it has received a broad interpretation and applies to any transaction, direct or indirect, by which a creditor obtains a preference and is not limited to preferences created by deed.⁶⁶ Again, though the Act uses the expression “voyd and

⁵⁷s. 115(3) and see also 1948 Act, s. 320.

⁵⁸See 1913 Act, s. 5.

⁵⁹*Standard Property Investment Co. Ltd. v. Dunblane Hydropathic Co. Ltd.* (1884) 12 R. 328.

⁶⁰*Clark v. Hinde, Milne & Co.* (1884) 12 R. 347.

⁶¹*Blinco's Tr. v. Allan* (1828) 7 S. 124, (1833) 7 W. & S. 148.

⁶²1913 Act, s. 9.

⁶³*Clark v. West Calder Oil Co.* (1882) 9 R. 1017.

⁶⁴1948 Act, s. 245(5) and s. 320(1), (3). See also para. 12.12.

⁶⁵*Fleming's Trs. v. McHardy* (1892) 19 R. 542; *McLaren's Trs. v. National Bank* (1897) 24 R. 920.

⁶⁶See Goudy, p. 78.

null", the courts have construed it to mean merely that the transaction is "voidable".⁶⁷

12.38 The most important feature of the construction of the Act has been the emphasis placed by the courts on the voluntary nature of the transaction. In the first place, challenge is excluded as it also is at common law in the case of (1) *nova debita* (transactions where the bankrupt and another party have undertaken reciprocal obligations); (2) cash payments of debts actually due; and (3) transactions in the ordinary course of trade or business. Such transactions and payments are completely protected unless they form part of a collusive arrangement to create a preference. The rational basis of these exceptions was stated by Lord President Inglis in *Anderson's Trustee v. Fleming*.⁶⁸

"It would be a very unfortunate thing for the trade of this country if such exception did not exist; because if the Act of 1696 were allowed to extend to all the ordinary transactions of traders, not contemplating bankruptcy, and not aware of their being insolvent, it would disturb their business relations to a most calamitous extent. A man may go on trading in the honest belief of his own solvency, and that even up to the date of bankruptcy, and his ordinary transactions will not be held to fall under the operation of this statute. The law is fixed, both in expediency and equity, that they shall not be so."

12.39 The position is more complicated where the debtor has taken action within the period of challenge to fulfil an obligation which he has already assumed. A common case is where, following an arrestment placed by a creditor, the debtor arranges to pay the debt by means of a mandate granted to the arrestee. In one sense such a payment is a voluntary payment, since the debtor could have allowed the arrestment to proceed to a furthcoming. The alternative view is that he is merely anticipating the inevitable. It is not easy to find a clear line of authority in the decisions as to whether or not any such payment is or is not protected either as a cash payment or as being made involuntarily.⁶⁹

12.40 Where the transaction is one in which, even to implement a pre-existing obligation, the debtor grants security or further security for a pre-existing debt, the court is likely to reduce the transaction.⁷⁰ It is otherwise, however, when the transfer of the security is part of the same transaction as the loan. In *Stiven v. Scott and Simson* Lord Kinloch remarked:⁷¹

"I hold the principle to be firmly established that wherever, on an advance of cash, a simultaneous engagement is made to give a specific

⁶⁷*Drummond v. Watson* (1850) 12 D. 604.

⁶⁸(1871) 9 M. 718 at 722.

⁶⁹*Taylor v. Farrie* (1855) 17 D. 639 at 649; *Richmond v. United Collieries Ltd.* (1905) 12 S.L.T. 741; *Craig v. Hunter and Son* (1905) 13 S.L.T. 525; *Newton and Sons' Trustee v. Finlayson & Co.* 1928 S.C. 637; *Robertson's Tr. v. P. & W. MacLellan Ltd.* 1957 S.L.T. (Sh. Ct.) 65; *Walkraft Paint Co. Ltd. v. Lovelock* 1963 S.L.T. (Notes) 6; 1964 S.L.T. 103.

⁷⁰*Barclay v. Cuthill* 1961 S.L.T. (Notes) 62; *MacArthur v. Campbell's Tr.* 1953 S.L.T. (Notes) 81; *Clydesdale and North of Scotland Bank v. Crosbie's Tr.* 1953 S.L.T. (Sh. Ct.) 29.

⁷¹(1871) 9 M. 923 at 935.

security for the specific advance, such security may be validly completed within sixty days of bankruptcy.”

The basis of this distinction had previously been stated by the consulted judges in *Taylor v. Farrie*⁷² as follows:

“We think that by [the 1696 Act] the legislature did not intend to disable persons, in the predicament therein set forth, from fairly paying their debts as these became payable—or from fairly and strictly performing their obligations *ad factum praestandum*, as these became pretable. It is legally necessary for such obligants so to pay their debts and to perform their obligations; and it was not the object of the statute to disable them from doing without compulsion what the law itself would compel them to do. What the legislature intended by the statute was to disable a debtor, who is in the predicament therein set forth, and unable to pay his debts, from entering spontaneously into some new transaction with a favoured creditor, whereby in lieu of—or as a substitute for—regular payment of a debt in cash, the debtor grants, and the creditor receives, a transference of some other funds or effects forming part of the debtor’s estate. We think that such was the object and intention of the legislature, and that it gave effect to that object and intention, by prohibiting persons in that predicament from making voluntary deeds (*i.e.* deeds which they could not have been compelled to make) in satisfaction of (*i.e.* as a substitute for) a prior debt.”

12.41 The 1696 Act does not limit the period *after* the constitution of notour bankruptcy of the debtor within which the grant by him of an unfair preference remains prohibited. The period persists so long as the debtor remains insolvent. This feature of the 1696 Act was criticised by Bell,⁷³ and subsequently Goudy remarked:⁷⁴

“... it would be an improvement on the law if the bankruptcy were in this case also restricted in its effects to a fixed period, as it is plain that to fasten the character of notour bankruptcy on a person for an indefinite period of time, without any public notification of his condition or divestiture of his estate, must frequently give rise to considerable hardship to creditors, as well as injury to the debtor himself.”

English law

12.42 In England, the common law provided that a payment made by a debtor which was designed to favour or prefer a particular creditor was voidable on the bankruptcy of the debtor if it prejudiced other creditors. The principle upon which this rule proceeded was that the object of bankruptcy law was to secure the equal division of the bankrupt’s property among his creditors and that such a payment conflicted with that object. The common law was eventually placed on a statutory basis and is now embodied principally in section 44 of the 1914 Act, subsections (1) and (2) of which provide:

⁷²(1855) 17 D. 639, at 649.

⁷³*Comm.* ii. 169.

⁷⁴At p. 76.

- “(1) Every conveyance or transfer of property, or charge thereon made, every payment made, every obligation incurred, and every judicial proceeding taken or suffered by any person unable to pay his debts as they become due from his own money in favour of any creditor, or of any person in trust for any creditor, with a view of giving such creditor, or any surety or guarantor for the debt due to such creditor, a preference over the other creditors, shall, if the person making, taking, paying or suffering the same is adjudged bankrupt on a bankruptcy petition presented within six months after the date of making, taking, paying or suffering the same, be deemed fraudulent and void as against the trustee in bankruptcy.
- (2) This section shall not affect the rights of any person making title in good faith and for valuable consideration through or under a creditor of the bankrupt.”

Independently of this provision, preferences to creditors may be susceptible to challenge within the normal limitation periods where intent to defraud can be established, notably under section 172 of the Law of Property Act 1925.⁷⁵

12.43 Section 44 presents a number of problems analysed by the Blagden Committee,⁷⁶ in particular the fact that, while the action is taken against the creditor preferred, in order to succeed the trustee must prove an intent in the mind of the debtor, who is not himself a party to the proceedings.⁷⁷ They proposed, as a partial solution of this problem, that the requirement of proof of intent to prefer should be waived in relation to preferences created within 21 days before the presentation of a bankruptcy petition.

Proposals for reform

General structure of the law

12.44 Our Working Party proposed that the challenge of unfair preferences under the common law should no longer be permitted.⁷⁸ They envisaged instead that every voluntary preference created by a debtor within the year prior to his public insolvency should be reducible, and that no other challenge should remain. We consider, however, that there would remain a need for the challenge of preferences created outside that period. The common law allows challenge of voluntary preferences on the ground of fraud—the debtor intending to prejudice other creditors—or on the ground of constructive fraud without limit of time apart from the rules of prescription. Fraud is inferred where a debtor voluntarily pays a debt not yet due or grants security for payment of a debt at a time when he is insolvent and is aware of that insolvency. Despite the fact that the debtor’s insolvency

⁷⁵c. 20.

⁷⁶See Report, pp. 39–41.

⁷⁷See *Peat v. Gresham Trust Ltd.* [1934] A.C. 252, per Lord Tomlin at 262. The Blagden Committee remarked of s. 44 “There is perhaps no provision in bankruptcy law that has given rise to so much litigation as that relating to a payment made by a debtor with intent to prefer a particular creditor.”

⁷⁸Memo. No. 16, pp. 14–15.

at the date of creation of the preference and his knowledge of his insolvency may be difficult to prove, it is thought that these rules of common law are of some utility and that, with only minor modifications,⁷⁹ they should be retained. We so recommend.

12.45 Our Working Party considered that the rules relating to the cutting down of gratuitous alienations and unfair preferences should so far as possible be similar—hence their proposal that preferences given within the year prior to the debtor's notour bankruptcy or (as they proposed to call it) the debtor's public insolvency should be reducible.⁸⁰ Again, we are in agreement with the general objective of the Working Party but we do not think that the extension of the period of vulnerability to the statutory challenge from six months to one year is justified, and for reasons which we have already given⁸¹ are opposed to determining that period by reference to the debtor's public insolvency. The latter objection, of course, applies also to the scheme of the 1696 Act. The Act, as we have noted, is also unsatisfactory in permitting, without any limitation in time, the statutory challenge of unfair preferences granted *after* the constitution of notour bankruptcy.⁸² Like the Working Party, therefore, though for different reasons, we recommend that the 1696 Act should be repealed and replaced by a provision that every unfair preference should be reducible when granted during the period of six months preceding the date of the sequestration of a living debtor's estate or the date of his granting a trust deed for his creditors that subsequently becomes a protected trust deed or, in the case of the sequestration of the estate of a deceased debtor or the appointment of a judicial factor on his insolvent estate occurring in either case within seven months after his death, during the period of six months preceding his date of death.⁸³

Voluntary nature of preference

12.46 We envisage that, under our proposals for the challenge under statute of preferences, the transactions excluded from challenge should be the same as under existing law. In particular, for the reasons given by Lord President Inglis in the passage cited above,⁸⁴ we recommend that *nova debita*, cash payments and transactions in the ordinary course of trade should continue to be exempt from challenge. We have noted that the position is not free from doubt where a debtor, after the arrestment of property belonging to him, grants a mandate for the transfer of the arrested property to the arrester,⁸⁵ in order to avoid the expense of further diligence.

⁷⁹The only alteration of substance to the common law that we propose is that the right to challenge voluntary preferences at common law should (as in the case of the challenge of gifts) be extended to a trustee under a protected trust deed and to a judicial factor on the insolvent estate of a deceased debtor—see paras. 12.16, 12.19.

⁸⁰Memo. No. 16, pp. 14–15.

⁸¹See paras. 12.17 and 12.18.

⁸²See para. 12.41.

⁸³*Cf.* 1913 Act, s. 106.

⁸⁴See para. 12.38.

⁸⁵See para. 12.39.

The reported cases on this subject disclose unusual circumstances, and while we are disposed to recommend that in the interests of certainty the law should be clarified to the extent of exempting such a mandate from challenge as an unfair preference, there must be safeguards against abuse. We consider that there must be a decree for payment in favour of the arresting creditor, preceded by an arrestment on the dependence of the action or followed by an arrestment in execution of the decree, of a debt or other sum of money payable to the debtor (and not an arrestment of corporeal moveable property). Where these requirements are satisfied, the granting of a mandate authorising payment of the whole or part of the arrested fund to the arrester should not *of itself* constitute the creation of an unfair preference, though it would remain open to challenge if there were evidence of some design to defeat the rights of the creditors as a body. We recommend accordingly. We do not intend by this recommendation to prejudice the right of a trustee in sequestration to recover a payment from an arrester where the arrestment which results in the payment is rendered ineffectual by a supervening sequestration.

Who should be entitled to challenge unfair preferences?

12.47 There remain for consideration a number of questions of detail, and the first of these is the question of the entitlement to challenge unfair preferences. For reasons similar to those we have already stated⁸⁶ in the context of gratuitous alienations, we recommend that the statutory challenge should be available to (1) a trustee in sequestration (including a trustee on the sequestrated estate of a deceased debtor when sequestration is awarded within the period of seven months after the date of death); (2) a trustee under a protected trust deed irrespective of the terms of the deed; (3) a judicial factor appointed on the insolvent estate of a deceased debtor when the appointment is made within the period of seven months after the date of death; and (4) any creditor of the debtor irrespective of the date when his debt was contracted.

Protection of third parties

12.48 We recommend that there should be express protection for a third party who acquires the subject of the preference from the preferred creditor in good faith and for value. It should be provided that the preferred creditor is in such a case liable to account for the proceeds resulting from his disposal of the property.

Forum of challenge

12.49 For reasons similar to those which we advanced in the context of gratuitous alienations,⁸⁷ the present rules relating to the competence of the Court of Session and of the sheriff courts in the challenge of unfair preferences should remain undisturbed.

⁸⁶See paras. 12.16 and 12.19.

⁸⁷See paras. 12.27 and 12.28.

Application of proposals to companies registered under the Companies Acts

12.50 As with challenges of gratuitous alienations,⁸⁸ we see no reason why the liquidator of a registered company which is being wound up on account of insolvency, or an individual creditor of that company, should not enjoy powers to challenge unfair preferences (whether under statute or at common law) similar to those conceded to a trustee in sequestration. We recommend, therefore, that section 320 of the 1948 Act (which relates to the reduction of unfair preferences created by a company) should be amended accordingly, and that the liquidator as well as any individual creditor of a company should be entitled to challenge unfair preferences at common law.

12.51 There is a speciality in the case of a floating charge created by a company. Section 322(1) of the 1948 Act provides that such a charge is invalid in whole or in part where it is created within 12 months of the commencement of a winding-up unless it is proved that the company was solvent immediately after the creation of the charge. There was previously some doubt as to whether a floating charge could be challenged as a fraudulent preference only under section 322(1) of the 1948 Act, or whether challenge under the common law also remained and, in consequence, we recommended in 1970 that this doubt should be removed.⁸⁹ Section 322 was, therefore, expanded⁹⁰ to provide that a floating charge was reducible only under section 322(1). We now consider, however, that in the interests of a consistent and logical scheme for the reduction of alienations and preferences, this limitation upon the grounds of challenge of a floating charge should be removed. It should be challengeable on the same grounds (and on no other grounds) as any other alienation or preference. We recommend, therefore, that section 322 of the 1948 Act be repealed.

⁸⁸See para. 12.29.

⁸⁹See paras. 31 and 32 of *Report on Companies (Floating Charges) (Scotland) Act 1961—* (1970) Cmnd. 4336; Scot. Law Com. No. 14.

⁹⁰By the addition of subsection (3)—see *Companies (Floating Charges and Receivers) (Scotland) Act 1972 (c. 67), s. 8.*

CHAPTER 13

THE EFFECTS OF INSOLVENCY ON DILIGENCE

Introduction

13.1 In the absence of provision to the contrary, an advantage at the expense of the general body of creditors might be secured not only by a person receiving a gift from the debtor or by a creditor receiving payment before payment is due, but also by a creditor enforcing his debt by diligence against funds or assets belonging to the debtor. Scots law eliminates inequalities which would otherwise arise from such use of diligence in three ways: namely, (a) by the equalisation of some forms of diligence (adjudications, arrestments and poindings) outside sequestration; (b) by the equalisation or reduction of these forms of diligence in the event of sequestration; and (c) by the suspension of diligence during sequestration.

Equalisation of diligence outside sequestration

13.2 Scots law is unusual among legal systems in creating rules for the *pari passu* ranking of creditors on the proceeds of diligence outside sequestration. These rules were designed to discourage a race of diligence among creditors, which might precipitate or aggravate the debtor's insolvency and lead to greater inequalities among the unsecured creditors. Independently of sequestration, provision is made for the *pari passu* ranking of creditors on the proceeds of adjudications for debt, arrestments and poindings. In the case of the two most common forms of diligence, arrestments and poindings, equalisation depends on notour bankruptcy.¹ Under section 10 of the 1913 Act, poindings and arrestments used within 60 days before or four months after the constitution of notour bankruptcy rank equally "as if they had all been used of the same date". The section further provides that any creditor producing in that period a decree for payment or liquid grounds of debt shall be entitled to rank as if he had executed an arrestment or a poinding. Section 10 does not expressly refer to the hybrid diligence of arrestment and sale of a ship, but in two sheriff court cases the provisions of section 10 (and its predecessor) have been applied to the diligence.² Provision similar in principle but different in detail is made for the equalisation of adjudications for debt,³ which are, however, now uncommon. The equalisation of adjudications is unrelated to notour bankruptcy and operates only in favour of creditors actually adjudging before or within a year and a day after an effectual adjudication, not in favour of creditors who merely hold decrees or liquid grounds of debt.

¹An incorporated company may be made notour bankrupt and is therefore subject to the normal rules for the equalisation of diligence—*Clark v. Hinde, Milne & Co* (1884) 12 R. 347.

²*Harvey v. McAdie* (1888) 4 Sh. Ct. Rep. 254 (construing s. 12 of the 1856 Act); *Munro v. Smith* 1968 S.L.T. (Sh. Ct.) 26.

³Under the Diligence Act 1661 (c. 34, in 12 mo. ed. c. 62) and the Adjudications Act 1672 (c. 45, in 12 mo. ed. c. 19).

13.3 The rules for equalisation of diligence outside sequestration apply only to arrestments (including, it appears, arrestments and sales of ships) and poindings and adjudications for debt. Equalisation is not suited to other forms of diligence for a number of reasons. An inhibition, for example, is merely a preventive diligence, and although it secures to the inhibiting creditor a preference on sequestration, no payment is recovered outside sequestration so that there is no fund on which other creditors could claim a *pari passu* ranking. Other forms of diligence against property and income are available only to particular classes of creditors, so that no question of competition or equalisation of diligence can arise. Examples of such forms of diligence are sequestration for rent under the landlord's hypothec and the heritable creditor's remedies of poinding of the ground and action of maills and duties.

13.4 The equalisation of arrestments and poindings under section 10 of the 1913 Act depends upon the constitution of notour bankruptcy. In our recommendations for the restatement of the conditions for sequestration, we have proposed that the concept of notour bankruptcy should be replaced by that of "apparent insolvency". The new concept is in essence the same as its predecessor, although we have recommended an expansion of the circumstances by which it can be constituted.⁴

13.5 The case law suggests that section 10 of the 1913 Act is most often invoked in sequestrations and liquidations, and it was proposed to us that, in view of the provisions of sections 103 and 104 of the 1913 Act for the equalisation or reduction of diligence where there is a sequestration process and the corresponding provisions relating to liquidation in the 1948 Act, section 10 was hardly necessary and could with advantage be repealed. It certainly complicates the law and does not necessarily secure equality among *all* the unsecured creditors. We have, however, received submissions that section 10 is invoked outside sequestrations and liquidations sufficiently frequently to justify its retention, especially in relation to arrestments by commercial creditors. In the light of this conflict, we intend to consult more widely in the context of our examination of the law of diligence on the question whether the section should be repealed or retained and, if retained, whether provision should be made for the removal of certain apparent doubts and anomalies which have been identified.

13.6 We have proposed⁵ that the granting by a debtor of a trust deed for his creditors combined with his practical insolvency should constitute apparent insolvency. The effect of this will be that arrestments and poindings executed within the period of 60 days preceding the granting of a trust deed will be equalised. A trust deed for creditors may contain a provision to the effect that creditors acceding to the deed will surrender preferences acquired by arrestments or poindings during the abovementioned period of 60 days.

⁴See paras. 5.18–5.20. If our recommendations in Chapter 12 are accepted, sequestration or its equivalent will replace notour bankruptcy (and hence also apparent insolvency) as the prerequisite for the statutory challenge of an unfair preference.

⁵Para. 5.20.

Our proposals envisage that, when a trust deed for creditors becomes a “protected” trust deed, non-acceding creditors will be placed in relation to the recovery of their debts in substantially the same position as acceding creditors. Accordingly, where any trust deed contains such a provision the effect will be that, when the trust deed becomes a “protected” trust deed, all creditors will be put on an equal footing with any creditor who has executed an arrestment or poinding within the period of 60 days before the granting of the deed, whether or not that creditor has actually acceded to it.

Equalisation or reduction of prior diligence on sequestration

Introduction

13.7 Whatever view may ultimately be taken of the need for the equalisation of diligence outside sequestration, in our opinion sequestration should continue to be placed upon an equal footing with diligences effected within a short period preceding its date. The justification for retaining this principle is simply that embodied in the 1772 Act⁶ which, with reference to the diligences of arrestment and poinding, proceeded on the narrative that:

“... the personal estates of such debtors as become insolvent are generally carried off by the diligences of arrestment and poinding, executed by a few creditors who, from the nearness of their residence to, and connection with such debtors, get the earliest notice of their insolvency, to the great prejudice of creditors more remote and unconnected, and to the disappointment of that equality which ought to take place in the distribution of estates of insolvent debtors among their creditors.”

If, as we believe, this justification remains valid and is applicable to other diligences, we consider that, with the minor amendments which we later propose, the substance of the present law should be retained, and we so recommend. In the discussion which follows, which is concerned with certain questions of detail, it is implicit that we recommend the retention of the present law unless a specific recommendation to a different effect is made.

Adjudications

13.8 The equalisation of adjudications operates, as we have noted,⁷ in favour of creditors adjudging before or within a year and a day after an effectual adjudication. Equalisation of adjudications arises independently of notour bankruptcy or of sequestration, but section 103 of the 1913 Act provides that:

“The sequestration shall, as at the date thereof, be equivalent to a decree of adjudication of the heritable estates of the bankrupt for payment of the whole debts of the bankrupt ...”

A provision similar to section 103 applies in the liquidation of an incorporated company.⁸ Accordingly, where sequestration or liquidation

⁶12 Geo. 3, c. 72.

⁷See para. 13.2.

⁸1948 Act, s. 327(1) (b).

occurs not later than a year and a day after an effectual adjudication, the general body of creditors are put on the same footing as any antecedent adjudger or adjudgers (who thereby effectively lose their preferential rights in the heritable estate of the bankrupt or the insolvent company). In our opinion the present law should be retained. While, arguably, it is anomalous that the period for the equalisation of adjudications is as long as one year while the maximum period for the equalisation of arrestments and poindings is six months (and the period may be as short as 60 days), we cannot recommend that these periods be altered for the purposes of sequestration (or liquidation) while they remain unaltered for equalisation of diligence outside sequestration. This would be likely to introduce anomalies and inconsistencies into what is already a complex branch of the law. We make no recommendations, therefore, for the alteration of the present law.

Arrestments and poindings

13.9 The equalisation of arrestments and poindings, unlike the equalisation of adjudications, comes into play only on the constitution of notour bankruptcy. Section 10 of the 1913 Act provides that poindings and arrestments used within 60 days before or four months after the constitution of notour bankruptcy rank equally "as if they had all been used of the same date". Equalisation of arrestments and poindings arises independently of sequestration, but an award of sequestration during the period of equalisation nevertheless has important consequences for the equalisation process. This results from the provision in section 104 of the 1913 Act that:

"The sequestration shall, at the date thereof, be equivalent to an arrestment in execution and decree of furthcoming, and to an executed or completed poinding."

Accordingly, the combined effect of sections 10 and 104 of the 1913 Act will be to equalise the sequestration with any arrestment or poinding occurring within the same equalisation period. This, in effect, means that all the creditors represented by the trustee in the sequestration are put on the same footing and entitled to the same ranking on the arrested or poinded property as an actual arrester or poinder.⁹

13.10 Section 104 of the 1913 Act also provides that:

"no arrestment or poinding executed of the funds or effects of the bankrupt on or after the sixtieth day prior to the sequestration shall be effectual."¹⁰

Accordingly, where the first constitution of notour bankruptcy is its constitution by an award of sequestration, section 10 and section 104 operate to produce the same result: section 10 equalises the sequestration with any arrestment or poinding executed within the period of 60 days preceding the sequestration, and section 104 renders any such arrestment or poinding ineffectual to secure a preference for the arrester or poinder.¹¹ But, where

⁹*Stewart v. Jarvie* 1938 S.C. 309.

¹⁰There is a similar provision in s. 327(1) (a) of the 1948 Act.

¹¹See *Dow v. Union Bank* (1875) 2 R. 459.

there has been an antecedent constitution of notour bankruptcy within the period of four months preceding an award of sequestration, the combined effect of the two sections is to equalise the sequestration with any arrestment or poinding executed on or after the sixtieth day before the earlier constitution of notour bankruptcy.¹² We propose that the substance of these provisions should be retained.

Deceased debtors

13.11 Where the sequestration of the estates of a deceased debtor is dated within seven months after his death, section 106 of the 1913 Act renders of no effect preferences acquired by legal diligence on or after the sixtieth day before the debtor's death. Although the general expression "legal diligence" is used, it would seem that the provision is directed principally if not entirely at arrestments and poindings. This is entirely appropriate. But it would seem inappropriate that adjudications should be rendered ineffectual (or equalised) only where they are executed within 60 days before the date of death. Where a living debtor's estate is sequestrated, the sequestration is equalised with adjudications within the year preceding the date of sequestration. The position should not differ materially where the estate of a deceased debtor is sequestrated within seven months of his death, that is, adjudications within the year preceding the date of death should be rendered ineffectual. We recommend accordingly. We further recommend that these provisions for the cutting down of diligence where there is an award of sequestration within seven months after the date of a debtor's death should also be applied where there is an appointment of a judicial factor within that period and the estate was insolvent at the date of death.

13.12 Section 104 of the 1913 Act provides that:

"... no arrestment or poinding executed of the funds or effects of the bankrupt on or after the sixtieth day prior to the sequestration shall be effectual;¹³ and such funds or effects, or the proceeds of such effects, if sold, shall be made forthcoming to the trustee."

Doubts have arisen as to the limits of the application of this provision in relation to both arrestments and poindings. In the case of arrestments, the interpretation of section 104 and its counterpart section 327(1)(a) of the 1948 Act has, arguably, been too favourable to arresters. In *Johnston v. Cluny Estates Trustees*,¹⁴ an action by the liquidator of a company for recovery of payment from an arrester, the court held that section 327(1)(a) of the 1948 Act (and inferentially also section 104 of the 1913 Act) applied only to an arrestment that was actually subsisting at the date of commencement of winding-up (or of sequestration) and had therefore no application where the arrestment had been superseded by payment and was no longer subsisting at that date. It may seem harsh that a creditor who has executed an arrestment

¹²For an illustration of this effect of s. 10, see *Stewart v. Jarvie* 1938 S.C. 309.

¹³"Effectual" has the qualified meaning of effectual to secure a preference for the arrester or poider in a question with the trustee. The trustee succeeds to the benefit of the arrestment in a question with the arrestee—*Dow & Co. v. Union Bank* (1875) 2 R. 459, 462.

¹⁴1957 S.L.T. 293.

and received payment of his debt from the arrested fund (whether by a forthcoming or by mandate) should be required to surrender the payment to the trustee for the benefit of the creditors; but the decision in *Johnston* unduly favours the prosecution of diligence at a time when the debtor may well be irretrievably insolvent. The question, however, relates rather to the law of diligence than to that of bankruptcy, and we propose to examine it in the context of our review of the law of diligence.

13.13 In the case of poindings, conversely, the present law may be unduly harsh to the pointer. It is not entirely clear at what stage in the process of pointing of moveables the pointing creditor obtains a right over the pointed goods which will entitle him to receive satisfaction or part satisfaction of his debt from the proceeds of the pointed goods before any other claim can rank upon these proceeds. Section 104 of the 1913 Act, in providing that sequestration renders certain poindings ineffectual, refers to a "pointing executed ... on or after the sixtieth day prior to the sequestration". It has been an open question for a century and a half whether a pointing is held to be "executed" for this purpose at (a) the date of execution of the pointing (when the officer "adjudges" the goods to belong to the pointing creditor) or (b) only when the report of the sale is lodged, or there is delivery of the goods to the creditor.¹⁵ We think that this doubt in the law should be resolved and again propose to examine it in the course of our review of the law of diligence.

Inhibitions

13.14 Though in principle an inhibition is a protective diligence only and does not divest the debtor of any of his property, on the debtor's sequestration the inhibitor is entitled to receive the same dividend from the heritable property as he would have received if no debts affecting it had been created after the date of the inhibition.¹⁶ This is achieved by a complicated process which, in effect, results in the inhibitor being compensated for any shortfall in his dividend at the expense of posterior creditors.¹⁷ It would

¹⁵Support for this latter view is found in *Tullis v. Whyte* 18 June 1817 F.C.; *Samson v. McCubbin* (1882) 1 S. 407; *Wm. S. Yuile Ltd. v. Gibson* 1952 S.L.T. (Sh. Ct.) 22. The former view appears to receive recognition in *New Glenduffhill Coal Co. Ltd. v. Muir & Co.* (1882) 10 R. 372; *Galbraith v. Campbell's Trustees* (1885) 22 *Scottish Law Reporter* 602; *Bendy Bros. Ltd. v. McAlister* (1910) 26 Sh. Ct. Rep. 152.

¹⁶1913 Act, s. 97(2).

¹⁷*Bell, Comm.* ii. 346; see also *Baird and Brown v. Stirrat's Trustee* (1872) 10 M. 414 at 419. Lord President Inglis said that:

"The rule contemplates an inhibiting creditor, creditors whose debts were contracted prior to the inhibition, and creditors whose debts were contracted subsequent to the inhibition. All those creditors adjudge within year and day of one another, so that it does not matter which is the leading adjudication. In respect of their adjudications they all rank *pari passu*. But the inhibiting creditor has a preference over those whose debts were contracted subsequent to the inhibition. The prior creditors are to be neither hurt nor benefited by the inhibition. In these circumstances the clear and equitable rule of ranking was established, that the inhibitor's preference must be secured to him entirely at the expense of the subsequent creditors, while creditors whose debts were contracted prior to the inhibition draw just what they would have done had the whole creditors being ranked *pari passu*."

appear that an inhibitor would enjoy a like preference in a liquidation as in a sequestration.¹⁸

13.15 It seems to us that where an inhibition is in competition with a subsequent sequestration, the inhibition should be treated in much the same way as an arrestment or poinding. In particular, where the inhibition is of recent creation, the principle of equality among creditors seems to us to have stronger claims to recognition than the principle that the inhibitor should be protected against future debts affecting the debtor's heritable property. We recommend, therefore, that inhibitions which take effect within a specified period before sequestration¹⁹—we envisage the same period (at present 60 days) as that within which arrestments and poindings are rendered ineffectual—should be ineffectual to create any preference in the sequestration for the inhibitor. The trustee, on behalf of all the creditors, would, however, succeed to any rights of the inhibitor in a question with any person taking prior to the sequestration rights in the debtor's heritable property in contravention of the terms of the inhibition. We make no recommendation that an inhibitor whose inhibition is rendered ineffectual should be entitled to claim a preference in respect of the expenses of his diligence. An inhibition—unlike an arrestment or poinding—does not affect particular property from which these expenses can appropriately be met. We would add that where an inhibition is not rendered ineffectual the inhibitor should (as under existing law) be entitled to receive the same dividend as he would have received if no debts affecting the debtor's heritable property had been created after the taking effect of the inhibition. We also recommend that there should be express provision to the same effect in relation to the liquidation of an incorporated company.

Arrestment of a ship

13.16 Section 104 of the 1913 Act provides that “no arrestment or poinding executed ... on or after the sixtieth day prior to the sequestration shall be effectual”. There is no express reference to the arrestment and sale of a ship (although section 10, which likewise has no reference to the arrestment and sale of a ship, has been held to apply to it).²⁰ Although this diligence presents special features, being closer to a poinding than to an ordinary arrestment, its effect in withdrawing assets from the debtor's estate is essentially the same as a poinding or ordinary arrestment. Where the sequestration of the debtor's estate (or the commencement of winding-up) follows within a short period after the arrestment of a ship belonging to the

¹⁸There is no direct authority for the proposition but it appears to follow from the fact that a winding-up is “equivalent to a decree of adjudication of the heritable estates of the company for payment of the whole debts of the company”. This view finds support in *Graham Stewart*, p. 567.

¹⁹Where the registration of the inhibition in the Register of Inhibitions and Adjudications is preceded by registration of a notice of inhibition, the inhibition takes effect from the date of registration of the notice provided that registration of the inhibition and of the execution thereof follow within a period of 21 days from the date of registration of the notice (*Titles to Land Consolidation (Scotland) Act 1868* (c. 101), s. 155).

²⁰See para. 13.2.

debtor, we consider that the arrestment should fall, and we so recommend. The period, we consider, should be the same as that prescribed in the case of other arrestments, at present 60 days.

Poinding of the ground and actions of maills and duties

13.17 The next processes of diligence to be considered are poinding of the ground and actions of maills and duties. Poinding of the ground is a diligence open to a creditor holding a *debitum fundi* such as a superior or a heritable creditor. It enables the creditor to attach moveables on the heritable property affected by the diligence. The underlying principle is that the creditor is merely giving effect to a pre-existing right arising by virtue of his *debitum fundi*, and accordingly no competition of diligence can arise between creditors poinding the ground, since they have priority according to the dates of their respective infestments. For the same reason there can be no competition of diligence between those creditors and creditors in an ordinary poinding. An action of maills and duties is available to a secured creditor whose security includes an assignation of rents. The creditor becomes vested in the landlord's rights and accordingly may recover rents and exercise the landlord's right of hypothec. A standard security contains no assignation of rents but, under the Conveyancing and Feudal Reform (Scotland) Act 1970,²¹ the creditor has, on default by the debtor, a right to enter into possession of the security subjects and receive or recover *inter alia* the rents.²² Accordingly, actions of maills and duties—which are already rare—will eventually wither away.

13.18 The original approach of Scots bankruptcy law to poindings of the ground and actions of maills and duties was to leave undisturbed the priority which they enjoyed at common law. Section 95 of the 1839 Act, however, altered the law in relation to both processes by providing that a poinding of the ground not carried into execution by sale of the effects, or a decree of maills and duties on which no charge had been given, at least 60 days before the sequestration, should not be available in any question with the trustee except in respect of the interest on the debt for the current half-yearly term and of the interest remaining due for the year immediately before that term. This provision, re-enacted in section 118 of the 1856 Act, was repealed by section 55 of the Conveyancing (Scotland) Act 1874²³ but restored by section 3 of the Conveyancing (Scotland) Act 1874, Amendment Act 1879²⁴ in relation to poindings of the ground alone. This provision is now contained in section 114 of the 1913 Act and section 327(1)(d) of the 1948 Act.

13.19 It may seem anomalous that whereas an action of maills and duties is now unaffected by a sequestration, a poinding of the ground is again affected by it as explained above. But an action of maills and duties, which puts a heritable creditor in the position of the landlord in relation to his

²¹c. 35. See s. 11, and Sched. 3, standard condition 10(3).

²²For a discussion of the position under a standard security, see Halliday, *The Conveyancing and Feudal Reforms (Scotland) Act 1970*, 2nd ed. (Edinburgh, 1977), p. 197.

²³c. 94.

²⁴c. 40.

tenants, has a natural connection with the debtor's heritable property, whereas the remedy of poinding of the ground is directed not at the debtor's heritable property but at moveables on the property. This, we think, justifies to some extent the different effects of sequestration upon an action of maills and duties and a poinding of the ground. In practice, both actions of maills and duties and poindings of the ground are rare and we make no proposal for altering the law.

Diligence suspended during sequestration

13.20 The provisions of sections 29, 104 and 106 of the 1913 Act have the effect of making incompetent or rendering ineffectual certain diligences (notably adjudications, arrestments and poindings) against the sequestrated estate of a living or deceased debtor.²⁵ These provisions do not affect the landlord's right of hypothec²⁶ or the right of a heritable creditor to raise an action of maills and duties. Poindings of the ground also remain competent after sequestration although, in any question with the trustee, they are available only for the interest on the debt for the current half-yearly term, and for arrears of interest for the year immediately before that term.²⁷

13.21 We have already recommended that, subject to certain minor modifications, the substance of these provisions should be retained. They prevent, however, the execution of diligence only upon the estate belonging to the bankrupt at the date of sequestration and not upon *acquirenda*. This results from the construction which the courts have placed upon section 98(1) of the 1913 Act, which provides that any estate acquired by the bankrupt after the date of the sequestration and before his discharge "shall *ipso jure* fall under the sequestration". It is the duty of the trustee, however, to present a petition for declarator that the estate is vested in him, and it has been held that:

"until the decree is given on the petition, the trustee's right is only an inchoate right which may be defeated by diligence carried through by a subsequent creditor."²⁸

We have recommended that the requirement for such a declarator should be abandoned and that any acquisition of the bankrupt (subject to certain exceptions, notably his income) after the date of the sequestration should vest in the trustee as at the date of acquisition by virtue of the trustee's act and warrant. It is consistent with this recommendation that the prohibitions and restraints upon diligence to which we have referred should apply to *acquirenda* of the bankrupt which vest in the trustee during the course of the sequestration as well as to estate belonging to the bankrupt at the date of the sequestration. We recommend accordingly.

²⁵The effect of the provisions is to prevent diligence against the estate for the debts of the bankrupt but not for debts contracted by the trustee—*Thomson & Co. v. Friese-Green's Trustee* 1944 S.C. 336.

²⁶1913 Act, s. 115.

²⁷1913 Act, s. 114.

²⁸*Caldwell v. Hamilton* 1919 S.C. (H.L.) 100, *per* Lord Dunedin at 110.

CHAPTER 14

THE BANKRUPT'S EXAMINATION

Introduction

The present law of Scotland

14.1 The 1913 Act makes examination of the bankrupt mandatory. It directs that "the trustee shall, within eight days after the date of the act and warrant confirming him, apply to the sheriff to name a day for the public examination of the bankrupt".¹ Though this provision refers to public examination, it may be inferred from the concluding part of section 88² that private examination by the sheriff is not incompetent and is regarded as a matter within the discretion of the trustee.³ In current practice, however, the examination is nearly always conducted in public. Where it is held in private the creditors are not excluded.

14.2 The purposes of the examination do not directly appear from the terms of the Act. Section 86 provides for the examination of the bankrupt's wife and other persons "who can give information relative to his estate"⁴ and the following section requires the bankrupt and these other persons to "answer all lawful questions relating to the affairs of the bankrupt". The public examination of the bankrupt was introduced by the Payment of Creditors (Scotland) Act 1783.⁵ This provided for the examination of the debtor by the sheriff of the district where he resided so that the creditors might "have an opportunity of putting such questions as shall be judged of importance for rendering the discovery and surrender more complete".⁶ Lord President Inglis has explained that the primary purpose of the examination is "to ascertain what the bankrupt's estate consists of, where it is, and what he has done with it or to affect it".⁷ Lord Deas put the matter succinctly:

"The object of it is to discover and trace the bankrupt estate for distribution among the creditors."⁸

14.3 Although this is the primary purpose of the bankrupt's examination, it has been traditional for trustees and creditors to utilise the occasion to examine the debtor as to the causes of his bankruptcy. In terms of section 143 of the 1913 Act a bankrupt is not entitled to his discharge until the trustee has prepared a report:

¹s. 83.

²"Provided also that, if the trustees shall make application to that effect, the examination of the bankrupt ... shall take place in open Court."

³*Wright v. Guild* (1878) 6 R. 289.

⁴It is enough for the trustee to state that he believes that the party can give information: he need not explain the basis for this belief—*Burnet v. Calder* (1855) 17 D. 933.

⁵c. 18.

⁶s. 15. The 1783 Act provided for four diets of examination. This number was reduced to two and finally to one by s. 65 of the 1839 Act.

⁷*Delvoitte v. Baillie's Tr.* (1877) 5 R. 143 at 144. Cf. *Park v. Robson* (1871) 10 M. 10 at 14.

⁸*Wright v. Guild* (1878) 6 R. 289 at 292.

“with regard to the conduct of the bankrupt, and as to how far he has complied with the provisions of this Act, and, in particular, whether the bankrupt has made a fair discovery and surrender of his estate, and whether he has attended the diets of examination ... and whether his bankruptcy has arisen from innocent misfortunes or losses in business, or from culpable or undue conduct; and such report shall be prepared by the trustee as soon as may be after the bankrupt’s examination.”

The Accountant of Court’s notes, therefore, for the guidance of trustees in sequestrations indicate that the examination ought to disclose the causes of the bankruptcy.⁹

14.4 The examination is taken on oath and proceeds as prescribed in Rule 65 of Schedule 1 to the Sheriff Courts (Scotland) Act 1907.¹⁰ It is laid down, however, that:

“the examination of the bankrupt shall in every case be authenticated in the ordinary way as a regular deposition, but that the examination of [such] other persons shall only be so authenticated if, in the opinion of the sheriff, such authentication is necessary.”¹¹

Before the close of the proceedings the bankrupt is given an opportunity to add to or alter his state of affairs and then in public takes a solemn oath, which is engrossed in the sederunt book, to the effect that his state of affairs subscribed as relative to the oath contains a full and true account of his assets, including contingent rights and claims and estate in expectancy, and of his liabilities and that he promises forthwith to:

“reveal all and every other circumstance or particular relative to my affairs which may hereafter come to my knowledge, and which may tend to increase or diminish the estate in which my creditors may be interested, directly or indirectly.”¹²

It is understood that, in practice, the diet of public examination may be continued to permit of the notes of the examination to be engrossed and read over to or by the bankrupt before he signs these notes as a deposition and takes the oath.¹³

14.5 The examination of the bankrupt has always been regarded by the Scottish authorities as one of the more important steps in the process of sequestration, being:

⁹“Besides affording all necessary information in regard to the position of the Bankrupt’s affairs at the date of the sequestration, the examination ought to disclose the causes of the Bankruptcy, where these are not set forth by the Bankrupt in his state of affairs, so that parties interested may be able to ascertain, from one or other of these sources, whether the Bankruptcy has arisen from innocent misfortunes or losses in business, or from culpable or undue conduct (see section 143). If more than one of these causes have operated to bring about the result of Bankruptcy, the examination and state ought to make it clear, in so far as practicable, to what extent the deficiency has been created by the separate operation of these respective causes.”

¹⁰c. 51.

¹¹1913 Act, s. 88.

¹²The oath is contained in s. 91 of the 1913 Act.

¹³See Goudy, p. 238.

“of vital importance for enabling the trustee and creditors to understand the state of affairs.”¹⁴

For this reason, whatever deviations there may be in practice from the rule, it is required by law to be held before the sheriff.¹⁵ To permit of the examination of latent partners of the bankrupt, section 90 of the 1913 Act requires a latent partner of a company whose estates have been sequestrated to intimate to the trustee that he is such a partner on or before the day appointed for the examination of the known partners. There are other supporting rules relating to the apprehension of the debtor and his delivery from jail for examination,¹⁶ and to his apprehension and transmission to Scotland where he is in another part of the United Kingdom.¹⁷ It is also possible, by a request to the courts in England or Northern Ireland, to secure the examination there of the relatives of the bankrupt and other persons having information relating to his estate.¹⁸

14.6 The bankrupt and any other person examined are required to “answer all lawful questions relating to the affairs of the bankrupt”¹⁹ and, if he or any other person refuses to answer or without lawful cause refuses to sign the notes of his examination, he may be committed by the sheriff to prison “there to remain until he comply with the order”.²⁰ Is the bankrupt, however, in consequence, bound to reply to questions, the answers to which might incriminate him? Though the question, as Goudy explains,²¹ has not been directly decided in Scotland, Lord Deas has stated that the debtor is bound to answer any relevant question put to him:

“Suppose there were no criminal investigation in progress the bankrupts could not refuse to answer questions with reference to their estate on the ground that the answers shew they had been guilty of fraudulent bankruptcy. But it is said, and not denied, that a criminal investigation is in progress at the instance of the procurator-fiscal, which may issue in a charge of that kind. I do not think, however, that that is a sufficient reason either for adjourning the examination of the bankrupt or for refusing to allow the questions. To adopt either of these courses might defeat the object of the statutory enactments.”²²

14.7 Though Goudy²³ suggests that witnesses other than the bankrupt need not answer questions the replies to which might incriminate them, Lord Deas’ reasoning would seem to apply equally to such a case. It is certainly clear that witnesses are bound to answer questions in the course of a

¹⁴Goudy, p. 232.

¹⁵1913 Act, s. 88.

¹⁶1913 Act, s. 84.

¹⁷1913 Act, s. 85.

¹⁸See the 1914 Act, s. 122 and *Park v. Robson* (1871) 10 M. 10, a case decided with reference to the predecessor of s. 122 (s. 74 of the Bankruptcy Act 1869).

¹⁹1913 Act, s. 87.

²⁰s. 89.

²¹p. 237.

²²*Wright v. Guild* (1878) 6 R. 289, per Lord Deas at 292. See also *Sawers v. Balgarnie* (1858) 21 D. 153, per Lord Cowan at 157.

²³At p. 237.

bankruptcy examination even if they tend to incriminate third parties.²⁴ It is thought that the terms of section 86 preclude any plea of confidentiality on the part of the bankrupt's solicitor²⁵ though, like other persons called,²⁶ he may refuse to answer questions which do not relate to the estate and affairs of the bankrupt.²⁷

14.8 Finally, allusion may be made to the question whether the statements of the bankrupt and of other persons examined may be used against them in subsequent proceedings. W. G. Dickson²⁸ gives an affirmative answer to the question, but the authorities cited are not wholly conclusive. Perhaps the strongest case is that of *Fleming*,²⁹ where the prosecution in a charge of breach of trust and embezzlement attempted to found on the deposition of the panel in the sequestration of another person's estate. Lord McLaren sustained an objection to the question, observing³⁰ that:

“unless in a very exceptional case, the proceedings in one court in a different case could not be used as evidence against a prisoner in the Criminal Court.”

Some doubt, however, is thrown on this proposition by the decisions in *Banaghan*³¹ and in *Foster v. Farrell*.³² In the latter case the appellant founded upon the rule relating to the inadmissibility of involuntary statements established in *Chalmers v. H.M. Advocate*,³³ but Lord Justice-Clerk Grant expressed the view³⁴ that:

“That case, however, was dealing solely with the position at common law and has, in my opinion, no relevance when one is dealing with a statement lawfully and properly obtained under express statutory authority.”

The admissibility, therefore, in subsequent criminal proceedings of statements made in the course of the bankrupt's public examination cannot be regarded as settled.

English law

14.9 In formulating our proposals relating to the public examination of the bankrupt, we have had regard to analogous procedures in other systems and to proposals relating to their reform. Considerations of space, however, compel us to refer only to the position under English law. In English law,

²⁴*Sawers v. Balgarnie* (1858) 21 D. 153; *Wright v. Guild* (1878) 6 R. 289.

²⁵*Mackenzie v. Mackersy* 1st March 1823 F.C. and (1823) 2 S. 256; *A.B. v. Binny* (1858) 20 D. 1058; *Rankin v. Jamieson* (1868) 6 Scottish Law Reporter 108. As to solicitor of claimant creditor, see *Paul v. Laing's Tr.* (1855) 17 D. 457.

²⁶*Jacks' Trustee v. Jacks' Trustees* 1910 S.C. 34.

²⁷*Tod's Trustee v. Officer* (1872) 10 M. 980.

²⁸*The Law of Evidence in Scotland*, 3rd ed. (Edinburgh, 1887), para. 292.

²⁹(1885) 5 Coup. 552.

³⁰At 581.

³¹(1888) 15 R. (J.C.) 39.

³²1963 J.C. 46.

³³1954 J.C. 66.

³⁴At 53.

prior to 1976, a public examination of the bankrupt was mandatory in all cases save those in which the court dispensed with the examination by reason of the debtor's mental or physical disability.³⁵ The court is directed to examine the bankrupt "as to his conduct, dealings and property",³⁶ and to that extent the purposes of the examination appear from the statute itself. It has been explained, however, by Lord Hanworth M.R. that:

"... the object of the examination being not merely for the purpose of collecting the debts on behalf of the creditors or of ascertaining simply what sum can be made available for the creditors who are entitled to it, but also for the purpose of the protection of the public in the cases in which the bankruptcy proceedings apply, and that there shall be a full and searching examination as to what has been the conduct of the debtor in order that a full report may be made to the Court by those who are charged to carry out the examination of the debtor. To concentrate attention upon the mere debt collecting and distribution of assets is to fail to appreciate one very important side of bankruptcy proceedings and law."³⁷

14.10 Contrary to the position in Scotland, the examination must always be held in public, and it has been suggested³⁸ that a further purpose of the public examination consists in its giving warning to the public of the occurrence of the bankruptcy and the nature of the debtor's conduct. Differing in this respect also from the position in Scotland, English law makes it clear that the bankrupt is not entitled to refuse to answer questions addressed to him and that, subject to certain exceptions, his answers when recorded in writing and signed by him may be used in evidence against him.³⁹

14.11 Section 6 of the 1976 Act empowers the court in its discretion to make an order dispensing with the debtor's public examination on the application of the Official Receiver and it provides that, in exercising this discretion, the court shall have regard to all the circumstances of the case, including in particular—

- (a) whether the debtor has made a full disclosure of his affairs;
- (b) whether he has been adjudged bankrupt on a previous occasion;
- (c) the number and nature of his debts;
- (d) whether his bankruptcy would for any reason be a matter of public concern; and
- (e) such other matters as may be prescribed by rules.

³⁵1914 Act, s. 15(10).

³⁶1914 Act, s. 15(1).

³⁷*Re Paget* [1927] 2 Ch. 85 at 87.

³⁸"Justice" Report, p. 18.

³⁹See 1914 Act, ss. 15(8) and 166 (as amended by the Theft Act 1968 (c. 60), s. 33(2) and Sched. 2, Pt. 3). The exceptions relate to proceedings against the debtor or his spouse in respect of an offence under the Theft Act 1968. In the English case of *R. v. Pike* [1902] 1 K.B. 552, it was held that an answer in a debtor's statement of affairs, although obtained under compulsion, was admissible in criminal proceedings against him. See also critical comments of Wright J. in that case.

14.12 The public examination in England is held after the debtor has submitted his statement of affairs and prior to his adjudication in bankruptcy. It is apparent, therefore, that one of its functions is that of enabling the creditors to judge what procedure should follow the making of the receiving order. But it also assists the official receiver to complete his statutory reports⁴⁰ on the conduct of the debtor, including matters such as whether he has committed bankruptcy offences or other acts which would justify the court in refusing, suspending or qualifying an order for his discharge. This indirect connection between the debtor's public examination and discharge is now strengthened by section 7 of the 1976 Act. This section provides that, where the debtor's examination has been concluded or dispensed with, the court may make a further order which, if the debtor is adjudged bankrupt, will ordinarily have the effect of a discharge from bankruptcy after five years from the date of the adjudication.

Proposals for reform

The need for public examination

14.13 We have seen that in the Scots law of bankruptcy the purposes of the public examination traditionally have been to obtain from the bankrupt a full disclosure of his assets and their situation and to investigate any transactions, such as gratuitous alienations or unfair preferences, whose challenge may be conducive to the recovery of assets or to the reduction of purported security rights for the benefit of the bankrupt's creditors. The occasion has also been utilised to enable the trustee and creditors to examine the causes of the bankruptcy and whether the deficiency has arisen as a consequence of the bankrupt's "culpable or undue conduct",⁴¹ which may be relevant in connection with his discharge. Creditors, moreover, will often feel that they have been misled by the bankrupt as to the state of his business. The public examination provides them with an opportunity for directly questioning the bankrupt on the matter.

14.14 We consider that the need for a public examination of the bankrupt will be reduced by the proposals which we have made for preliminary inquiries by the interim trustee.⁴² There will always be cases, however, where a public examination of the bankrupt will be desirable, either because the results of the preliminary inquiries are incomplete or because the conduct or past history of the debtor or the cause of the bankruptcy seems to call for a public examination into his affairs. There may be some cases where the trustee or the creditors consider that the bankrupt's open and public examination under oath may disclose matters, including evidence of fraud, which his previous investigations have left unrevealed. For many persons the psychological impact of examination upon oath before a judge is significant and provides the best opportunity for the trustee to probe the truthfulness and fullness of the information given. It also enables the creditors, who may have personal knowledge of the debtor's transactions, to

⁴⁰See 1914 Act. s. 73(a), (b).

⁴¹See 1913 Act, s. 143.

⁴²Paras. 7.23-7.25.

present questions which may assist the court to secure a full disclosure by the bankrupt and to ascertain the reasons for his failure. There may also be a number of bankruptcies which affect so seriously other businesses and employment opportunities, particularly in a local situation, that the causes of the bankruptcy may be a matter of some public concern. These considerations seem amply to justify the inclusion of a public examination of the bankrupt as a feature of the bankruptcy process.

14.15 In the following paragraphs we consider certain aspects of the bankrupt's examination which may merit re-appraisal, including the questions whether the examination should continue to be mandatory in every case or whether it should be held only in those cases where there is an apparent need for it and, if so, how this question should be determined and within what period; whether the examination should always be held in open court; the questions which may be asked; the classes of persons who may ask them and those who may be required to answer them; the special problems of incrimination and confidentiality; and certain procedural matters.

Should the public examination be mandatory?

14.16 We have received conflicting advice on the question whether the current practice of the mandatory judicial examination of the bankrupt should continue. In England it has been said that:

“In the majority of cases the public examination of the debtor is a pure formality and merely an expensive waste of time.”⁴³

A similar, though possibly less trenchantly expressed, view was taken by individual accountants and solicitors whom we asked for informal advice. On the other hand, the Bankruptcy and Insolvency Committee of the Law Society of Scotland have stressed the importance of the public examination of the bankrupt and stated that in the course of it information relating to the bankrupt's affairs is often disclosed under oath, which would not otherwise come to light. The Committee suggested that, “until the examination has actually occurred, no-one can anticipate with any degree of certainty whether it will turn out to have served a useful purpose”. The police also stressed the importance in the public interest of the bankrupt's judicial examination. The notes of evidence may be useful to them as a record of statements relating to the bankrupt's past conduct and financial affairs. The “Justice” Committee on Bankruptcy, whose members included several experienced bankruptcy practitioners, concluded that while in certain circumstances the public examination can perform an important and useful function, there are a considerable number of cases where it is of little or no practical value.⁴⁴ We are ourselves persuaded that this accurately sums up the position in Scotland, and the question is whether the utility of a public examination in some cases justifies its mandatory retention in all cases. We are convinced that a negative answer must be given to this question against the

⁴³I. F. Fletcher, *Law of Bankruptcy* (Plymouth, 1978), p. 390.

⁴⁴“Justice” Report, p. 20, para. 51.

background of present bankruptcy procedures in Scotland and more especially against the background of the procedures which we envisage.

14.17 The public examination of the bankrupt in its present form is an expensive process, from both the standpoint of the creditors and that of the State. Expense is incurred in preparing the application to the sheriff under section 83 of the 1913 Act, serving the warrant upon the bankrupt, advertising the date and place of the examination in the *Gazette*,⁴⁵ procuring where necessary and serving warrants for the examination of persons who can give information relative to the bankrupt's estate, and paying the travelling and other expenses of such persons. Particularly heavy costs are incurred in connection with the employment of shorthand writers and the extension by them of the notes of the examination. Regard must also be had to the time likely to be taken up by court officials and by the sheriff in the context of the public examination. This suggests that, in the interests both of the creditors and of the State, the public examination of the bankrupt should be held only where this seems strictly necessary.

14.18 Moreover, in relation to the bankrupt himself, there is a case within the framework of the present law for limiting the occasions on which a public examination is held. There is little doubt that the public airing of the bankrupt's business dealings—and presumably of his business ineptitude, and even of his personal transactions—in open court, accompanied perhaps by publicity in the local press, may be humiliating for him. In cases where the insolvency was occasioned by misfortune rather than by misconduct, such humiliation strikes us as being quite unnecessary. The treatment of the bankrupt should be no harsher than may be necessary for the protection of the interests of his creditors and of society.

14.19 These arguments for discrimination in recourse to the public examination of the bankrupt are considerably reinforced if account is taken of the procedures which we have proposed. In every case the interim trustee will have conducted preliminary inquiries into the bankrupt's conduct and affairs and, if necessary, may compel the bankrupt, his wife and other persons who may be able to give information to appear before the sheriff for private examination. Indeed, speaking of the present law, Sheriff Dobie has remarked:

“If the trustee obtains full information privately from the bankrupt or others, there is no object to be served by a formal examination, and the fact that the trustee is satisfied is recorded in the sederunt book and the statutory oath is administered ... In that event no examination takes place.”⁴⁶

While we understand that this procedure is rarely followed in current practice, it does seem to us that, where the bankrupt has already made an apparently full and honest disclosure of his affairs and the bankrupt's failure is attributable to misfortune rather than to “culpable or undue conduct”,⁴⁷

⁴⁵Notice in the *Edinburgh Gazette* at present costs a minimum of £20.60.

⁴⁶W.G. Dobie, *Sheriff Court Practice* (Edinburgh, 1952), p. 373.

⁴⁷1913 Act, s. 143.

there is no need to require him to submit to a public examination of a merely formal character.

14.20 These arguments evidently appealed to Parliament, because in England the former requirement that the debtor should undergo a public examination unless he was excused by ill-health has been modified by section 6 of the 1976 Act which, on an application by the Official Receiver, empowers the court if it thinks fit to make an order dispensing with the public examination of the debtor.⁴⁸

14.21 We conclude, therefore, that while opportunity for the public examination of the bankrupt should continue to be available to the trustee and the creditors, it should cease to be a necessary feature of every bankruptcy. This leads to the further question: who should decide in any particular case whether there should be a public examination? It seems to us that the permanent trustee must be the primary judge in this matter. He will have the interim trustee's report on the causes of the bankruptcy and the conduct of the bankrupt and, guided by that report and his own assessment of the situation he should be well able to judge whether a public examination is or is not likely to serve any purpose. But it would be inappropriate and perhaps unsafe to leave matters entirely in the hands of the permanent trustee. He might decide not to apply for the debtor's examination in a case where a substantial proportion of the creditors considered it to be justified. To meet this case, we recommend that it should be open to the commissioners or to a representative proportion of the creditors (we suggest one-quarter in number and value) to require the trustee to apply for the public examination of the bankrupt.

14.22 This does not answer the problem which may arise where an individual creditor has reason to believe that an examination is required but cannot disclose to the trustee or to other creditors substantial grounds. We concede that it is not easy to meet this case. To admit that a creditor should have the power to apply to the court to require the debtor to be publicly examined would be to concede a right open to abuse and one, moreover, unlikely to assist the creditor where hard evidence is not available to him. In any case we consider that the trustee would usually yield to a creditor's request for a public examination even where the creditor cannot, or does not wish to, disclose the precise grounds for his request. To strengthen, however, the position of the individual creditor, we propose that the commissioners and the Accountant in Bankruptcy should have the right to require the trustee to make application for the debtor's examination. The Accountant in Bankruptcy, if necessary, could act on information given to him by the police. These proposals, in our view, go as far as is practicable to meet the pre-occupations of an individual creditor without serious risk of abuse of process. They will not result in the expense of a public examination being avoided in every case, but they will help to ensure that it is incurred only in appropriate cases.

⁴⁸See para. 14.11.

Should dispensation with the public examination require judicial approval?

14.23 It is implicit in the foregoing scheme that there should be no requirement for judicial approval of, or of dispensation with, the holding of the examination. It would create unnecessary delay, and generate unnecessary expense, to introduce a requirement for judicial approval of, or of dispensation with, the examination. This should be a matter for the decision of the interested persons alone. The very purposes of the examination make it undesirable that the trustee should be required to disclose in open court the reasons which, in his view, might justify the holding of a public examination. Under the scheme, therefore, which we propose, the decision whether to apply for the examination rests initially with the trustee, but he may be required to make such application by one-quarter in number and value of the creditors or by their representatives, the commissioners, or by the Accountant in Bankruptcy. In this scheme a judicial discretion whether or not to hold a public examination becomes superfluous.

Should the public examination always be held in open court?

14.24 In England, the public examination of the debtor necessarily takes place at a public sitting of the court.⁴⁹ The matter, as we have seen,⁵⁰ is not quite so clear in Scotland and we have received representations that it should be expressly stated that the bankrupt's public examination should always be held in open court. We are in complete agreement since, if our proposals are accepted, the seriousness and solemnity of the public examination will, on those occasions when it is held, be emphasised. It is therefore fitting that if a public examination of the debtor is required, that examination should take place in open court and before the sheriff in person. We so recommend.

Where should the examination take place?

14.25 Our Working Party pointed out⁵¹ that while in terms of section 83 of the 1913 Act the place of the public examination is stated to be the sheriff courthouse, Schedule F to the Act contemplates that it may take place elsewhere. Our Working Party thought that the position should be clarified and recommended that section 83 should be amended to provide for the examination to take place in the sheriff courthouse or other convenient place. It is, however, a corollary of our last recommendation that the examination, unless conducted on commission, should be conducted only within the sheriff courthouse. We so recommend.

Time within which application for the public examination must be made

14.26 If the public examination is not to be required in every case, but only when requested by the trustee at his own instance or at the instance of other persons, it seems clear that the persons concerned should be given a reasonable period within which to assess carefully whether a public examination is necessary. We therefore recommend that the permanent trustee may or, if requested to do so by one-quarter in number and value of

⁴⁹1914 Act, s. 15 and the Bankruptcy Rules 1952, Rule 8(1) (a).

⁵⁰1913 Act, s. 88 proviso, and para. 14.1.

⁵¹Memo. No. 16, p. 84.

the creditors, the commissioners or the Accountant, shall apply to the sheriff for the public examination of the bankrupt. Such application should be competent at any time after the appointment of the permanent trustee but not later than eight weeks before the end of the first accounting period. In effect, this would normally allow the interested parties a period of approximately three months within which to decide whether or not there should be a public examination of the bankrupt.

Notice of the examination

14.27 Under the present law, on the sheriff granting warrant for the examination, the trustee is required to publish an advertisement⁵² in the *Gazette* relating to the examination, and send by post or otherwise to every creditor who has lodged a claim or who is named in the bankrupt's state of affairs a notice relating to the examination.⁵³ We make no proposals for change of the procedure for notice of the public examination, except to recommend that the examination should take place not earlier than eight days and not later than 16 days from the date of the warrant issued by the sheriff for the attendance of the bankrupt for examination. Accordingly, notice in a prescribed form of the day, hour and place of the examination should be given in the *Gazette* and sent by post or otherwise to every creditor who has lodged a claim or who is named in the bankrupt's statement of affairs. The creditors would be informed that they might participate in the examination.

Form of the examination

14.28 Section 88 of the 1913 Act provides that the examination of the bankrupt and of any other person whose examination is ordered by the sheriff is to be taken on oath and is to be taken down in the manner prescribed by Rule 65 of Schedule 1 to the Sheriff Courts (Scotland) Act 1907;⁵⁴ that the bankrupt's examination is to be authenticated as a regular deposition, and also that of other persons if the sheriff considers it to be necessary. In practice, the record of evidence is usually taken by a shorthand writer and, when extended, entered in the sederunt book, and is subscribed by the bankrupt and the sheriff. The depositions of other witnesses are similarly recorded, but are not usually subscribed by the witness or by the sheriff, and it seems to us sufficient to retain the requirement of subscription only in relation to the deposition of the bankrupt. In other respects we make no recommendation for the alteration of the law. The judicial examination of the bankrupt should under our proposals take place only where it is considered to be necessary, and the accuracy of the record will remain a matter of primary importance. We consider, therefore, that the examination of the debtor should continue to be taken under oath and that the existing practice of taking down the evidence in shorthand and recording the transcript of the evidence in the sederunt book should continue. Accordingly, we make no recommendation for alteration of the law in this respect.

⁵²Prescribed in Sched. F. to the 1913 Act.

⁵³1913 Act, s. 83.

⁵⁴c. 51.

14.29 At the end of the examination, the bankrupt is required to take a solemn oath in relation to his state of affairs.⁵⁵ It seems to us that the contents of this oath are relevant chiefly to the bankrupt's discharge and that the oath is out of place in the context of the public examination. It would certainly seem inappropriate to require an oath only in those cases where a public examination is being held. We recommend, therefore, that the debtor's oath in the course of his public examination should be discarded. We later recommend that a declaration containing certain elements of the oath should be a condition of application by the debtor for his accelerated discharge and of his opposing an application for the deferment of his discharge by operation of law.⁵⁶

Who may be examined?

14.30 The examination is primarily of the bankrupt himself but we consider that, in accordance with the existing law, the bankrupt's wife, members of his family, his employees, his solicitor, his accountant and any other persons able to give information relevant to his assets, his dealings with them, or his conduct in relation to his business and financial affairs should also be compellable witnesses.⁵⁷

Who may ask questions?

14.31 We envisage that, as at present, the trustee would take the leading part in the examination, though the creditors or their mandatories should be entitled to put questions. The sheriff, of course, should be entitled to ask questions, particularly where he considers that clarification is necessary. Where third parties are examined, we suggest that it should be made clear that the bankrupt or his representative is entitled to put questions. Although we envisage that the trustee would normally conduct the examination himself, we do not exclude either his legal representation or that of any other participant.

What questions may be asked?

14.32 Certain issues have recently been raised as to the questions which may be asked in the course of a public examination and, more generally, as to its scope. There are three main issues which require special consideration, namely—

- (1) issues as to confidentiality;
- (2) issues relating to self-incrimination; and
- (3) issues relating to the problem of third parties who may be prejudiced as a result of statements made in the course of the examination.

Confidentiality

14.33 We have considered whether the bankrupt or other persons questioned in the course of the public examination should enjoy a privilege

⁵⁵1913 Act, s. 91.

⁵⁶Paras. 19.16 and 19.22.

⁵⁷1913 Act, s. 86.

of confidentiality, in particular, whether the person questioned should be entitled to refuse to answer questions because this would breach the confidential nature of communications between husband and wife or between solicitor and client. In relation to the former, section 3 of the Evidence (Scotland) Act 1853⁵⁸ makes the husband or wife of any party a competent witness in any action or proceeding in Scotland, with the proviso that no spouse is competent or compellable to give evidence against the other spouse of any matter communicated by him or her during the marriage. Husbands or wives are, of course, competent and compellable witnesses in the examination of the bankrupt.⁵⁹ While it is thought that the proviso to section 3 of the 1853 Act is inapplicable in this context,⁶⁰ we think that the point should be expressly clarified in the legislation to follow on this Report. It would be inimical to the purposes of the examination to extend special privileges to the spouse of the bankrupt in relation to communications between them during the marriage. In our Memorandum No. 46, moreover, on the law of evidence, we provisionally recommend the repeal of the proviso to section 3.⁶¹ The bankrupt's solicitor at present has no privilege to refuse to answer questions on the ground that this would involve a breach of the confidential relationship between solicitor and client.⁶² We note, too, that where the affairs of a company are being investigated under section 164 of the 1948 Act, the persons who may be examined by the court and must answer such questions as the court may think fit include the bankers and solicitors of the company. While recognising the importance of preserving the general principle that disclosures by a client to his solicitor should remain confidential, we conclude that it would be inadvisable to depart from the existing rule relating to public examinations except by the introduction of one qualification. It should be expressly provided that no person subject to examination should be required to disclose any matter which is privileged between himself and any other person, not being a person called for examination.

Self-incrimination

14.34 We have already seen that there is authority in Scotland that the bankrupt and other persons questioned may not refuse to answer questions on the ground that the answers might incriminate another person, and at least persuasive authority for the view that the bankrupt and, it would seem, any other persons questioned cannot refuse to answer questions on the ground that their answers might incriminate themselves.⁶³ The rule in England is clear: the debtor has no right to refuse to answer any question on the ground of self-incrimination, and his answer or admission is, subject to

⁵⁸c. 20.

⁵⁹1913 Act, s. 86.

⁶⁰*Sawers v. Balgarnie* (1858) 21 D. 153.

⁶¹Para. S. 10.

⁶²*Mackenzie v. Mackersy* 1st March 1823 F.C. and (1823) 2 S. 256; *Rankin v. Jamieson* (1868) 6 *Scottish Law Reporter* 108.

⁶³We note, however, that where there is an investigation into the affairs of a company under section 164 of the 1948 Act, the statements given on compulsory examination by an officer or agent of the company or any other person examined are taken down in writing and signed by the person concerned "and may thereafter be used in evidence against him"; 1948 Act, s. 167(4).

certain exceptions, available against him on a criminal charge.⁶⁴ Section 15(8) of the Bankruptcy Act 1914 provides for notes of the debtor's examination to be made, for the notes to be read over to or by him and signed by him, and for the notes "save as in this Act provided,⁶⁵ [to] be used in evidence against him". The rule does not in terms extend to cases where another person is being examined and his answers may incriminate himself, though it appears that he would be bound to answer at least questions having a tendency to incriminate the bankrupt or a third party.

14.35 The law is faced here with a classic conflict between, on the one hand, the need to protect the individual by not placing him in the dilemma of having either to tell lies or to harm himself or others, coupled with the need to secure that the evidence given on public examination should be given freely and without risk of the deponent being deterred by the possible consequences to himself and to others, and, on the other hand, the need to facilitate the prosecution of criminal offences.⁶⁶ On the whole, we consider that the balance of public interest lies in adopting a solution similar to that proposed by the Irish Bankruptcy Law Committee, which would compel all persons examined to answer all relevant questions but make their answers inadmissible against them in subsequent proceedings, except upon a charge of perjury in respect of such answers.⁶⁷ We recommend, therefore, that the bankrupt or any other person examined in the course of the public examination should not be excused from answering questions the answers to which may tend to incriminate himself, but that those answers should not be admissible in evidence against the person examined in subsequent criminal proceedings, except where the proceedings relate to a charge of perjury arising from the answers.

Protection of third parties

14.36 Occasionally, questions may be asked in the course of the public examination, the answers to which may be defamatory, or at least derogatory, of other persons who may neither be present nor represented at the examination, and will have no opportunity of controverting the statement or of cross-examining the maker of it. Public attention was drawn to this issue in England by the statements made in the course of the public examination of Mr. John G. L. Poulson at Wakefield County Court in June, July and August 1972.⁶⁸ It has been suggested, therefore, that special provision should be made to protect third parties from the risk of such defamatory or derogatory statements being made at the bankrupt's examination. While we have considerable sympathy with this suggestion, the

⁶⁴See para. 14.10 above. See also *R. v. Scott* (1856) 25 L.J. (M.C.) 128; *Ex parte Schofield* (1877) 6 Ch. D. 230; *R. v. Erdheim* [1896] 2 Q.B. 260; *Re Atherton* [1912] 2 K.B. 251; *Re Harris* (Richard) [1970] 3 All E.R. 746.

⁶⁵See 1914 Act, s. 166 and Theft Act 1968 (c. 60), s. 33(2) and Sched. 2, Pt. 3.

⁶⁶*Cf. Re Poulson, ex parte Granada Television Ltd. v. Maudling* [1976] 2 All E.R. 1020, per Walton J. at 1026.

⁶⁷See draft Bankruptcy Bill annexed to Budd Report, clause 31(4).

⁶⁸See the statement of Lord Hailsham L.C., H.L. Deb., ser. 5 (Feb. 8, 1973), Vol. 338, cols. 1228 *et seq.*; and *Re Poulson, ex parte Granada Television Ltd. v. Maudling* [1976] 2 All E.R. 1020.

problem is not confined to examinations in bankruptcy. Moreover, the court will disallow questions which are not truly directed at the discovery of the bankrupt's estate.⁶⁹ But where the answers are relevant to the purposes of the examination, there would seem to be no case for excluding them. This suggests that the problem is best tackled by considering the scope of the examination. Section 87 of the 1913 Act requires the bankrupt and any other persons who may be cited to appear to answer "all lawful questions relating to the affairs of the bankrupt". Goudy⁷⁰ points out that it is sometimes "a matter of considerable difficulty to determine whether a particular line of inquiry falls within this statutory description or not, and a wide discretion is given to the sheriff to admit or exclude questions". This in itself suggests that it may be desirable to give statutory guidance as to the scope of the examination. We note that, in England, it is provided that "the debtor shall be examined as to his conduct, dealings and property" and that it is recognised there, and in the United States of America, that the examination may relate to any matter which may affect the administration of the debtor's estate and his right to a discharge. We consider, however, that it would be desirable to adopt a relatively restrictive approach to the scope of the public examination and to make it clear that the bankrupt's examination may relate, but relate only, to the debtor's assets, his dealings with them, and his conduct of his financial and business affairs.

Procedural matters

Apprehension of bankrupt

14.37 Section 84 of the 1913 Act makes it competent for the sheriff to grant a warrant to apprehend the bankrupt and bring him before the sheriff for examination. Section 85 makes provision for the bankrupt's apprehension where he is elsewhere in Great Britain and Northern Ireland, and his transmission to the place of the examination. Section 86 makes similar provision to section 84 as respects other persons who can give information about the bankrupt's affairs. Provisions broadly to the same effect should be included in the legislation to follow on this Report, but section 85 should be extended to persons other than the bankrupt who can give information about his affairs. Moreover, since bankruptcy will usually be a sheriff court process, we recommend that the powers conferred on the Lord Ordinary by section 85 should be extended to the sheriff.

When the bankrupt is imprisoned

14.38 When the bankrupt is imprisoned for civil debt in Scotland, section 84 makes provision for the bankrupt's delivery for the purposes of the examination. Corresponding provision is made in section 85 for the case where the bankrupt is imprisoned elsewhere in Great Britain and Northern Ireland. Though the latter provision is not in terms confined to cases of civil imprisonment, it is possible that it would be so construed. Now that civil imprisonment for debt is competent only in exceptional circumstances, we

⁶⁹*Delvoitte v. Baillie's Tr.* (1877) 5 R. 143.

⁷⁰At p. 236.

consider that these provisions could be safely discarded. Where the bankrupt, or any other person requiring to be examined, is in prison he may be examined on commission.

Examination on commission

14.39 Where for any reason the bankrupt or any other person liable to be examined cannot attend, sections 84 and 86 make provision for his examination on commission. These provisions should be retained, but it should be made clearer that the sanctions for refusal to answer questions on examination (at present contained in section 89) apply also to persons who do not attend for examination on commission or who in the course of examination on commission decline to answer lawful questions.

Record of the examination

14.40 At present only the bankrupt's oath is required to be entered by the trustee in the sederunt book, though Goudy states that:

“The regular practice is for the shorthand writer to extend the notes into the sederunt-book, and at an adjourned diet the deposition is read over to the deponent and signed by him and by the Sheriff.”⁷¹

14.41 We have recommended above the abolition of the requirement of the bankrupt's statutory oath.⁷² The Accountant of Court has proposed to us that express statutory provision should be made for entering a record of the examination in the sederunt book and for a copy thereof being sent to him. We agree, and so recommend. We envisage that the principal record of the examination should be subscribed by the sheriff and the bankrupt but not by any other person examined, that the record should be retained with the sederunt book, and that one copy thereof should be sent to the Accountant in Bankruptcy.

Ancillary provisions

14.42 We do not suggest any material alteration (beyond updating) of the existing provisions on such ancillary matters as the production of documents (section 87), the adjournment of the examination (sections 84 and 86) and the penalty upon a person refusing to answer questions at the examination (section 89). The provisions for re-examination of the bankrupt (section 84) are, however, no longer appropriate, and we are advised that section 90 (penalty on latent partner of a bankrupt company who does not come forward) is in practice not used. We therefore recommend that these last-mentioned provisions be omitted.

⁷¹p. 238.

⁷²See para. 14.29.

CHAPTER 15

PREFERRED AND POSTPONED DEBTS

General background to preferences

The Scottish setting

15.1 In the distribution of the estate the Scots law of bankruptcy, like that of other legal systems, concedes priority over other unsecured debts to certain classes of debts, often referred to as preferred debts. These are largely the creation of statute. The common law of Scotland recognised only limited categories of preferred debts,¹ of which only the preference for death-bed and funeral expenses remains effective today.² In the opinion of Bell, "considerations of humanity" justify the common law preferences. He notes that "the expenses of the last sickness and funeral, and the wages of servants, are, by almost all laws, held entitled to this privilege; and the doctrine is fully established in the law of Scotland".³ Crown preference was unknown in Scotland until it was introduced into the procedure of the Court of Exchequer by statute in 1707.⁴ Doubts as to the extent of that preference in sequestration were not resolved until 1916, when it was held that in Scotland the Crown enjoyed no preference in sequestration beyond that accorded to it by section 118 of the 1913 Act.⁵ The position under English law is quite different. The Crown had enjoyed extensive preferences, and the introduction by statute of defined (and limited) preferences was viewed as an abridgement of the Crown's rights under common law. In short, Crown preference was created by statute in Scotland and curtailed by statute in England.

15.2 The creation of preferences in bankruptcy, principally for claims of the Crown, local authorities and the employees of the bankrupt, although somewhat random and disconnected at the outset, had established by the end of the nineteenth century the framework that exists today.⁶ The principal

¹The common law categories are (a) death-bed and funeral expenses, (b) the wages of farm and domestic servants for the term current at the date of sequestration, and (c) (possibly) a year's rent of the house where a bankrupt has died—Erskine, *An Institute of the Law of Scotland* (Edinburgh, 1871), III. 9.43.

²The common law preference for death-bed and funeral expenses is expressly preserved in s. 118(5) of the 1913 Act. The common law preference for wages has been effectively superseded by the wider preference for wages and salary accorded by statute to clerks, servants and workmen. The remaining common law preference—for a year's rent of the house where a bankrupt has died—rests only on the decision in *Dunipace v. Watson* (1750) Mor. 11852, the authority of which is doubted by Goudy at p. 516.

³Bell, *Comm.* ii. 147.

⁴The Exchequer Court (Scotland) Act 1707 (c. 53), s. 7.

⁵See *Admiralty v. Blair's Trustee* 1916 S.C. 247. The court over-ruled the decision in *Lord Advocate v. Galbraith* (1910) 47 *Scottish Law Reporter* 529 where Lord Cullen held that the Postmaster-General was entitled to a preferential ranking in a sequestration for the amount of a telephone rent.

⁶s. 88 of the Poor Law (Scotland) Act 1845 (c. 83) created a preference in bankruptcy for assessments for relief of the poor, and s. 122 of the 1856 Act created a preference for one month's wages for employees of a bankrupt whose wages did not exceed £60 per annum. The statutory preferences were brought together in s. 1 of the Preferential Payments in Bankruptcy Act 1888 (c. 62) which was replaced by s. 118 of the 1913 Act. This provision has since been extensively amended to create preferences for a variety of taxes and other charges.

preferences are for local rates and certain taxes for a period of one year and for the salaries or wages of the bankrupt's employees in respect of service during a specified period. There has been, however, a great expansion of the category of preferred debts during the present century, particularly during the period since the end of the Second World War. Preferences have been created in respect of many new taxes and other imposts without, it is thought, adequate consideration of the cumulative effects of such preferences in the distribution of insolvent estates.

Crown preferences: analysis of justifications

15.3 It may be convenient at this stage to examine the specific justifications which have been presented to us for the retention of Crown preferences in bankruptcy, with particular reference to fiscal debts. The principal justifications are these—

- (1) *It is contended that debts owed to the community are of a different character from those owed to private persons and should, in the public interest, take precedence over them to the extent provided by statute.* The general proposition that debts owed to the community ought to take precedence over those owed to individuals is, as our Working Party commented, by no means a self-evident proposition.⁷ It can also be said, and the point is made forcefully in the Tassé Report,⁸ that a result of Crown preference is that it is not the debtor but his creditors who are in fact discharging his obligations to the community. The objections in principle to the doctrine that debts owed to the community should take precedence are well summed up in the following passage from the opinion of Lord Anderson in *Admiralty v. Blair's Trustee*:

“In the case of *Palmer* Lord Macnaghten justifies the doctrine on the ground that its assertion results in the benefit of the general community (that is, the general body of taxpayers) although at the expense of the individual. I should have thought this was a reason for condemning the principle. Why should individuals be made to suffer for the general good, especially in a case like the present, where the general benefit is infinitesimal but the individual loss substantial? In the second place, this alleged prerogative is hostile to the general policy of the Bankruptcy Acts, which aim at equal treatment of all creditors in the matter of the distribution of the estates of a bankrupt.”⁹

- (2) *It is also argued that, in relation to fiscal debts, the Crown is an involuntary creditor and that there are no circumstances at all in which the Inland Revenue can decline to do business with those liable to tax.* There is an element of artificiality in this argument, since the methods of collecting tax are in fact methods of the creditor's

⁷Memo. No. 16, p. 38.

⁸It is stated in para. 3.2.076 that “it could even be argued that the government should rank after ordinary creditors, as the public treasury is, in fact, in a better position than anyone to bear the inevitable losses ...” and that “certainly, there can be no rational explanation for the government to attempt to obtain payment of the tax due by a bankrupt from his creditors”.

⁹*Admiralty v. Blair's Trustee* 1916 S.C. 247 at 248.

choosing, but it is true that the Inland Revenue cannot choose its debtors. The same, however, may be said of such other creditors as an alimentary creditor or a creditor whose claim results from a delict by the bankrupt. These involuntary creditors receive no preference, and it is difficult to see why the Crown should be in any different position. The argument that a distinction falls to be made between "voluntary" and "involuntary" creditors is unconvincing even where the position of the Crown is contrasted with that of a trade creditor. Many persons who supply goods or services are in effect compelled to give credit facilities if they are to compete with other suppliers and, even if they could choose to discriminate, it would often be impossible for them to judge which of their customers are likely to become insolvent. The notion that a creditor can by the use of reasonable foresight protect himself against bankruptcies may have been valid in the nineteenth century when trading was more localised and business structures much less complex, but it is hardly relevant to the trading patterns of today.

- (3) *It is also argued that the Inland Revenue will be a creditor in virtually every sequestration.* The position of a commercial creditor who "can establish at the outset what is owing to him" and take appropriate recovery action after any permitted period of credit expires, is contrasted with that of the Board of Inland Revenue who may be aware only long after the event, of the existence of tax liabilities. There is some substance in this argument but it oversimplifies the contrast with commercial contracts, particularly those for building and engineering works, where quick recovery may be impossible.
- (4) *It is also argued that commercial creditors are well placed in comparison with the Inland Revenue in respect that they can demand security from their debtors or prospective debtors where circumstances warrant this. A supplier of goods, it is said, can obtain considerable protection by reserving title to the goods until the monies owed to him are paid.*¹⁰ It is open to question whether the Inland Revenue is alone in being unable to protect itself against securities (or quasi-securities). In practice, a reservation of title on the part of one creditor may occasion serious loss to the others, and the maintenance of Crown preferences can only make that loss even more serious. It is, indeed, open to question whether such a security (or device for the purposes of security) should receive effect against a trustee in sequestration or liquidator, but that is a question which has wide implications and which will be considered in the context of our examination of the law relating to moveable property and the securities that may be created over it.¹¹ Moreover, the Inland

¹⁰See *Aluminium Industrie Vaassen B.V. v. Romalpa Aluminium Ltd.* [1976] 1 W.L.R. 676, a case that has, of course, widely publicised the protection available under English law to suppliers of goods.

¹¹We have set up a working Party on Security over Moveable Property who are considering the implications of the introduction into Scots Law of a system of security over moveable property based upon the recommendations in the *Report of the Committee on Consumer Credit* (the Crowther Report), Cmnd. 4596 (1971).

Revenue, despite its inability to protect itself directly against securities, has the advantage of certain procedures and facilities for the recovery of tax debts that are not available to the ordinary creditor.¹² We consider, therefore, that while the question of securities in relation to bankruptcy is a matter that merits examination, the recognition under existing law of security devices such as reservation of title clauses is not a justification for Crown preference.

Crown preferences: countervailing arguments

15.4 Our conclusion is that the arguments adduced above in favour of Crown preferences are not of a compelling nature. To the extent that these arguments may be thought to be persuasive, they must be set against others which, in our view, are more persuasive—

- (1) In general the aim of Scottish bankruptcy law has been to treat unsecured creditors equally and to eliminate any unfair or unjustified preferences or advantages. The rights of creditors who have taken securities in proper circumstances or who have obtained a preference by timeous diligence have always been respected. But, as we have explained above,¹³ the common law provision for the reduction of gifts and unfair preferences by an insolvent was strongly re-inforced in the seventeenth century,¹⁴ and this trend towards equality was continued in the following century when equalisation of diligences was introduced. Viewed against this background, the introduction of special preferences was out of character with the development and purposes of Scottish bankruptcy law. The justification for a preference must be based upon the reasonableness of the preference or the hardship that could result if it were not conceded.
- (2) It is axiomatic that where the assets are insufficient to meet all claims, every preference will prejudice the ordinary creditors.¹⁵

¹²See e.g. s. 63 of the Taxes Management Act 1970 (c. 9) (which enables the Collector of Taxes to use a special procedure of poinding and sale under summary warrant to obtain payment of arrears of income tax, capital gains tax and corporation tax) and s. 64 of the Act (which requires an arrester or poinder of a debtor's goods to pay any arrears of taxes to the extent of one year's arrears before he takes the arrested or poinded goods).

¹³Paras. 12.5 and 12.35.

¹⁴By the 1621 and 1696 Acts.

¹⁵The available statistics do not permit us to quantify with precision the proportion of the total realisations year by year taken respectively by preferred creditors and ordinary creditors, because the statistics distinguish merely between "secured" creditors (including preferred creditors) and unsecured creditors. Many creditors, however, who in the legal sense of the term possess a security will stand outside the sequestration process, so that the following figures taken from the Civil Judicial Statistics (Scotland) for 1978 (Cmnd. 7762 (1980)), Table 18, may be of some significance:

	1973	1974	1975	1976	1977
Payments to "secured" creditors	£245,003	£119,793	£150,588	£163,652	£283,823
Payments to unsecured creditors	£174,822	£207,700	£102,488	£73,640	£114,992

Accordingly, the actual loss sustained by these creditors is likely to be substantial if the amount of the preferred debts is large. Indeed, the dividend to be paid to the ordinary creditors may be so reduced¹⁶ that their interest in the sequestration process may fade away and, if there is not to be a State system of bankruptcy administration, it is important to maintain creditor interest in the sequestration process. Moreover, any reduction of the fund available in a sequestration for the ordinary creditors is likely to increase the risk of that sequestration being the cause of other failures.

- (3) Another reason for reducing drastically the existing preferences is that they have expanded greatly both in amount and in extent over recent decades. Crown preference in bankruptcy meant at one time little more than a preference for a modest amount of income tax. But both the high level of taxation and the multiplicity of fiscal charges that enjoy preference have completely altered the position. A claim for rates and the claims for wages of the bankrupt's employees may also exact a heavy toll upon the bankrupt's available assets. In many cases the hardship to the ordinary creditors is likely to be much greater than any benefit to the community at large resulting from the preference for taxes and rates.¹⁷ The minimisation of hardship to the ordinary creditors must always be a consideration of prime importance.
- (4) We fully appreciate that the question of preferential claims cannot be considered in a purely Scottish setting. It would not be realistic to suppose that Crown preference in Scotland should differ substantially from Crown preference elsewhere in the United Kingdom. In putting forward these recommendations for reform of the law of Scotland we recognise that we are in effect recommending reforms that (if implemented) must also be implemented in other parts of the United Kingdom. We note, however, that there has recently been support outside Scotland for the abolition or reduction of preferential claims in bankruptcy. The abolition of preference for rates and taxes has been recommended in recent years by bankruptcy law reform committees in Canada and Ireland,¹⁸ and the Irish Committee go so far as to recommend the abolition of all preferences.¹⁹ The Report of the Blagden Committee states that "many of the witnesses have been in favour of the total abolition of

¹⁶In most estates the dividend per £ on unsecured debts (as defined in the preceding footnote) has been small in recent years:

	1973	1974	1975	1976	1977
No dividend	14	2	6	10	11
Dividend under 25p in £	13	17	15	15	8
Dividend over 25p in £	13	18	22	15	17

¹⁷The benefit to the ordinary creditors resulting from the abolition of Crown preference is likely to result in an increase in their tax liability. The loss to the Exchequer from the abolition of Crown preference may therefore be less than it seems.

¹⁸Tassé Report, paras. 3.2.075-3.2.079. Budd Report pp. 342-354.

¹⁹At p. 354.

priority for rates and taxes” and accept that there is much to be said for that view.²⁰ The “Justice” Report implies a dislike of preferential debts.²¹

15.5 Our conclusion, therefore, is that our bankruptcy law should adhere to the principle that there should be equality of treatment among the unsecured creditors except where the case for departure from equality is clearly made out. This conclusion enables us to proceed to consider the particular debts that enjoy preference in a sequestration²² with a view to deciding whether the justification for any of them is stronger than the principle of equality among creditors. It is appropriate that we should commence with discussion of the preferences that have the greatest impact upon a bankrupt’s estate, those accorded to the Crown in respect of taxes and other charges, and then proceed to discussion of the remaining preferences such as those for local rates and for the wages or salary of an employee of the bankrupt.

Particular preferences

Income Tax, Capital Gains Tax, and Corporation Tax

15.6 The preference for income tax (other than income tax collected by an employer under the P.A.Y.E. system) is contained in section 118 of the 1913 Act, the relevant provision being subsection (1)(a) which is as follows:

“(1) In the division of a bankrupt’s estate under the provisions of this Act the following shall be paid in priority to all other debts:—

- (a) All poor or other local rates due by the bankrupt at the date [of the award of sequestration] and having become due and payable within twelve months next before that date, and all assessed taxes, land tax, property or income tax or Class 4 contributions under Part I of the Social Security Act 1975 or Part I of the Social Security (Northern Ireland) Act 1975, assessed on the bankrupt up to the fifth day of April next before the said date, and not exceeding in the whole one year’s assessment;”

This provision has been construed to mean that the Crown may claim priority for assessed taxes for any year,²³ and may indeed select different fiscal years for each of its preferred taxes.²⁴ The Crown’s right to select the “best year” for its assessments has often been criticised,²⁵ and the Blagden Report recommended²⁶ that the Inland Revenue’s right of choice should be

²⁰p. 30. The Report, however, did recommend only that the preferences be restricted.

²¹Paras. 77 and 78.

²²We do not discuss taxes that cannot give rise to a claim in a sequestration (as opposed to a liquidation) Nor do we discuss certain preferences created by enactments which are for all practical purposes obsolete, for example, the preference created by s. 56 of the National Service Act 1948 (c. 64).

²³*Re Pratt; ex parte Inland Revenue Commissioners v. Phillips* [1951] Ch. 225.

²⁴*Lord Advocate v. Liquidators of Purvis Industries Ltd.* 1958 S.C. 338, a case relating to s. 319(1) (a) (ii) of the 1948 Act.

²⁵See e.g. Williams, *Bankruptcy* (18th ed.), pp. 229/30.

²⁶At p. 32.

limited to one of the last two complete fiscal years before the bankruptcy. For the reasons already given, we would, however, go further and recommend the abolition of any preference in bankruptcy for income tax, capital gains tax or corporation tax.²⁷

P.A.Y.E.

15.7 The position is rather different where money is collected under the P.A.Y.E. system by an employer who has become insolvent. The tax debt here consists (or should consist) not of the insolvent's own money but of money that he has collected for the Crown under a statutory requirement to do so. In any such case the Crown should be in neither a better nor a worse position than any other principal whose agent's estate has been sequestrated, that is, if the money belonging to the principal has been set apart from the agent's own funds and is identifiable, it should be excluded from the estate vesting in the trustee in sequestration. If, on the other hand, the money has been inmixed with the agent's own funds and is no longer separable, the principal should forfeit his claim to it. Under existing law the Inland Revenue is, however, in a much stronger position than any other principal, because an employer is accountable to the Inland Revenue not simply for sums collected by him but for sums which he should have collected even if he has not in fact done so.²⁸ That is not unreasonable in a question between an employer and the Inland Revenue, but it has the effect of giving the Inland Revenue an absolute preference for the deductions over the relevant period (of 12 months) which an insolvent employer was liable to make. There is no apparent justification for the special privilege accorded to the Inland Revenue. We recommend, therefore, that any preference for monies collected under the P.A.Y.E. system should be abolished and the Inland Revenue's claim against a bankrupt employer treated in the same way as any other claim by a principal in the sequestration of his agent's estate.

Value Added Tax

15.8 There are a number of taxes and duties on goods and services which are administered not by the Commissioners of Inland Revenue but by the Commissioners of Customs and Excise. The best known of these is probably value added tax, because it relates not to a particular commodity or activity but to a broad range of goods and services. Value added tax was introduced by the Finance Act 1972, and section 1(1) of that Act provides for the tax to be charged on the supply of goods and services in the United Kingdom and on the importation of goods into the United Kingdom. The tax is payable by the person supplying the goods or services, and the statutory conception is, therefore, not that he is a collector of tax on the goods or services supplied by him (although that is what actually happens) but a person directly responsible for payment of tax on these supplies.²⁹ His actual liability is,

²⁷Capital gains tax and corporation tax have the same priority in a bankruptcy or winding-up as income tax—Finance Act 1965 (c. 25), Sched. 10, para. 15(1); Finance Act 1966 (c. 18), Sched. 6, para. 14.

²⁸See Finance Act 1952 (c. 33), s. 30.

²⁹Finance Act 1972 (c. 41), s. 2.

however, calculated by reference to the difference between the amount of "input tax" that may be deducted by him and the amount of "output tax" due from him.³⁰ A taxable person must account to the Commissioners of Customs and Excise for the amount by which the output tax due from him exceeds the input tax that may be deducted by him. Conversely, if the amount of his input tax exceeds the amount of his output tax, the amount of the excess is to be paid to him by the Commissioners. The practical effect of the legislation is, therefore, that a person either must account for the amount by which tax collected by or due to him exceeds tax paid or payable by him or is entitled to recover the amount by which the tax paid or payable by him exceeds the tax collected by or due to him.³¹ The existing preference is for tax which has become due within the period of 12 months before the date of the award of sequestration.³² Although value added tax has different features from tax collected under the P.A.Y.E. system, the collection system is essentially the same, that is, the supplier in the case of the one and the employer in the case of the other is an involuntary collector. We recommend, for the reasons already stated with regard to the preference for tax collected under the P.A.Y.E. system, that the preference for value added tax be abolished.

Car Tax

15.9 This special tax on motor cars (which is also administered by the Commissioners of Customs and Excise) was also introduced in 1972.³³ It is chargeable, in addition to value added tax, on cars made or registered in the United Kingdom and is in general payable by the person who makes or imports the car. The tax (like value added tax) is paid quarterly, payment being required within one month after the end of the quarter.³⁴ The existing preference is for tax which has become due within the period of 12 months before the date of the award of sequestration.³⁵ For the reasons already given with regard to the preferences for tax collected under the P.A.Y.E. system and value added tax, we recommend abolition of the preference.

Betting and gaming duties

15.10 These duties (which again are administered by the Commissioners of Customs and Excise) are chargeable under the Betting and Gaming Duties Act 1972. A preference in bankruptcy is accorded to general betting duty, to certain sums representing duty or additional duty for operating gaming facilities, and to bingo duty, the preference in each case relating to sums which have become due within the period of 12 months preceding the date of

³⁰"Input tax" is (a) tax on the supply of goods or services to a taxable person for the purpose of his business, and (b) tax paid or payable by him on the importation of goods used for such purpose, whereas "output tax" is the tax payable by him on the goods or services supplied by him.

³¹s. 12 of the Finance Act 1978 (c. 42) provides for repayment of value added tax where the person who has paid it to the Inland Revenue cannot recover it because of the insolvency of the person to whom the goods or services have been supplied.

³²Finance Act 1972 (c. 41), s. 41. The section confers the same preference in a liquidation.

³³See Finance Act 1972 (c. 41), s. 52 and Sched. 7.

³⁴The Car Tax Regulations 1972 (S.I. 1972/1345) Reg. 4.

³⁵Finance Act 1972 (c. 41), Sched. 7, para. 18. There is the same preference in a liquidation.

the award of sequestration.³⁶ General betting duty and bingo duty are charged at a rate representing a percentage of the stake money (with an additional element in the case of bingo duty),³⁷ whereas gaming licence duty is recovered by half-yearly licences, the duty on a licence being determined by reference to the rateable value of the premises at which the gaming takes place and the number of tables provided for gaming purposes.³⁸ Betting duties are payable on a monthly or shorter basis,³⁹ and bingo duty in respect of periods which end on the last Sunday of each month.⁴⁰ We can see no justification for continuation of a preference in relation to any of these duties, and recommend that the preferences should be abolished.

Development Land Tax

15.11 This tax on the realisation of the development value of land was created by the Development Land Tax Act 1976 (c. 24). Section 42(1) of that Act provides that in a bankruptcy or winding-up, development land tax shall have the same priority as income tax. Our arguments against preferences in bankruptcy (and, in particular, the arguments against Crown preference for income tax) seem to us to be directly applicable to the preference for development land tax. We recommend, therefore, that the preference should be abolished.

Social Security contributions

15.12 Social security legislation makes provision for a wide range of benefits including unemployment, sickness, and widow's benefit, pensions and industrial injuries benefit, etc. Section 118 of the 1913 Act (as amended) gives priority to "Class 4 contributions under Part I of the Social Security Act 1975 (c. 14) ... not exceeding ... one year's assessment" and "all the debts specified in section 153(2) of the Social Security Act 1975, Schedule 3 to the Social Security Pensions Act 1975 and any corresponding provisions in force in Northern Ireland". Leaving aside Schedule 3 to the Social Security Pensions Act 1975 (c. 60) (which relates to preference in bankruptcy for contributions to occupational pensions schemes), we find that the principal effect of the foregoing is to give priority to the following contributions for the financing of social security benefits, the national health service and the redundancy fund—

- (a) Class 1 contributions payable in the period of 12 months preceding bankruptcy (earnings-related contributions, a primary Class 1 contribution being exigible from the earner and a secondary from the employer).
- (b) Class 2 contributions payable in the same period (flat rate contributions, payable by self-employed earners).

³⁶See Betting and Gaming Duties Act 1972 (c. 25), Sched. 1, para. 14; Sched. 2, para. 11; and Sched. 3, para. 16. There is the same preference in a liquidation.

³⁷See Betting and Gaming Duties Act 1972 (c. 25), s. 1 (general betting duty) and s. 17 (bingo duty).

³⁸Betting and Gaming Duties Act 1972 (c. 25), s. 14.

³⁹See the General Betting Duty Regulations 1973 (S.I. 1973/118).

⁴⁰See the Bingo Duty Regulations 1969 (S.I. 1969/1100).

- (c) Class 4 contributions (payable in respect of the annual profits or gain of a trade, profession or vocation) not exceeding one year's assessment.⁴¹

The social security legislation places upon the employer liability "in the first instance to pay also the earner's [Class 1] contribution, on behalf of and to the exclusion of the earner". The employer becomes an involuntary collector. Entitlement to benefit depends upon *inter alia* the payment of contributions in accordance with the legislation, but an employee need not fear that failure by his employer to account for the earner's contributions will affect benefit. Provision is made for those contributions to be treated as paid (and entitlement to benefit thereby secured) in any case where the employee is free from blame for the failure in making payment of the contributions.⁴²

15.13 We think that the arguments which we have already advanced against the justification for Crown preference for its fiscal dues apply with equal force in the case of social security contributions. Again, the community is better able to withstand the loss than the individual creditors of a bankrupt. We recommend abolition of these preferences.

Occupational pension schemes

15.14 It is convenient at this point to deal with the preference accorded to contributions to occupational pension schemes. The framework for those schemes is contained in the Social Security Pensions Act 1975.⁴³ That Act *inter alia* enables an employed earner to be contracted out of full social security contributions and benefits, where benefits in accordance with the requirements of the Act are provided for the earner by an occupational pension scheme.⁴⁴ The payments necessary for the financing of an occupational pension scheme must be provided by the employer, or by the earner or his employer or both of them, and the Occupational Pensions Board⁴⁵ must be satisfied that the payment of certain minimum benefits under the scheme is adequately secured.⁴⁶ There are complicated provisions for according priority in bankruptcy and liquidation to an earner's contributions and an employer's contributions to an occupational pension scheme,⁴⁷ the broad effect of those provisions being to accord preference to an earner's contributions deducted during the period of four months preceding sequestration and to an employer's contributions payable in the period of 12 months preceding sequestration towards minimum guaranteed pensions for his employees. For reasons already given, we recommend abolition of the preference for both the earner's contributions and the employer's contributions. The abolition should not adversely affect employees, as section 123 of the Employment Protection (Consolidation) Act

⁴¹There is a similar preference in liquidation for all these contributions.

⁴²See regulation 39 of the Social Security (Contributions) Regulations 1979 (S.I. 1979/591).

⁴³c. 60.

⁴⁴See ss. 33 and 34 of the Act. The requirements relate to the commencement, continuation and rate of pensions.

⁴⁵This Board was established by s. 66 of the Social Security Act 1973 (c. 38).

⁴⁶Social Security Pensions Act 1975, s. 40.

⁴⁷*Ibid.* Sched. 3, paras. 1, 2.

1978⁴⁸ makes provision for the payment by the Secretary of State of an employer's or employee's unpaid contributions to an occupational scheme, in a case where the non-payment has resulted from insolvency.⁴⁹ Where the Secretary of State makes a payment in respect of contributions to an occupational pensions scheme, the rights and remedies in respect of the contributions belonging to the scheme managers become his rights and remedies.⁵⁰

15.15 A preference in bankruptcy and liquidation is also accorded to state scheme premiums.⁵¹ These are premiums payable to the Secretary of State by an employer or other person for the protection of the members of an occupational pension scheme in the event of their severing their connection with the scheme or in the event of the scheme itself ceasing to be a contracted-out scheme. Provision is made for treating a state scheme premium payable in respect of any person as actually paid in any case where that person is free from blame for the failure in making the payment.⁵² Again we consider, for the reasons already stated, that this preference should be abolished.

Local rates

15.16 Section 118(1) of the 1913 Act also gives preference to "all poor or other local rates due by the bankrupt [at the date of the award of sequestration] and having become due and payable within 12 months next before that date".⁵³ Our Working Party were sympathetic to the preference for local rates on the ground that a local authority had no option but to continue to provide services for good and bad debtors alike⁵⁴ (and in that respect is in a different position from a statutory undertaking such as an electricity or gas board). We accept that this is so, but nevertheless we are not convinced that this is a sufficient reason for maintaining the preference for rates. The arguments for and against a preference for rates are similar to those which we have already stated for and against a preference for taxes. A local authority also has at its disposal machinery for recovery of arrears of rates under a summary warrant procedure and a priority in diligence over individual creditors, and in this respect may also be compared with the Crown.⁵⁵ In short, the preference for local rates seems to be neither less nor more justified than Crown preference for income tax. Accordingly, we recommend that the preference for local rates be abolished.

⁴⁸c. 44.

⁴⁹Payments on behalf of an employee can be made only where the payment represents a sum deducted from the employee's pay.

⁵⁰Employment Protection (Consolidation) Act 1978 (c. 44), s. 125(3).

⁵¹Sched. 3 to Social Security Pensions Act 1975 (c. 60), para. 3.

⁵²Sched. 2 to that Act, para. 6(3).

⁵³s. 319 of the 1948 Act gives a similar preference in liquidation.

⁵⁴Memo. No. 16, p. 35.

⁵⁵See Local Government (Scotland) Act 1947 (c. 43), ss. 247, 248; Taxes Management Act 1970 (c. 9), ss. 63, 64.

Wages, salaries and other benefits to employees

15.17 The preference for wages or salary “of any clerk or servant” and for wages “of any workman or labourer” is regulated by section 118(1)(b) and (c) of the 1913 Act as read with sections 91(4) and 115(1) of the Companies Act 1947⁵⁶ (which provide that pay in respect of a holiday period or of absence from work through sickness shall be deemed to be wages in respect of services rendered to the bankrupt). The preference accorded to a clerk, servant, workman or labourer is, in each case, for an amount not exceeding £800⁵⁷ and in respect of service or services rendered to the bankrupt during the four months preceding the date of award of sequestration. It is likely that the preference extends to wages or salary earned wholly or in part by way of commission.⁵⁸

15.18 The consensus of opinion favours the continuation of the preference for wages or salary. None of the consultees on the proposals in Memorandum No. 16 were opposed to the preference, and the Blagden Report recommended not only that the preference should be retained but that a week’s wages or salary should take precedence over all other priority payments.⁵⁹ The Tassé Report accepts the justification for the preference.⁶⁰ Only the Budd Report sounds a different note by recommending abolition of the preference on the ground that “employees need no longer remain with an employer who fails to pay wages or salary”.⁶¹ But this course is not necessarily open to an employee and there are likely to be cases where the preference—which is not large in relation to each individual employee—has a just and useful place.

15.19 The provisions of Part 7 of the Employment Protection (Consolidation) Act 1978⁶² have an important bearing upon the preference for wages or salary. Section 121 of that Act in effect extends the meaning of the word “wages” for the purposes of the preference by providing that certain specified amounts⁶³ are to be treated for those purposes “as if [they] were wages payable by the employer to the employee”. Section 122 makes provision for the payment by the Secretary of State of certain debts (including specified arrears of pay and holiday pay) owed by an employer to an employee where the former has become insolvent, and section 125 of the Act gives the Secretary of State the rights and remedies of the employee in respect of monies paid to the employee under section 122. It is no doubt true that the provisions of section 122 of the 1978 Act would protect the

⁵⁶c. 47.

⁵⁷The limit of the preference was increased to this figure by the 1976 Act, s.1 and Sched. 1.

⁵⁸Memo. No. 16, p. 35.

⁵⁹Blagden Report, pp. 31, 32.

⁶⁰Para. 3.2.072. The Report considers a preferential period of three months “ample time”, but recommends that the limit of the preference be increased from 500 to 1,000 dollars.

⁶¹p. 353.

⁶²c. 44.

⁶³The specified amounts are any amount owed by an employer to an employee in respect of (a) a guarantee payment in respect of a period where the employee is not provided with work, (b) remuneration on suspension on certain medical grounds, (c) any payment for time-off under certain provisions of the Act, and (d) remuneration under a protective award on redundancy.

employee against hardship if the preference for wages or salaries was abolished, but the debt to an employee to which preference is given under section 118 of the 1913 Act is somewhat different from the debts which the Secretary of State may be required to pay under section 122 of the 1978 Act. Either section may yield benefits which the other does not, according to the circumstances of the case.⁶⁴ Accordingly, we recommend the retention of the preference for wages or salary and its re-enactment in the legislation that we propose. In view of this recommendation, and in view also of the recommendation that we make below⁶⁵ for the extension to bankruptcy of the preference given by the 1948 Act to the lender of money for the purpose of paying the wages or salary of the employee of a company, we think it reasonable that, in any case where the Secretary of State makes payment of wages or salary owed to an employee, the Secretary of State should succeed to the priority enjoyed by that employee. Accordingly, we make no recommendation for alteration of the provisions of section 125 of the Employment Protection (Consolidation) Act 1978.⁶⁶

15.20 An employee is also accorded a preference for "accrued holiday remuneration" becoming payable to him on the termination of his employment before or by the effect of the award of sequestration.⁶⁷ "Accrued holiday remuneration" refers to remuneration which would have become payable to the employee for his holiday period if his employment with the bankrupt had continued until the arrival of that period. Again, we recommend retention of the preference and its re-enactment in the legislation that we propose.

15.21 Section 319(4) of the 1948 Act⁶⁸ provides that on the winding-up of a company the lender of money advanced for the purpose of paying the salary or wages of any employee shall have the preference which would have been enjoyed by the employee if he had not been paid. There is no corresponding provision in bankruptcy legislation and our Working Party, strongly influenced by that inconsistency, recommended the introduction into bankruptcy legislation of a provision akin to section 319(4) of the 1948 Act.⁶⁹ In formulating their recommendation the Working Party found it necessary to balance two conflicting considerations: on the one hand, it was undesirable that the preference should be used to keep a "dying concern" on its feet, but on the other, it was in the public interest that banks should be encouraged to give short-term credit "to concerns or individuals who have

⁶⁴e.g. the preference given by s. 118 of the 1913 Act to each individual employee is for wages or salary not exceeding £800 in respect of the period of four months before sequestration. The employee's entitlement under s. 122 of the 1978 Act is to *inter alia* arrears of pay only "in respect of a period or periods not exceeding in the aggregate eight weeks." and the maximum amount that may be paid in respect of any one week must not exceed £100. On the other hand, s. 122 gives the employee an entitlement to certain payments (for example, compensation for unfair dismissal) which do not enjoy preference under s. 118.

⁶⁵See para. 15.22.

⁶⁶c. 44.

⁶⁷See Companies Act 1947 (c. 47), ss. 91(5), (6), 115(1).

⁶⁸The provision originates in s. 264(3) of the Companies Act 1929 (c. 23).

⁶⁹Memo. No. 16, pp. 46, 49, 50.

present difficulties but a bright future". Against that background, the Working Party agreed to recommend that the period of preference be reduced from four to three months and the monetary limit increased from £200 to £300.⁷⁰ The same question had exercised the Blagden Committee, but they accepted evidence that the provision in the 1948 Act was open to abuse because of the difficulty of proving how money advanced was in fact used and, that apart, might (undesirably) encourage an insolvent person to carry on his trade or business. They concluded "that such a provision in bankruptcy is most undesirable from all points of view".⁷¹ The Department of Trade Advisory Committee on the E.E.C. Convention on Bankruptcy simply note that "the concept of subrogation to the preferential rights of employee creditors ... appears not to exist in the other States".⁷²

15.22 It is not easy to decide which of the two conflicting considerations alluded to by our Working Party should be given greater weight, but on balance we agree with them that the preference should be retained. The Committee of Scottish Clearing Bankers have pointed out that the preference can ensure that the labour force of an organisation is still intact at the commencement of winding-up, and that may be of great assistance to the liquidator (or in the case of sequestration, to the trustee). It should also be noted that the preference is not additional to an employee's preferential claim for arrears of wages or salary but is in substitution for it. We therefore recommend that the preference, as it exists under section 319 of the 1948 Act as amended by the 1976 Act, should also apply in the case of bankruptcy.

Friendly Societies Act 1974

15.23 Section 59 of the Friendly Societies Act 1974⁷³ makes provision for the case where an officer of a friendly society dies or is rendered bankrupt, and has in his possession by virtue of his office any money or property belonging to the society. In any such case the society may require the executor or, as the case may be, the trustee in bankruptcy to pay the money or deliver the property to the society in preference to any other debt or claim against the estate of the officer. Section 27 of the Act, however, makes provision for the giving of security by an officer who is to be entrusted with money. We consider that the protection afforded by section 27 should suffice and that a friendly society should not be entitled also to a preference in bankruptcy. We recommend, therefore, that this preference should be abolished. This would not prejudice the right of a friendly society under the principle of tracing to recover any money or property which can be identified as belonging to the society.

Deathbed, funeral and administration expenses

15.24 There is a common law preference for deathbed and funeral

⁷⁰Para. 92. The limit of the preference has, of course, been increased to £800 by the Insolvency Act 1976, s. 1 and Sched. 1.

⁷¹Blagden Report, p. 32.

⁷²Consultative Paper (November 1974), para. 5.7.

⁷³c. 46.

expenses,⁷⁴ whose justification has been said to be that it is “a debt of humanity”.⁷⁵ We accept that justification and accordingly recommend retention of the preference. It would, of course, continue to be limited to the expenses of the deceased bankrupt’s last illness⁷⁶ and to funeral expenses which are reasonable in the circumstances of the case. Where an insolvent estate has been sequestrated there may, of course, also be the question of administration expenses incurred by an executor. It seems reasonable that any necessary expenses of this kind should also be accorded priority: if it were otherwise executors might be discouraged from taking up the administration of estates lest they proved to be insolvent. Claims to deathbed and funeral expenses rank *pari passu*⁷⁷ and we recommend that the necessary administration expenses of a deceased person’s estate should be placed on the same level of priority as claims to deathbed and funeral expenses. The relative priority of these claims in relation to other claims on the estate is discussed elsewhere in this Report.⁷⁸

Application of proposals in liquidation proceedings

15.25 The majority of the debts to which we have referred in this Chapter are common to both bankruptcy and liquidation. It is clearly desirable that the preferential or non-preferential status of those common debts should be the same in liquidation as in bankruptcy, particularly since in some cases the remedy of liquidation may be available as an alternative to sequestration.⁷⁹ The classes of preferred debts in bankruptcy and liquidation largely correspond. The counterpart of section 118 of the 1913 Act is section 319 of the 1948 Act and most of the particular enactments to which we have referred confer preference in both bankruptcy and liquidation. The one important exception (which we have already noted) is the preference given by section 319(4) of the 1948 Act to a person who has advanced money for the payment of wages of employees of a company. This preference does not at present apply in bankruptcy but we have recommended that it should be imported into bankruptcy.⁸⁰ We propose, therefore, that our recommendations for the abolition of preferences in bankruptcy should also be adopted in relation to the liquidation of companies under the provisions of the Companies Acts.

E.E.C. Bankruptcy Convention

15.26 The draft E.E.C. Bankruptcy Convention in the latest form available to us⁸¹ concedes to the public authorities, Government departments and other public agencies of a Contracting State—

⁷⁴See 1913 Act, s. 118(5), which preserves the common law preference.

⁷⁵*Peter and Munro* (1749) Mor. 11852.

⁷⁶*Sanders v. Hewat* (1822) 1 S. 333.

⁷⁷*Peter and Munro* (1749) Mor. 11852.

⁷⁸See paras. 18.4–18.14, but especially para. 18.5.

⁷⁹*e.g.* a partnership of eight or more members may be subject to either sequestration proceedings or winding-up—see 1913 Act, s. 2 and 1948 Act, ss. 398 and 399.

⁸⁰See para. 15.22.

⁸¹April 1980.

- (a) a right to the preferences accorded to them under the law of that State out of the assets situated there; and
- (b) subject to certain conditions, a right to rank as unsecured creditors for the balance of any fiscal or quasi-fiscal debts out of the debtor's assets in other Contracting States.⁸²

The draft Convention, moreover, preserves within Contracting States any special rights to collect in their territories fiscal and quasi-fiscal debts,⁸³ and preserves the jurisdiction of their own courts to determine the existence of such debts (and debts arising under a contract of employment) and their preferential status.⁸⁴

15.27 It is evident, therefore, that the draft Convention gives no incentive to Contracting States to reduce the range of their fiscal and quasi-fiscal preferences and, arguably, discourages them from doing so. We note the comments of the Advisory Committee on the E.E.C. Preliminary Draft Convention⁸⁵ on this subject. In consonance with our preceding recommendations for the abolition of fiscal and quasi-fiscal preferences within the United Kingdom, we recommend that the United Kingdom authorities, in the course of further negotiations concerning that Convention, should argue for the general abolition of those preferences within the Contracting States and, failing that, in consonance with the views of the Advisory Committee, for the retention of the existing principle that foreign fiscal debts should not be given extra-territorial recognition.

Postponed debts

15.28 Scots law admits certain classes of creditors to a ranking only upon such estate as may remain after the claims of other creditors have been satisfied. The first class comprises persons who have sold the goodwill of a business, or lent to a business, in consideration of a share of its profits or at a rate of interest varying with its profits.⁸⁶ We have received no representations that this rule should be amended. It is not unreasonable that the claim of a person who has involved himself directly in the fortunes of a business, whether or not a partner thereof, should be deferred to that of the ordinary creditors.⁸⁷ In our view, this rule should be retained.

15.29 The second class of postponed creditors are married women who, in terms of section 1(4) of the Married Women's Property (Scotland) Act 1881,⁸⁸ are postponed creditors in relation to monies lent or entrusted by them to their husbands or inmixed with their funds. In Chapter 11 of this Report⁸⁹ we have recommended, in effect, the extension of the rule in section 1(4) of the 1881 Act to the husbands of bankrupt wives, but the restriction of

⁸²Article 44.

⁸³Article 23.

⁸⁴Article 15(7).

⁸⁵(Chairman: Sir Kenneth Cork) Department of Trade, January 1976, paras. 261-264.

⁸⁶Partnership Act 1890 (c. 39), s. 3.

⁸⁷See J. Bennett Miller, *The Law of Partnership in Scotland* (Edinburgh, 1973), p. 94.

⁸⁸c. 21.

⁸⁹Para. 11.16.

its application to cases where the spouse who has lent or entrusted the funds cannot instruct the loan or trust by a contract in writing signed by the parties thereto.

15.30 A speciality exists in relation to interest on moneylenders' debts. Section 9(1) of the Moneylenders Act 1927,⁹⁰ as applied to Scotland by section 18 of that Act, provides that interest on a moneylender's debt so far as the rate exceeds five per cent per annum is to be treated as a postponed debt. Section 9 has, however, been repealed in relation to agreements between money-lenders and bodies corporate and in relation to all loans by moneylenders of sums exceeding £5,000 by the Consumer Credit Act 1974 (Commencement No. 5) Order 1979.⁹¹ The complete repeal of section 9 under the provisions of the Consumer Credit Act 1974⁹² is expected to follow in due course, and there will thereafter be no speciality as regards interest on loans by moneylenders. We do not think it necessary to make any recommendation on this matter.

15.31 We have considered whether claims on the part of any other creditors should be classified as postponed claims. One possible claim is that of a spouse in respect of unpaid financial provision. Section 26 of the Succession (Scotland) Act 1964,⁹³ in providing for the payment of a capital sum or of periodical allowances on divorce, made no express provision relating to the rights and obligations of the parties following the bankruptcy of the debtor in the obligation. Nor is any such provision made by section 5 of the Divorce (Scotland) Act 1976,⁹⁴ which re-enacts section 26. We consider, however, that it would be inappropriate in this respect to treat divorced spouses as if their marriage still subsisted. We discuss elsewhere⁹⁵ the status of claims to arrears of periodical allowance.

⁹⁰c. 27.

⁹¹S.I. 1979/1685.

⁹²c. 39.

⁹³c. 41.

⁹⁴c. 39.

⁹⁵Paras. 16.34-16.41.

CHAPTER 16

ADMISSIBILITY AND VALUATION OF CLAIMS

Introduction: General proposals for simplifying the law

16.1 Satisfactory rules for the admissibility and valuation of claims are of importance, primarily, to ensure that the debtor's assets are fairly distributed among the creditors. But they are important also where the system of bankruptcy envisages, as does the Scottish system, control by the creditors of the process of sequestration and the concession to them of voting rights corresponding with their stake from time to time in the remaining assets. The Scottish rules on these matters were not devised as a coherent whole, but were introduced piecemeal by legislation enacted between 1772 and 1856. Minor amendments were introduced by the 1913 Act. There are differences between the applicable rules in the context of a creditor's petition,¹ in the context of a creditor's claim to vote, and in the context of his claim to rank for a dividend.² Partly in consequence of those differences, the present law is complex and occasionally obscure and ambiguous.³ This is unsatisfactory, particularly since, in terms of section 318 of the 1948 Act, the rules for the proof and ranking of claims in sequestration apply also in the winding-up of a company registered in Scotland. While we would have preferred to recommend a uniform system for the valuation of all claims for any purpose in the course of a sequestration, we recognise that the different purposes of these valuations require certain differences to be maintained.

16.2 We have already recommended that it should continue to be incompetent to found a petition for sequestration upon a contingent debt and cease to be competent to found such a petition upon a future debt.⁴ Such debts, however, are, and in our view should be, susceptible of founding a claim to vote or to rank in a sequestration.⁵ This difference, therefore, between debts which found a petition for sequestration, and those which found a claim to vote and rank, must remain. Under the present law, a petitioning creditor who holds a security for his debt must specify—but probably need not deduct—the value of any security which he holds over the estate of the bankrupt or any co-obligant.⁶ On the other hand, a creditor who submits a claim for voting or ranking purposes must always specify *and* deduct the value of any security which he holds over the estate of the bankrupt, and in certain circumstances must also specify and deduct the value of any security which he holds over the estate of a co-obligant.⁷ We have recommended that a petitioning creditor should be required to specify

¹A creditor whose debt is contingent is not entitled to petition for sequestration though, after he has had his claim valued by the sheriff or trustee, he has a right to vote and rank—ss. 12, 49.

²The value of the claims against co-obligants must be deducted for voting purposes, but not for purposes of ranking—*cf.* ss. 55, 56, 61.

³See *Knowles v. Crooks and Balgarnie* (1865) 3 M. 457.

⁴Para. 5.31.

⁵See paras. 16.12, 16.13.

⁶Para. 5.32.

⁷See para. 16.4.

in his oath, and to deduct the value of, any security that he holds over the estate of the bankrupt but not over the estate of another obligant.⁸ Accordingly, the only remaining difference in the necessary elements of an oath required to support a petition for sequestration and those of a statement of claim for voting or ranking purposes will be the fact that a future or contingent debt will not support a petition for sequestration.

16.3 There are certain differences in the present law between the rules relating to the valuation of claims for voting purposes and those applicable for ranking purposes. The principal distinction relates to the trustee's power to take over securities. Where a creditor has valued a security for the purpose of drawing a dividend, section 61 of the 1913 Act permits the trustee with the consent of the commissioners to require the creditor to convey or assign the security to the trustee for the benefit of the estate at the value placed upon it by the creditor with no addition to such value. Conversely, where the creditor has in a claim valued a security for voting purposes only and made use of the claim at any meeting, section 58 of the Act empowers the trustee with the consent of the commissioners to require the creditor to convey or to assign the security to the trustee at the specified value with an addition of 20 per cent. This distinction is based on the view that the valuation of a security may be a complex matter and a creditor may have little time before a meeting to complete such a valuation. We understand that little use is made by trustees of their powers under section 58 and we consider that creditors would be sufficiently protected if they were given a reasonable period after the date of the sequestration within which to complete or to revise the valuation of any securities they possess.⁹ The effect of our proposals will be that no distinction will arise between the powers of the trustee to take over securities which have been valued by a creditor for voting purposes and those which have been valued for ranking purposes.

16.4 Another difference between the present rules for the valuation of claims for voting purposes and those applicable for ranking purposes relates to the valuation of claims against co-obligants. In presenting a claim for voting purposes, a creditor who has:

“an obligant bound with but liable in relief to the bankrupt, or holds any security from an obligant liable in relief to the bankrupt, or any security from which the bankrupt has a right of relief”

is required to place a specified value on the obligation or security, and to deduct it from his debt.¹⁰ The rules apply only where the co-obligant is liable in relief to the bankrupt, and would apply, therefore, where the bankrupt is himself a cautioner for the creditor's debt, but not where the co-obligant is a cautioner for the bankrupt's debt. Its effect is to limit the claim of the creditor for the purposes of voting in the sequestration to the amount

⁸Paras. 5.32-5.33.

⁹See para. 16.22.

¹⁰1913 Act, s. 56.

which he would have been able to claim if he had first proceeded against the primary obligant. No such limitation is introduced in the valuation of a claim for ranking purposes. While there is some justification in principle for the distinction, we consider that it is unduly fastidious to evaluate differently in this respect a creditor's claims for voting and ranking purposes. If the object of the rules is to make the creditor's voting rights correspond with his interest in the bankrupt's estate, a sufficiently accurate guide to that interest is the value of the creditor's claim for ranking purposes. We recommend, therefore, that a creditor need not deduct the value of any claim against or security from a co-obligant in his statement of claim for voting purposes. This will ensure that, for voting purposes as well as for ranking purposes, claims against or securities from co-obligants will be disregarded.

16.5 A similar distinction is made by the present law in relation to the valuation of claims in cases where the creditor in a debt owed by an insolvent firm claims upon the estate of a partner of that firm as being (in effect) its cautioner. In the context of valuation for voting purposes the creditor is bound to put a value on his claim against the estates both of the firm and of any other partners in so far as they are bound to relieve such partner and to deduct such value from his debt.¹¹ Where the debt is valued for ranking purposes, however, all that is deducted is the value of the creditor's claim against the estate of the firm (as fixed by the trustee on the estate of the partner).¹² This rule clearly proceeds upon a principle analogous to that which governs the deduction for voting purposes of the value of the obligations of co-obligants under section 56 of the 1913 Act. Having recommended with reference to that section that the rules applicable to the valuation of claims for ranking purposes should be applied to the valuation of claims for voting purposes, we recommend that the rules applying to the valuation of claims against the estate of a partner for ranking purposes should be applied also for voting purposes.

16.6 A further speciality in relation to voting is contained in section 60 of the 1913 Act. This provides that:

"Any person who shall acquire after the date of the sequestration, otherwise than by succession or marriage, a debt due by the bankrupt, and the wife of the bankrupt and any trustee for her shall not be entitled to vote in the election of trustee or commissioners, but in all other respects such person may be ranked as a creditor."

The restriction of the voting rights of creditors acquiring debts after the bankruptcy was designed to stop a creditor buying up the claims of others to enable him to select the trustee.¹³ Though we suspect that claims would rarely be purchased for this purpose today, we recommend that this restriction of the voting rights of creditors acquiring debts after the date of the sequestration should be retained, subject to the deletion of the words "or

¹¹1913 Act, s. 57.

¹²1913 Act, s. 62.

¹³See Goudy, p. 198.

marriage" which became redundant following the Married Women's Property (Scotland) Act 1881.¹⁴

16.7 The restriction of the voting rights of the bankrupt's wife presents greater problems. It has been held, on the one hand, that section 60 does not bar a wife from voting in a resolution under section 34 of the 1913 Act to wind up her husband's estate by deed of arrangement, though the effect of such a resolution is to prevent the election of a trustee.¹⁵ On the other hand it has been held that the wife of the bankrupt is not entitled to vote under section 71 for the removal of a trustee, since this is merely a step in the procedure for electing a new trustee.¹⁶ Section 60 applies to wives only, and not to husbands or other conjunct or confident persons.¹⁷

16.8 If this rule is to be retained it would clearly require to be extended to a female bankrupt's husband. We rather think, however, that even as so extended, section 60 would proceed upon the wrong principle. There should be a restriction on the right of voting only in respect of persons who have involved themselves directly in the fortunes of the bankrupt. There is already a sheriff court decision declaring invalid for voting purposes a claim by a creditor for the amount of a loan advanced to the bankrupt under an agreement stipulating *inter alia* for a share in the profits of the bankrupt's business.¹⁸ We recommend, therefore, that irrespective of his or her relationship with the bankrupt, a creditor should not be entitled to vote in the election or in the removal of the trustee or of the commissioners in a sequestration to the extent that his or her claim for ranking is postponed.

16.9 It should be noted that, apart from section 60 of the 1913 Act, no distinction is made between claims for voting purposes by reason of the nature of the claim or the person of the claimant. For voting purposes preferred, ordinary and postponed claimants have identical rights. It may be said, therefore, that apart from the special rules discussed in the preceding paragraphs, there are no distinctions between the rules relating to the valuation of claims for voting and those relating to their valuation for ranking. The proposals for the admissibility and valuation of claims which we make in the remainder of this Chapter are discussed primarily in the context of claims to rank, but they are intended (even where this is not expressed) to apply equally to claims for voting purposes.

Heads of claim

Introduction

16.10 The general principle, stated in section 48 of the 1913 Act, is that a creditor is entitled to vote and rank only for the accumulated sum of principal and interest to the date of the sequestration. This principle,

¹⁴c. 21.

¹⁵*MacNaught v. Sievwright* 1927 S.C. 285.

¹⁶*MacNaught v. Sievwright* 1928 S.C. 687.

¹⁷*Forrester & Forrester's Sequestration* (1892) 8 Sh. Ct. Rep. 43.

¹⁸*Scott Cran & Co.'s Sequestration* (1909) 25 Sh. Ct. Rep. 238.

however, is subject to many qualifications—which under the present law may differ in claims for voting and ranking—relating to interest for the period after the date of sequestration, future debts, annuities and contingent debts. In addition, a creditor may require to deduct the value of any securities which he may hold or the value of any claims which he may have against co-obligants. It may be convenient to deal first with questions relating to the determination of the principal sum due.

Trade discounts

16.11 Section 48 of the 1913 Act provides, but apparently only in relation to debts not payable until after the date of the sequestration,¹⁹ that a creditor must deduct from his claim any trade discount to which his claim is liable by contract, usage of trade or course of dealing. We have noted both the present rule on this matter in England²⁰ and the suggestion of the Blagden Committee that the rule should read:

“For the purpose of proof of a debt a creditor shall deduct therefrom all trade discounts, but he need not deduct any discount which he had agreed to allow for payment in cash.”²¹

While there seems to be no justification for restricting the application of the provision made by section 48 to future debts, it may be thought desirable to refer specifically to discounts for payment in cash. We recommend, therefore, that it should be made clear that, whether the debt is payable before or after the date of the sequestration, a creditor in calculating the amount of his claim shall deduct any discount (other than any discount for payment in cash) which may be allowable in terms of the contract between the parties, by reason of their course of dealing, or by virtue of any usage of trade.

Debts not yet due

16.12 Section 48 also provides that:

“if the debt is not payable till after the date of the sequestration, [the creditor] shall be entitled to vote and rank for it only after deduction of the interest from that date.”

Though the language of this provision is at first sight obscure, its purpose clearly was to discount the amount of a future debt as at the date of the sequestration by deducting interest at an appropriate rate from and after that date. Goudy suggests in this context that, in the absence of express stipulation, custom or usage, interest is to be deducted at the rate of five per cent per annum.²² It might be clearer to provide that, where a debt is not payable until after the date of sequestration, the creditor may claim in respect of the debt as if it were payable at the date of the sequestration, and may vote and rank accordingly, but only after deducting interest at a

¹⁹*Duncan v. Aitchison & Co.* (1879) 6 R. 582, a case decided on a consideration of s. 52 of the 1856 Act, which was in similar terms.

²⁰1914 Act, Sched. 2, para. 8.

²¹Report, p. 76.

²²p. 180.

prescribed rate²³ from the date of the sequestration until the due date of payment. We suggest to the rule-making authority that the prescribed rate should be the same as that prescribed for the calculation of post-sequestration interest. It would follow that, if a surplus were to emerge after the payment in full of the debts ranked, the creditor for a future debt, in addition to receiving the amount of his claim as valued in accordance with the preceding proposal, would receive interest at the prescribed rate on the amount of his claim as so valued for the period after the date of the sequestration.

Contingent debts and annuities

16.13 Where at the date of its lodging a creditor's claim is subject to a contingency which is then unascertained, he is not entitled to vote or rank in respect of that claim.²⁴ He may, however, apply to the sheriff or, after his election, to the trustee, to put a value on the debt and he may then vote or rank in respect of such value. It is essential, however, that the claim should be one inherently capable of valuation.²⁵ The deliverance of the sheriff or trustee is subject to review. A contingent creditor is not obliged to have his claim valued, and in some cases may prefer to await the purification of the condition on which his claim depends. He has then no right to vote but, in calculating the divisible estate for the payment of dividends, the trustee will set aside funds to meet the claim.²⁶ Separate, but slightly different, provision is made for annuities. We recommend that, with one minor alteration, the rules relating to the valuation of contingent debts should be retained but that those rules should be applied also to the valuation of annuities. The alteration which we propose is that those rules should apply not only where the existence or otherwise of the debt is subject to a contingency but also where, although the existence of the debt is not uncertain, its value may be affected by a contingency. This extension of the rules permits us to recommend the omission of separate statutory provisions regarding annuities (which are at present contained in sections 50 and 51 of the 1913 Act). An annuity, it seems clear, is either a debt whose value may be affected by a contingency or (where it is payable over a fixed period irrespective of circumstances) a series of future debts whose value may be calculated in the appropriate manner for future debts.²⁷ In the second place, we recommend that the rule in section 51 of the 1913 Act (which provides that after an annuity has been valued under the Act, a cautioner for its payment is liable only for the value so determined) should be applied to any valued debt whose existence or value depended upon or might have been affected by a contingency.

²³See para. 16.46.

²⁴1913 Act, s. 49 and *Creswell Ranche and Cattle Co. Ltd. v. Balfour Melville* (1902) 9 S.L.T. 356.

²⁵*Garden v. McIver* (1860) 22 D. 1190, per Lord Wood at 1194; *Mathew v. Mathew's trustee* (1907) 15 S.L.T. 326.

²⁶Goudy, p. 183.

²⁷See Goudy, p. 184.

Debts due under composition contracts

16.14 Where in the course of a sequestration the creditors accept a composition offer from the bankrupt and the latter in consequence is discharged, there is authority for the view that those creditors may rank only for the balance of the composition remaining unpaid in the case of the renewed sequestration of the bankrupt.²⁸ In extra-judicial composition contracts the rule is that if the condition for paying the composition is violated, the original debt will revive.²⁹ In our view, the latter approach is fairer to the original creditors of the bankrupt and should be adopted generally. We recommend, therefore, that, if following the acceptance of a composition contract a sequestration is subsequently revived, the creditors should be entitled to claim in the sequestration the same amount as if the composition had not been accepted, less any payments made to them under the composition contract.

Secured debts

16.15 The term "security" is widely defined by section 2 of the 1913 Act and includes "securities, heritable or moveable, and rights of lien, retention, or preference, and conveyances thereof and any part thereof". Inhibitions, arrestments in security, and a right of retention over the future proceeds of insurance policies have been held to come within the meaning of the term.³⁰

16.16 There are different rules relating to the deduction of the value of any security held by a creditor in statute law and in the common law. In terms of the 1913 Act³¹ a creditor who holds a security for his debt over any part of the estate of the bankrupt, in valuing his claim whether for voting or ranking purposes, is bound to put a value on his security, to deduct this value from his debt, and to claim to vote or to rank (as the case may be) only for the balance. Where, however, the voting relates to the management or disposal of the estate subject to the security, this deduction need not be made.³² In claims to vote, each security must be separately valued but, in claims to rank, separate values need be given only where required by the trustee.³³

16.17 The common law, however, is to a different effect:

"According to it, the creditors who have shared or appropriated one part of the property of the bankrupt, are still, in ranking on the residue; entitled to share according to the ratio of their whole original debts, always under the condition that, by so ranking, they shall not draw

²⁸*Saunders v. Renfrewshire Banking Company* (1827) 5 S. 565.

²⁹*Horsefall v. Virtue and Co.* (1826) 5 S. 36; *Woods, Parker & Co. v. Ainslie* (1860) 22 D. 723.

³⁰Goudy, p. 187.

³¹ss. 55, 61.

³²s. 55 *ad finem*.

³³s. 61. It should be observed that these rules apply only where the security is one over a part of the estate of the bankrupt at the date of the sequestration—*Royal Bank of Scotland v. Millar & Co.'s Tr.* (1882) 9 R. 679; *University of Glasgow v. Yuill's Tr.* (1882) 9 R. 643—and not to cases where the security is over the estate belonging to someone else, for example, an estate which the bankrupt has sold subject to the security.

more than full payment... The principle just referred to does no more than allow each responsible creditor to rank and share on each of the separate funds of division, according to the ratio of his original debt, just as each creditor ranks in a sequestration for his whole debt on each successively arriving fund of division."³⁴

The common law rules of ranking apply wherever the statutory rules are inapplicable. They apply in the ranking of creditors under private trust deeds for creditors unless—as is usually the case—they are expressly excluded.³⁵ They apply also, because of the terms of section 55, where the creditor's security is not or is no longer one over the estate of the bankrupt. Thus, where the bankrupt has sold heritable property subject to a security, the creditor in that security, in addition to recovering what he can under the security, may rank on the bankrupt's estate for the full amount of the debt in view of the subsisting personal obligation of the bankrupt.³⁶

16.18 The statutory rules are generally considered to be the fairer. Bell has observed:³⁷

“The principle of this rule, as being consistent with equity, ought to lead to its extension to other cases of bankruptcy. But as the law stands, the rule is different in an ordinary ranking and in a sequestration; and it is somewhat mortifying to find in a code of jurisprudence so much advanced as ours, a different rule in cases exactly parallel...”

The statutory rules at present apply where the insolvent estate of a deceased person is being wound up under section 163 of the 1913 Act, and by virtue of section 318 of the 1948 Act in relation to the liquidation of companies under the Companies Acts. They do not apply where an insolvent estate is wound up by a trust deed for creditors unless, as is usually the case, the trust deed so provides. We recommend that the statutory rules should apply or continue to apply in all insolvency situations and, in relation to trust deeds, recommend that they should be applied unless the deed expressly provides otherwise.

16.19 As we have explained above,³⁸ where the creditor has more than one security, he is required to put a value on each separate security for voting purposes,³⁹ but need do so for ranking purposes only when so required by the trustee.⁴⁰ We suggest that where a creditor has more than one security he must, in every claim submitted by him in which the securities figure, value each security separately.

³⁴*Kirkcaldy v. Middleton* (1841) 4 D. 202, per Lord Fullerton at 208.

³⁵Goudy, p. 476.

³⁶*Royal Bank of Scotland v. Millar's Tr.* (1882) 9 R. 679; *University of Glasgow v. Yuill's Tr.* (1882) 9 R. 643.

³⁷Bell, *Comm.* ii. 420; see also Goudy, p. 506.

³⁸Para. 16.16.

³⁹s. 55. This rule is criticised by J. Burns, “English and Scottish Bankruptcies”, 29 L.Q.R. (1913), p. 460 at 470.

⁴⁰s. 61.

16.20 The value of a security clearly may differ from time to time throughout the course of a sequestration. In practice, the creditor will make a single oath or notice of claim, but there is nothing to prevent his revaluing the security and claiming to be ranked for further dividends, so long as assets remain in the estate.⁴¹ We recommend, however, that the revaluation of a security should be incompetent after any intimation by the trustee to the creditor that he intends to redeem the security.⁴²

16.21 In English law, if a secured creditor surrenders his security for the general benefit of the creditors, he may prove for his whole debt.⁴³ There is no corresponding rule in the 1913 Act and a creditor must value any security which he possesses, even if it is worthless or virtually worthless.⁴⁴ Like our Working Party,⁴⁵ we consider that a provision modelled on the English rule would be useful and recommend that if a secured creditor surrenders, or undertakes in writing to surrender, his security for the benefit of the debtor's estate, he should be entitled to claim for his whole debt.

16.22 We have recommended above⁴⁶ the abolition of the present distinction between the rules empowering the trustee to take over securities at the valuation placed on them by creditors for voting purposes and ranking purposes respectively. We recognise, however, that creditors must be given a reasonable period after the date of sequestration within which to complete or revise the valuations of securities for which values have been specified in claims, without being at risk of having the securities taken over by the trustee at these possibly inadequate values. We consider that it would be reasonable to allow creditors a period of 12 weeks from the date of sequestration to complete the valuation of securities. We recommend, therefore, that a permanent trustee should be empowered to require a secured creditor at the expense of the estate to discharge a security or to convey or assign it to the permanent trustee at the value specified by the holder of the security in his claim, but only after the expiry of 12 weeks from the date of sequestration. As we have recommended, however, once the permanent trustee has required the creditor so to discharge, convey or assign his security, the creditor should not be entitled to produce another statement of claim specifying a different value for the security.⁴⁷

16.23 Our Working Party made further proposals,⁴⁸ closely modelled on English law,⁴⁹ designed to require the trustee to decide whether he would or would not exercise his power to redeem a security at the value placed on it

⁴¹*Commercial Bank of Scotland Ltd. v. Speedie's Tr.* (1885) 13 R. 257; *Wood v. MacKay's Tr.* 1936 S.C. 93.

⁴²For discussion of this question see para. 16.22.

⁴³1914 Act, Sched. 2, para. 11.

⁴⁴*Gibson v. Greig* (1853) 16 D. 233; *McEwan v. Cleugh* (1842) 5 D. 273.

⁴⁵Memo. No. 16, p. 73.

⁴⁶Para. 16.3.

⁴⁷Para. 16.20.

⁴⁸Memo. No. 16, pp. 71, 74.

⁴⁹1914 Act, Sched. 2, para. 13(c).

by the creditor or his power to require the security subjects to be offered for sale. The proposals, in brief, were that the security holder might call upon the trustee to exercise one power or the other, and that if the trustee chose to exercise neither, the security holder could demand that the security subjects be transferred to him—his claim being reduced by deduction of the value of the security after the transfer had taken place. These proposals were designed to avoid the expense to the creditor of calling up and realising the security and to avoid also the inflation of that creditor's claim on the estate for any unsecured balance. While we have considerable sympathy for these proposals, their implementation would require legislative provisions of some complexity. Under our proposals,⁵⁰ moreover, the trustee would have the right with the concurrence of any heritable creditor to sell the property. If the permanent trustee were requested by a heritable creditor to sell the property with his concurrence, the trustee would be failing in his duty if he did not adopt that course of action when it minimised losses to the estate. On balance, therefore, we make no recommendation for the implementation of these proposals.

16.24 Our Working Party proposed,⁵¹ on the model of a provision in paragraph 16 of Schedule 2 to the 1914 Act, that when a creditor's security has been realised, the net amount realised should be substituted for the amount of any valuation previously made by the creditor. This proposal could not be implemented precisely in these terms, since the creditor might be under an obligation in terms of section 27 of the Conveyancing and Feudal Reform (Scotland) Act 1970⁵² or otherwise to account to other security holders or, indeed, since the net amount realised might be greater than the amount of the secured creditor's debt. We consider that the point would be better dealt with by providing that where a creditor's security has been realised there shall be substituted for the amount of the creditor's valuation the amount (after deduction of the expenses of realisation) which the creditor has received or is entitled to receive in consequence of the realisation.

16.25 Even although the trustee may take over a security at the valuation placed upon it by a creditor, this may not always be a deterrent to the undervaluation of securities since, as our Working Party pointed out, the trustee may be unwilling to undertake the responsibility of borrowing funds to take over the security. The Working Party, therefore, proposed that the trustee should be entitled to require the property over which the security extends to be offered for sale on such conditions as might be agreed between the creditor and trustee or, on default of agreement, might be imposed by the court. Though we were initially disposed to agree, the problem arises in practice mainly in relation to heritable property and here our proposals conferring on the trustee a general power of sale, with specific provisions protecting the holder of any security, should suffice to deal with the problem.

⁵⁰Para. 10.18.

⁵¹Memo. No. 16, p. 75.

⁵²c. 35.

⁵³Para. 16.4.

We therefore make no recommendation in the sense of the Working Party's proposal.

Co-obligants

16.26 The Scottish rules relating to voting and ranking are somewhat complicated where a creditor has a personal security—in the form of a cautioner or a “true” co-obligant bound with the bankrupt—rather than a real security over the debtor's estate. Part of this complication arises from the fact that there are different rules for the valuation of claims for voting and for ranking purposes respectively. We have already recommended,⁵³ however, that in relation to claims involving cautioners or co-obligants the rules applicable for ranking purposes should also be applied for voting purposes.

16.27 In relation to ranking, the leading principle is that where there is a co-obligant with the bankrupt and the creditor proceeds in the first instance against that co-obligant and secures payment of his debt, the co-obligant is subrogated to the creditor's claim and will obtain a ranking in place of the creditor. The claim of the creditor and, to the extent that he is required to pay, that of the cautioner or “true” co-obligant are simply two sides of a single coin. From the point of view of the other creditors, the bankrupt has incurred one debt and one debt only and the fact that the creditor has secured collateral obligations from another person should not entitle that debt to a double ranking. The rule, which rests upon the common law, operates satisfactorily in practice. Given the variety of situations which the rule has to cover, we consider that it would be inadvisable to express it in statutory form. We recommend merely that, with the exceptions referred to below, nothing in the legislation to follow on this Report should derogate from the common law rules relating to the valuation of claims by or involving co-obligants in a sequestration. In this perspective it is unnecessary to retain the latter portion of section 52 of the 1913 Act, which should be discarded.

16.28 The exceptions to which we refer in the preceding paragraph are the following. It should be made clear that, where a creditor has a cautioner or co-obligant for the whole or part of the debt, the cautioner or co-obligant should not be freed from liability for the debt by reason only of the creditor's voting or drawing a dividend or assenting to the discharge of the debtor or to any composition or deed of arrangement. A special problem arises where the co-obligant holds a security over any part of the estate of the bankrupt. The creditor may choose to claim in the first instance either against the co-obligant or against the estate. Prior to the 1913 Act, if the creditor adopted the latter course, the loss to the estate was considerably greater, since the co-obligant did not require to account for the security. Accordingly, following a recommendation of the Cullen Committee,⁵⁴ a cautioner or co-obligant was required to:

⁵⁴Para. 39(e).

“... account for the security to the trustee as if he had paid the debt to the creditor and thereafter ranked on the sequestrated estate under deduction of the value of such security.”⁵⁵

This provision has been criticised in learned articles⁵⁶ and presents certain problems. It assumes, for example, the solvency of the cautioner. Though we have considered its deletion or amendment, no alternative formula has been proposed or has occurred to us for better achieving the primary end of securing, whatever course may be taken by the creditor, that the burden on the sequestrated estate remains the same. Subject to drafting amendments, therefore, we propose the retention of this provision.

Partnerships

16.29 The Partnership Act 1890⁵⁷ preserves the principle of Scots law that a partnership or firm has a legal personality distinct from that of its individual partners. A partner may stand in the relation of debtor or of creditor to the firm and the firm likewise to him. The firm has no general liability for the debts of a partner, but a partner is regarded as a species of cautioner for the debts of the firm. The law proceeds on the basis that the primary liability for a debt of the firm falls upon the firm itself, and that the liability of the partners is merely an accessory one. Though these principles are reflected in the rules of Scots law relating to the valuation of claims in partnership situations, there are differences in the rules respectively applicable in relation to claims for voting and ranking. We have recommended above⁵⁸ that these distinctions should be discarded and that the rules applicable in relation to ranking should apply for all purposes. We now consider these rules.

16.30 In accordance with the general principles of the law of partnership the sequestration of the estate of a firm does not necessarily entail the sequestration of the estates of its individual partners. Each may be sequestrated independently. On the sequestration, moreover, of a firm and of its individual partners, the creditors of the firm are entitled to be ranked for the amount of their debts both on the partnership estate and, when they have not been paid in full out of that estate, on the estates of the individual partners. When they rank on the estates of the individual partners, they do so *pari passu* with the ordinary creditors of such partners. When ranking on the estate of the firm, a creditor need not deduct the estimated value of his claim against the estates of the partners. On the other hand, where a creditor of the firm claims to rank on the estate of a partner for a firm debt, section 62 of the 1913 Act provides that:

“the trustee on the estate of such partner shall, before ranking such creditor, put a valuation on the estate of the company, and deduct from

⁵⁵s. 61 *ad finem*.

⁵⁶Anon, (1914), 30 S.L.R. 152; J. Burns, “English and Scottish Bankruptcies”, 29 L.Q.R. (1913), p. 460 at 470-471.

⁵⁷c. 39.

⁵⁸Para. 16.5.

the claim of such creditor such estimated value, and rank and pay to him a dividend only on the balance.”

This provision presents difficulties of construction. It seems to say that the trustee should deduct from the creditor's claim his valuation of the estate of the company rather than his valuation of the individual creditor's claim on the estate of the company. We agree, however, with Professor J. Bennett Miller⁵⁹ that this is merely a drafting infelicity and that the intention was to require the deduction only of the estimated value of the individual creditor's claim against the firm. We recommend that this should be made clear.

16.31 The law of England does not concede to a partnership independent legal personality. Nevertheless, for the purposes of ranking in bankruptcy, English law separates the joint estate of the partners from their individual estates and provides in section 33(6) of the 1914 Act that:

“In the case of partners the joint estate shall be applicable in the first instance in payment of their joint debts, and the separate estate of each partner shall be applicable in the first instance in payment of his separate debts. If there is a surplus of the separate estates, it shall be dealt with as part of the joint estate. If there is a surplus of the joint estate, it shall be dealt with as part of the respective separate estates in proportion to the right and interest of each partner in the joint estate.”

Lord Blackburn considered that this rule was adopted partly, at least:

“on the ground of convenience in administering the bankruptcy law. It was thought that the administration of the bankrupt law could not be conveniently carried out if the estates were to be mixed.”⁶⁰

It is, however, subject to various exceptions.

16.32 There was controversy in the past as to whether the English approach or the Scottish approach achieved the more satisfactory results. Scots law to some extent sacrifices the interests of the creditors of the individual partners, but the fact is entirely consistent with the role of the latter as cautioners for the debts of the firm. Under English law, moreover, it is possible so to frame documents of debt that the partners are bound personally.⁶¹ The difference in practice, therefore, between the two systems is probably small. We propose, therefore, that the principle embodied in the Scottish rules should be retained.

16.33 Section 62 in terms requires the trustee on the estate of the partner, rather than the creditor himself, to “put a valuation on the estate of the firm”. It could not apply in terms to the claim of a petitioning creditor. Yet we have proposed that a petitioning creditor should not only specify but

⁵⁹*The Law of Partnership in Scotland* (Edinburgh, 1973), pp. 578–579.

⁶⁰*Read v. Bailey* (1877) 3 App. Cas. 94 at p. 102. Lord Blackburn added: “Whether that was a right notion or not I do not know. I believe in Scotland the practice has not been the same, the firm has come to prove against the individual, and the individual against the firm, just as if they were separate persons. But the rule I have mentioned has been established here, and we must follow it.”

⁶¹See 1914 Act, Sched. 2, para. 19 and *Ex parte Honey Re Jeffery* (1871) 7 Ch. App. 178.

deduct the value of any "securities" he holds over the debtor's estate.⁶² We suggest that it is unnecessary to direct the trustee on the estate of the partner to put a value on any claim a creditor may possess on the estate of the firm. The matter may be left to the ordinary procedure for the submission of claims under which the trustee on the estate of the partner would require to adjudicate on the creditor's claim and, in that process, take account of his own estimated value of the creditor's claim on the estate of the firm. We so recommend.

Aliment and periodical allowances

16.34 The effect of bankruptcy on the alimentary obligations of the debtor under the present law is well stated by Lord Justice-Clerk Inglis in *Reid v. Moir*:⁶³

"The obligation is a constantly subsisting obligation, but it can only be enforced under certain conditions, and these conditions are, that there is indigence on the one side, and superfluity on the other—superfluity in this limited sense, that the person against whom the claim is made has more of the goods of this world than are necessary for his own support. Until there is a concurrence of these two conditions, no claim can be made, and no debt arises; but when they do concur, such a claim arises, and may be enforced by law. That being the nature of the claim, it follows that such claims never can be made effectual against a bankrupt estate, because there is no concurrence of these two requisites. There may be indigence on the one side, but of necessity there is no superfluity on the other, superfluity and insolvency being incompatible; and so it follows that the discharge of the bankrupt can never relieve him of that obligation, if at any future time he becomes possessed of that wealth which would enable him to fulfil the obligation."

These remarks might be possibly regarded as being limited to the continuing alimentary obligation rather than to claims for payment of arrears; but there is also authority for the view that a wife or child cannot claim in the sequestration of a husband or father for arrears of aliment due *ex lege* and remaining unpaid.⁶⁴ The authorities suggest that the position is different where the aliment is due under a decree, and the cases suggest that an alimentary creditor who is armed with a decree may claim for arrears as an ordinary creditor in the sequestration.⁶⁵

16.35 Where the alimentary obligation is quantified by contract, the position of the parties on bankruptcy will depend on whether the provision is onerous. In this context a provision in an antenuptial contract of marriage is normally,⁶⁶ but not necessarily⁶⁷ held to be onerous. The court, however,

⁶²Para. 5.32.

⁶³(1866) 4 M. 1060 at 1063.

⁶⁴*Muirhead v. Miller* (1877) 4 R. 1139; cf. *Marjoribanks v. Amos* (1831) 10 S. 79; *Downs v. Wilson's Trustee* (1886) 13 R. 1101.

⁶⁵*Thomson v. Sharp* (1828) 7 S. 1; *Matthews v. Matthews' Trustee* (1907) 15 S.L.T. 326; *Barnes v. Tosh* (1913) 29 Sh. Ct. Rep. 340.

⁶⁶*Scott v. Ross* (1822) 1 S. 481; *McLay v. McQueen* (1899) 1 F. 804.

⁶⁷*Muirhead v. Miller* (1877) 4 R. 1139.

has scrutinised post-nuptial agreements with care and an obligation to pay an annuity undertaken by a husband towards his wife during the subsistence of the marriage was held to be reducible (under the former law) as a donation *inter virum et uxorem* if it was not otherwise reducible as a gratuitous alienation.⁶⁸ Under the proviso to section 5, moreover, of the Married Women's Property (Scotland) Act 1920⁶⁹ donations between spouses still remain revocable at the instance of the donor's creditors if completed within a year and a day before the donor's sequestration. We have recommended that this proviso should be repealed.⁷⁰

16.36 We have so far been concerned with claims of arrears of aliment due for the period prior to the date of the sequestration. For the later period, the point of departure of the present law is the principle stated by Lord President Inglis in *Reid v. Moir*.⁷¹ A debtor has no current liability to meet such claims unless at the time he has a relative superfluity of income and, since a bankrupt debtor's income in principle belongs to his creditors, he can have no such superfluity. It has been held, for example, that even a wife who holds a decree for aliment cannot rank for future payments.⁷²

16.37 It was at one time held that the claim of an illegitimate child for aliment was of a different nature, and could be ranked for as an ordinary debt.⁷³ In view of changed attitudes, however, to illegitimate children, the status of this rule is questionable and the rule would not in any event survive the implementation of the recommendations contained in our Report on Aliment and Financial Provision.⁷⁴

16.38 The English authorities are not a helpful guide in this domain in view of the statutory nature and incidents of most claims to alimony, maintenance or financial provision and of certain limitations upon their method of enforcement.⁷⁵ The disposition, however, of the English courts has been both to deny that arrears of alimony⁷⁶ and maintenance⁷⁷ are provable debts in bankruptcy and to hold that future claims to maintenance are not provable as contingent debts.⁷⁸ The debtor's personal liability, however, remains notwithstanding his bankruptcy and notwithstanding his discharge.⁷⁹ We note that in New Zealand, against a similar background, there is statutory provision to the effect that arrears of maintenance and monies currently due under a maintenance order are provable in bankruptcy,

⁶⁸See *Dunlop's Trustee v. Dunlop* (1865) 3 M. 758.

⁶⁹c. 64.

⁷⁰Para. 12.22.

⁷¹See para. 16.4.

⁷²*Matthews v. Matthews' Trustee* (1907) 15 S.L.T. 326, though the reasoning in this case is open to question.

⁷³*Downs v. Wilson's Trustee* (1886) 13 R. 1101; *Barnes v. Tosh*, above, 344.

⁷⁴Scot. Law Com. No. 67 (1981), especially Recommendations 7 and 19; see also Memo. No 22, Vol. 2, para. 2.118.

⁷⁵*Re Hedderwick* (1933) 1 Ch. 669.

⁷⁶*Linton v. Linton* (1855) 15 Q.B.D. 239, C.A.

⁷⁷*James v. James* [1964] P. 303.

⁷⁸*Re Hawkins* [1894] 1 Q.B. 25 at 28.

⁷⁹*James v. James* [1964] P. 303; *Williams*, pp. 168-169.

but that claims to other rights of recovery remain unaffected by the debtor's bankruptcy or by his discharge.

16.39 We have not found it easy to balance the competing claims of alimentary and other creditors in sequestrations. As we have indicated, it would appear that under the present law an alimentary creditor is not entitled to rank in the sequestration of the alimentary debtor for arrears of aliment arising *ex lege*. Though we considered whether this rule should be modified to permit of the ranking of such claims, we decided to reject this on the grounds that it would be extremely difficult to quantify the amount of such claims and that their admission would open the way to fraudulent claims. The position under the present law is different where the amount of the aliment has been quantified by contract or by decree of court and there it seems likely that an alimentary creditor may claim for arrears. In our view it would again be preferable to retain the present law and to ensure that it would be applied to arrears of periodical allowances payable after divorce.⁸⁰ We recommend, therefore, (1) that it should be made clear that claims for arrears of aliment (however arising) cannot be claimed in the sequestration unless the amount has been quantified by court decree or in respect of which there is other evidence in writing, and (2) that claims for arrears of periodical allowances payable after divorce should be treated similarly. In claims for arrears of aliment by spouses, this rule should be limited to arrears which have accumulated while the parties were living apart since there might otherwise be a danger of collusive agreements for aliment, or even collusive actions for aliment.⁸¹

16.40 We propose that in future the debtor's earnings and other income should no longer vest in the trustee but that the debtor should be permitted to retain such earnings and income as if they were alimentary benefits in his favour. The trustee, however, would have the right to apply to the court for the payment to him of the amount (if any) beyond what is required for a suitable aliment for the bankrupt and his family. It seems right, therefore, that after the date of the sequestration creditors in respect of currently due aliment and instalments of periodical allowances should have no claim against the bankrupt estate. We recommend accordingly.

16.41 Although there is no statutory provision to this effect, it is thought that under the present law the debtor's liability to meet his current alimentary obligations is not excluded by the debtor's discharge.⁸² We recommend that the law be clearly stated in this sense both in relation to alimentary obligations howsoever arising and in relation to periodical allowances payable on divorce.

⁸⁰See Divorce (Scotland) Act 1976 (c. 39), s. 5.

⁸¹This is unlikely under the present law of Scotland. See *McDonald v. McDonald* (1875) 2 R. 705; *Winton v. Grieve* (1830) 2 Sc. Jur. 370 at 371; *Donachie v. Donachie* 1965 S.L.T. (Sh. Ct.) 18. We have suggested in Memo. No. 22, Vol. 2, para. 2.182, however, that a spouse should be able to obtain and enforce a decree for aliment, notwithstanding that the spouses are cohabiting.

⁸²*Marjoribanks v. Amos* (1831) 10 S. 79; *Reid v. Moir* (1866) 4 M. 1060, per L.J.C. Inglis at 1064-1065. Goudy, however, at p. 389 treats the question as being an open one.

Interest

Present Scots law

16.42 Under section 48 of the 1913 Act, a creditor is entitled to vote and rank for the accumulated sum of principal and interest for the period to the date of the sequestration (if interest is due under contract or otherwise) but not to vote and rank in respect of interest for any period after the date of the sequestration. Where, however, there is any residue of estate after the discharge of the ranked debts a creditor is entitled "to claim out of such residue the full amount of the interest on his debt in terms of law".⁸³ It is not clear whether, where there is a surplus of the estate after its division among the ordinary creditors, their claims for post-sequestration interest take priority over the claims of postponed creditors to repayment of the principal sum owing to them.⁸⁴

English law

16.43 In English bankruptcy law a creditor may prove in the bankruptcy, subject to certain qualifications, not only for the principal of his debt but for interest due up to the date of the receiving order.⁸⁵ This interest in terms of section 66 of the 1914 Act is to be calculated at a rate not exceeding five per cent per annum,⁸⁶ reserving however "the right of a creditor to receive out of the estate any higher rate of interest to which he may be entitled after all the debts proved in the estate have been paid in full".⁸⁷ Interest for the period after the date of the receiving order is payable only where there is a surplus after payment of the provable debts and then it is paid at a standard rate of four per cent per annum.⁸⁸

Proposals for reform

16.44 We are satisfied that, on interest-bearing debts, a creditor should be entitled to claim in the sequestration of his debtor not only the principal sum but any interest thereon to the date of the sequestration. While noting that the 1914 Act restricts interest in claims for an ordinary ranking to the rate of five per cent,⁸⁹ we consider that recent rates of interest have made such a restriction inappropriate. We consider that pre-sequestration interest on interest-bearing debts should be calculated at the conventional or other rate appropriate to the debt. We recommend, therefore, that as under the 1913 Act such interest should be accumulated as at the date of the sequestration with the principal sum for the purposes of voting and ranking and for the calculation of post-sequestration interest on the debt.

⁸³1913 Act, s. 48.

⁸⁴See Goudy, pp. 318 and 331.

⁸⁵1914 Act, s. 30(3), s. 32, Sched. 2, para. 21.

⁸⁶1914 Act, s. 66(1).

⁸⁷1914 Act, s. 66(1); *Re a debtor; Ex parte Official Receiver v. United Auto and Finance Corporation* [1947] 1 All E.R. 417.

⁸⁸1914 Act, s. 33(8).

⁸⁹A similar rule applied (and still applies to a limited extent) to moneylenders' claims by virtue of s. 9(1) of the Moneylenders Act 1927. See para. 15.30.

16.45 In relation to secured debtors, our Working Party proposed that, where a surplus emerged after payment of the debts, a secured creditor should receive either interest at the contract rate or simple interest at five per cent, whichever is the higher.⁹⁰ It is difficult, however, to see why the right of a secured creditor to interest should be affected by the debtor's sequestration—either to the creditor's advantage or to his disadvantage. Section 97 of the 1913 Act, moreover, provides for the vesting of the estate (whether heritable or moveable) in the trustee, "subject always to such preferable securities as existed at the date of the sequestration". A heritable creditor need not rank on the estate at all but may simply realise his security.⁹¹ It will be noted, too, that where the trustee sells the heritable estate without the concurrence of any heritable creditor, the upset price must "not be less than sufficient to pay the debt, principal, interest, and expenses of the heritable creditor".⁹² We consider that this approach is right in principle and that nothing in the legislation to follow on this Report should derogate from the right of a secured creditor to receive payment out of the security subjects of the principal debt, and of interest at the rate stipulated in the security documents, to the date of payment. If, however, a creditor holding a security over the bankrupt's estate chooses to submit a claim, in calculating the amount of his debt he must deduct the value of his security or surrender it to the trustee.

16.46 In relation to unsecured debts, our Working Party in effect proposed that interest should be paid upon them from the date of sequestration at a standard rate of five per cent per annum, but only where a surplus emerges after payment of the principal sums due.⁹³ Under the present law, where creditors may claim post-sequestration interest out of the residue of the estate after payment in full of their debts as at the date of the sequestration, the trustee is presented with the complicated task of discovering and calculating the interest applicable to each interest-bearing debt. This task is not facilitated by the uncertainties of the present rules relating to liability for interest on different classes of debt, and the liability may depend on a foreign system of law if that is the proper law applicable to the debt. But it is possible to argue that the fact of sequestration fixes the rights of ordinary creditors *inter se* in relation to the estate and that from the date of sequestration their claim is not one to contractual interest but to a species of moratory interest in respect of their lying out of their money during the period of the sequestration. Although this argument is by no means conclusive, we tend to agree with our Working Party that where a surplus emerges after payment of the debts in full, creditors who are claiming as unsecured creditors, whether or not interest is payable on their debts, should be paid interest at a standard rate. Since our Working Party reported, however, the high interest rates of an inflationary economy have made a fixed rate of five per cent seem inappropriate and we recommend that interest should be paid at a prescribed rate. We suggest that this rate

⁹⁰Memo. No. 16, p. 68.

⁹¹1913 Act, s. 108.

⁹²1913 Act, s. 110.

⁹³Memo. No. 16, pp. 67-68.

should be specified as one of eight per cent or such other rate as may be prescribed from time to time by statutory instrument. We so recommend.

16.47 Goudy suggests⁹⁴ that postponed creditors may be entitled to payment of the principal sum claimed by them before the ordinary and preferred creditors are entitled to payment of post-sequestration interest on their claims. In relation to postponed claims under section 3 of the Partnership Act 1890,⁹⁵ however, it is provided that the postponed creditor "shall not be entitled to recover anything in respect of his loan ... until the claims of the other creditors of the borrower or buyer for valuable consideration in money or money's worth have been satisfied". A similar formula is used in section 1(4) of the Married Women's Property (Scotland) Act 1881.⁹⁶ There is a strong case, therefore, for saying that under the present law post-sequestration interest on the claims of preferred and ordinary creditors would take precedence over the claims (whether for principal or for interest) of postponed creditors. We consider that this principle should be maintained. The *ratio* for the postponement of the debts of partners is that they have thrown in their lot with the bankrupt and so, as we have proposed,⁹⁷ should themselves have no claim on the available funds until the bankrupt's preferred and ordinary creditors have received payment in full. We have also proposed⁹⁸ that where one spouse has lent or entrusted money to the other spouse, and that money has become inmixed with that spouse's funds, the claim for the money lent or entrusted should be a postponed claim in the event of that spouse's bankruptcy. This proposal is aimed at the prevention of fraud, and it seems reasonable that the spouse who has lent or entrusted the money should have no claim on the available funds until the preferred and ordinary creditors have received payment in full.

16.48 Our recommendations relating to the payment of interest on debts, and the inter-relationship of such payments and the payment of the claims of postponed creditors, may be summarised as follows—

- (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 on such debts 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;

⁹⁴p. 331.

⁹⁵c. 39.

⁹⁶c. 21.

⁹⁷Para. 15.28.

⁹⁸Para. 15.29.

- (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.

Balancing of accounts in bankruptcy

16.49 Although neither the 1913 Act nor earlier Scottish bankruptcy legislation has prescribed specific rules for the compensation of debts in bankruptcy situations, there is well-settled case law modifying the ordinary rules of compensation. In the first place, the sequestration effects a separation of interests in the sense that there is no concurrence of debt and credit between a debt due by the bankrupt and one subsequently owed to the trustee,⁹⁹ nor between a debt due to the bankrupt estate and a right of credit assigned to the debtor after the bankruptcy.¹ There are other differences in the relevant rules, notably a widening of the ordinary rule that compensation is pleadable only² in respect of liquid debts to permit, by a species of retention, a debtor to withhold payment to the trustee until performance of other obligations, even illiquid and future,³ and whether or not arising out of the same contract.⁴ Similar rules apply in the liquidation of companies.⁵

16.50 Article 2 of the Uniform Law annexed to the draft E.E.C. Bankruptcy Convention contains certain minimum requirements relating to set-off in bankruptcy situations:

“1. The bankruptcy shall not preclude set-off where the creditor’s claim and the debt to be set off existed in the same estate at the date when the bankruptcy was opened.

“2. The bankruptcy shall not preclude set-off where at the time of the opening of the bankruptcy, the debts to be set off, or one of them, were payable at a future date, or the claim of the creditor of the bankrupt was not expressed in money, or was expressed in currency other than that of the State in which the bankruptcy was opened. Such debts shall be valued as at the date of the opening of the bankruptcy, and in accordance with any other provisions of the law of the State where the bankruptcy was opened.”

We see no conflict between these rules and the existing rules of Scots law which permit of the compensation of any species of claim capable of being ranked in the sequestration. The terms of the draft Convention, therefore, do not appear to require any statutory alterations to our law.

⁹⁹ *Asphaltic Limestone Concrete Co. Ltd. v. Glasgow Corporation* 1907 S.C. 463, at 471–2.

¹ *Cauvin v. Robertson* (1783) Mor. 2581.

² In principle at least, but see *Ross v. Ross* (1895) 22 R. 461, per Lord McLaren at 464–465.

³ See *Scott’s Trustee v. Scott* (1887) 14 R. 1043, per Lord President Inglis at 1051; *National Westminster Bank v. Halesowen Presswork* [1972] A.C. 785, per Lord Kilbrandon at 822.

⁴ Bell, *Comm.* ii. 122.

⁵ See *Atlantic Engine Co. (1920) Ltd. v. Lord Advocate* 1955 S.L.T. 17.

16.51 Although we received no proposals for the reform of the common law rules in this area, we have considered in the context of our general review of bankruptcy law whether any changes might be desirable. In particular, we considered whether the present rule that compensation must be specifically pleaded should be retained. Though this rule differs from that of English law,⁶ we have concluded that no hardship is occasioned by the denial of *ipso jure* compensation and do not, in this respect, propose any change in the existing common law. We are aware that there is some disquiet among members of the legal and accountancy professions in relation to the discretion given to the court by section 35 of the Crown Proceedings Act 1947⁷ to allow the Crown to avail itself of compensation arising out of obligations affecting different departments.⁸ Any satisfactory solution, however, would require to deal with this problem generally, and not solely in the context of bankruptcy. We propose, therefore, to make no recommendation on this matter in the present Report. We do not exclude, however, its examination when we come to consider compensation in the context of our examination of the law of obligations.

⁶Bankruptcy Act 1914, s. 31 and *National Westminster Bank v. Halesowen Presswork* [1972] A.C. 785, especially *per* Lord Kilbrandon at 822.

⁷c. 44. As applied to Scotland by s. 50 of that Act.

⁸As to the present law see *Atlantic Engine Co. (1920) Ltd. v. The Lord Advocate* 1955 S.L.T. 17; *Laing (Liquidation of Inverdale Construction Co. Ltd.) v. Lord Advocate* 1973 S.L.T. (Notes) 81; and *Smith v. Lord Advocate* 1981 S.L.T. 19. The Blagden Committee refer to the problem in paras. 83–85 of their Report and recommend that set-off should not be allowed as between a debit or credit arising from a statutory obligation and a credit or debit arising from a contractual obligation.

CHAPTER 17

SUBMISSION, RECORDING AND ADJUDICATION OF CLAIMS

Introduction

17.1 In Chapter 15 we dealt with preferred and postponed debts and in Chapter 16 with the admissibility and valuation of claims. We are now in a position to deal with the mechanics of the process of submission, recording and adjudication of claims. While it is desirable that the rules governing these processes should be simple and accessible to persons without special knowledge of the law, the need to take proper account of the interests of the general creditors, as well as of the claimant himself, makes certain formalities indispensable. We have sought, however, to simplify the law wherever practicable.

Form of claims and supporting evidence

17.2 Section 45 of the 1913 Act¹ provides that:

“(1) Subject to section 118(3) of this Act, to entitle a creditor to vote or draw a dividend, he shall be bound to produce at the meeting, or in the hands of the trustee, the account and vouchers necessary to prove the debt claimed by the creditor, and either—

- (a) a notice of claim to the debt in such form as the Secretary of State may by regulations made by statutory instrument prescribe; or
- (b) in any case in which the trustee so requires, an oath to the effect and taken in manner hereinbefore appointed in the case of creditors petitioning for sequestration.”

Section 118 of the 1913 Act relates to the payment of preferential debts and subsections (3) and (3A) of that Act² are as follows:

“(3) Where in respect of any of the foregoing debts the trustee has not required an oath in terms of section 45(1)(b) of this Act he may, with the consent of the Commissioners, also dispense with any requirement to produce a notice of claim in respect of that debt.

(3A) The trustee may, with the consent of the Commissioners, pay any of the foregoing debts before the period for payment of the first dividend.”

17.3 Our Working Party considered that the requirement of an oath should be superseded in all cases by that of a statement of claim. As we have already explained,³ we feel constrained to recommend the retention of the requirement of an oath on the part of a petitioning or concurring creditor. Otherwise, however, we recommend that a creditor claiming in a

¹As amended by s. 5(3) of the 1976 Act.

²See 1976 Act, s. 5(4).

³Para. 7.7.

sequestration should submit a statement of claim only and that it should no longer be open to a trustee to require the submission of an oath. If the trustee has doubts about the validity or correctness of a claim, the appropriate course is for the trustee to require production (as he is entitled to do⁴) of further evidence in support of the claim. An oath will not of itself take matters further.

17.4 The contents of the statement of claim must clearly be determined by the requirements of the trustee for the adjudication of claims. Although the 1913 Act does not specify the precise form of the oath, section 21 provides that the creditor:

“... shall in such oath 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, and depone that he holds no other obligants or securities than those specified; and, where he holds no other person than the bankrupt so bound, and no security, he shall depone to that effect.”

The Notice of Claim prescribed under section 45(1)(a) of the 1913 Act is less specific and requires only a statement of the claim and particulars of any security held. The Notice of Claim is in the following terms:⁵

**SCHEDULE
BANKRUPTCY (SCOTLAND) ACT 1913**

NOTICE OF CLAIM

Sequestration of [Name and address]
awarded on

NAME OF CREDITOR

Occupation

Address

TOTAL AMOUNT OF CLAIM

¹PARTICULARS OF CLAIM

²PARTICULARS OF ANY SECURITY HELD

³Signature.....

¹Include nature of debt and date incurred.
Attach documentary evidence available.

²Include nature of security, date granted and amount or value.

³Signature of creditor or solicitor.

Where a creditor is a firm a partner should sign and where a limited company a director the Secretary or a principal officer.

⁴See para. 17.17.

⁵See Notice of Claim (Scotland) Regulations 1977 (S.I. 1977/1495).

17.5 It will be observed that the contents of this form are not consistent with the requirements of the present law relating to the contents of oaths for petitions, prescribed by sections 20 to 24 of the 1913 Act, and extended to oaths for voting and ranking by section 45 of that Act, *inter alia* in so far as the form permits a creditor's solicitor to present a notice of claim and allows the director of a limited liability company to sign on its behalf. The requirements, moreover, of the form in relation to the specification of securities are imprecise.

17.6 Under section 45 of the 1913 Act a creditor, as a condition of his entitlement to vote or to draw a dividend, must produce an oath to that effect and in the manner prescribed earlier in the Act, notably in section 21.⁶ The requirement that the creditor should specify "what other persons, if any, are, besides the bankrupt, liable for the debt or any part thereof" is hardly necessary, since the fact that another person is concurrently liable does not affect the quantification of the creditor's claim. But the requirement that the creditor must "specify any security which he holds over the estate of the bankrupt" is necessary, and it should continue to be provided that a creditor who holds such a security is required to specify its value in his claim and to deduct that value from the amount of his debt.⁷ This rule, as we have already recommended, should apply to each separate security.⁸ The claimant, however, should be given the option of surrendering any security for the benefit of the creditors as a whole. The reference, again, to securities over the estates of "other obligants" is not necessary since the value of such a collateral security need not be deducted. Finally, it may be noticed that under the present law a creditor need not specify separately in his oath or claim the amount of interest due on his debt or, in the case of debts not yet due, the amount of any interest deductible therefrom to discount the value of the debt. The Law Society of Scotland suggested⁹ that the trustee should always be in possession of this information and we recommend to the rule-making authority that a creditor's claim should disclose the amount of interest added to or deducted from the principal amount of the debt.

17.7 In relation to the contents of statements of claim we have received suggestions that a relatively brief form should be adopted. We have designed, therefore, a form of statement of claim which, although brief, should furnish the trustee with sufficient information to enable him without obtaining further information to adjudicate upon most claims. This form of statement of claim is set out in Appendix 3 to this Report. Since we consider, however, that the form and contents of statements of claim should be a matter of prescription, we merely draw it to the attention of the rule-making authorities. We envisage, of course, that the creditor would produce along with this statement of claim vouchers or other evidence of his debt. This requirement is considered below.¹⁰

⁶Cited in para. 17.4.

⁷1913 Act, s. 61.

⁸Para. 16.19.

⁹See Memo. No. 16, p. 67.

¹⁰Para. 17.10.

17.8 The requirement to produce a statement of claim as a condition of a creditor's entitlement to vote or to draw a dividend seems unexceptionable, but under the present law the requirement is qualified in relation to preferred creditors by section 118(3) of the 1913 Act,¹¹ to the effect that where the trustee has not required an oath in terms of section 45(1)(b) of the Act he may, with the consent of the commissioners, also dispense with any requirement to produce a notice of claim in respect of the debt. We are advised that this power of waiver is of considerable utility. We find it difficult, however, to justify its limitation to preferred creditors.¹² While the employees of a debtor firm may be numerous, so too may be persons who have ordered and paid in advance for goods from a mail order company. We also propose that the extent of the dispensing power should be widened. We recommend, therefore, that the interim trustee during his period of office and subsequently the permanent trustee with the consent of the commissioners (if any) may dispense with any requirement relating to the statement of claim or to the vouchers or other evidence in relation to any debt or class of debts.

17.9 We next consider claims on the part of creditors outside the United Kingdom. Claimants within the United Kingdom are assumed to be aware of the sequestration by virtue of its advertisement in the *Edinburgh* and *London Gazettes*. Under the draft E.E.C. Bankruptcy Convention provision is made for advertising the bankruptcies to which it applies in the Official Journal of the European Communities,¹³ but, additionally, Article 31 declares

"1. Where the law of the State in which the bankruptcy has been opened requires that claims should be lodged, known creditors who reside in a Contracting State other than that in which the bankruptcy has been opened shall be individually notified of the opening of the bankruptcy. The notification shall indicate

- whether creditors whose claims are preferential or secured need prove in the bankruptcy and
- the manner in which the true nature of the claim must be affirmed if this formality is required.

2. Subject to any necessary formality as to affirmation, creditors who reside in a Contracting State other than that in which the bankruptcy has been opened may lodge their claims by writing informally in a letter written in one of the official languages of the Contracting States to the bankruptcy authorities specified in Article X of the Protocol to this Convention which shall, where necessary, provide for translation. The claim shall indicate the date, the amount of the debt and whether or not the debt is preferential or secured and shall be accompanied by a copy of such supporting documents as exist."

Our bankruptcy legislation will require to conform to this provision if and when the United Kingdom ratifies the Convention. We consider, however, that the principles embodied in Article 31 could reasonably be applied more

¹¹See para. 17.2.

¹²*Cf.* Companies (Winding-Up) Rules 1949, (S.I. 1949/330), Rule 91.

¹³Article 26.

generally. In the first place, the trustee should, by letter, inform known creditors who neither reside nor have a place of business in the United Kingdom that they may submit claims in the sequestration. In the second place, without prejudice to the power of the trustee in an appropriate case to require further particulars of the grounds of debt, the trustee should be empowered to accept an informal claim in writing from any such creditor. This is entirely consistent with our preceding recommendation that the trustee, where he considers it appropriate, should be empowered to dispense with any requirement relating to the production of a statement of claim.

17.10 Under the present law a creditor who claims in a sequestration must also produce “the account and vouchers necessary to prove the debt” claimed by the creditor.¹⁴ The literal wording of this provision has not been followed. All that must be produced is an account *or* voucher which, according to the nature of the debt, constitutes *prima facie* evidence of it.¹⁵ This we consider to be entirely appropriate, and the terms of the statute should reflect this practice.¹⁶ If the trustee requires further evidence of the debt or of the creditor’s entitlement to a preferential ranking, he may call upon the creditor to produce it.¹⁷ As we explain later, we are recommending that a provision to that effect should be included in the legislation to follow on this Report.

17.11 Section 179 of the 1913 Act provides that a creditor who “wilfully, and with intent to defraud, makes any false claim, or makes or tenders any proof, affidavit, declaration or statement of account which is untrue in any material particular” shall be guilty of an offence. Section 178(B)(1) of the Act makes it an offence for the bankrupt to fail to report the making of a false claim to the trustee. We consider that corresponding provisions should be included in the legislation to follow on this Report, modified, however, in accordance with our general policy relating to *mens rea* in bankruptcy offences.¹⁸

Submission of claims

17.12 The general scheme of the 1913 Act is that a creditor must have produced his oath or, since the coming into force of section 5(3) of the Insolvency Act 1976, a notice of claim, and also in either case the grounds of his debt, before he can vote at a meeting or draw a dividend. The fact, nonetheless, that a creditor has not produced his oath and grounds of debt in time for the first dividend does not preclude him, if it is submitted in time for the second dividend, from participating in the second dividend. He may also receive an equalising dividend in respect of his non-participation in the

¹⁴1913 Act, s. 45(1).

¹⁵Goudy, pp. 159, 314–315.

¹⁶We have already made a proposal in the same sense in para. 7.11 in relation to the petitioning creditor’s oath.

¹⁷s. 123. We propose that a provision to a similar effect should be retained—see para. 17.17.

¹⁸See para. 23.7.

first dividend.¹⁹ A secured creditor may also revalue his security at any time except where he has been required to convey it or assign it to the trustee.²⁰ Indeed, the language of the 1913 Act might suggest that a claim should be re-submitted and adjudicated upon by the trustee, and a security revalued, on each occasion when a dividend is to be paid and, in a case concerning the right of a creditor to realise his security in connection with payment of a second dividend, Lord Robertson remarked that:

“It appears plain, under the Bankruptcy (Scotland) Act 1913, ... particularly sections 61 and 119, that, upon the occasion of each dividend being paid in a sequestration, the whole procedure of making claims and adjudicating upon them ought to be gone through.”²¹

Such an approach would seem to place an undue burden on creditors and trustee alike. We need not, however, pursue the question of the procedure that should be followed under the 1913 Act.²² In the first place, our proposals envisage that any claim submitted by a creditor, including a secured creditor, for voting purposes should, if not amended, become his claim for payment of a dividend. As we have already explained, it should be open to a secured creditor to revalue his security at any time except where the trustee has intimated his intention to take it over.²³ In the second place, it should be made clear that a claim submitted by a creditor, whether in the context of a meeting of creditors for voting or for the purpose of ranking in respect of any dividend, should be regarded (if accepted in whole or in part) as having been submitted for both voting and ranking purposes in respect of every subsequent meeting or distribution of dividend throughout the course of the sequestration. In such a system, as indeed under the present law, there is some risk that a creditor may fail to revalue a security or otherwise revise his claim in the light of changed circumstances. We do not consider, however, that it is necessary to make special penal provisions to meet this problem: in certain circumstances the creditor's inaction might be construed as fraud and be punishable under the general law.

17.13 The present law provides for the situation where the creditor is unable to produce the vouchers and accounts necessary to prove the debt within the period assigned for the lodging of claims. If in his oath he explains the reason for this failure, he will be entitled to have a dividend set apart “till a reasonable time be afforded for production thereof, or for otherwise establishing his debt according to law”.²⁴ We consider that this rule is satisfactory and we advocate its retention and application to statements of claim.

¹⁹*Commercial Bank of Scotland Ltd. v. Muirhead's Trustee* 1918, 1 S.L.T. 132.

²⁰*Commercial Bank of Scotland Ltd. v. Speedie's Tr.* (1885) 13 R. 257.

²¹*Union Bank of Scotland v. Calder's Trustee* 1937 S.C. 850 at 857.

²²We understand that it is normal in practice—except where there is a revaluation of a security—for a creditor to submit one claim only.

²³See para. 16.20.

²⁴1913 Act, s. 46.

Examination and adjudication of claims

17.14 The trustee, but only "where a dividend is to be paid",²⁵ must examine every claim within 14 days of the expiry of a period of four months from the date of the deliverance actually awarding sequestration,²⁶ unless payment of the dividend is accelerated or postponed in terms of section 130 or section 131 of the 1913 Act. He is required within that 14-day period to examine the claims submitted, and in writing to reject or admit them, or to require further evidence in support of them.²⁷ If he rejects the claim, he must state the grounds of rejection, but he may call upon a claiming creditor to rectify or amend his claim.²⁸ He must carry out the same procedure on the expiry of eight months from the date of the sequestration and at three-monthly intervals thereafter.²⁹

17.15 The procedure that we envisage is that a creditor may submit his claim at any time after the award of sequestration, but must submit it not later than eight weeks before the end of an accounting period if he is to participate in the dividend payable in respect of that period. The claim, if admitted, should be available to the creditor for voting or (as the case may be) for ranking purposes. Accordingly, at the commencement of every meeting of creditors the interim trustee or, as the case may be, the permanent trustee must accept or reject for voting purposes every claim submitted to him by a creditor at or before this meeting. This acceptance or rejection of a claim for voting purposes should not, however, be conclusive of the question whether the claim is to be accepted or otherwise for payment of a dividend. During the period which elapses from the time of submission of a claim for voting purposes until the trustee is required to determine who is entitled to a dividend, the trustee is entitled to review every claim submitted to him.

17.16 Section 47 of the 1913 Act provides that where it appears to the sheriff or trustee that the oath or claim of any person produced with a view to voting or ranking:

"is not framed in the manner required by the Act, the sheriff or trustee, as the case may be, shall call upon such person, or his agent or mandatory, to rectify his oath and claim, pointing out to him wherein it is defective."

Thus, where a creditor claims merely an ordinary ranking, when it is apparent that he is entitled to a preferential ranking, the trustee should return the claim to be rectified.³⁰ Section 47 may well have been designed to apply merely to defects of a formal character in the oath or statement of claim, since there is no reference to the vouchers produced as proof of the

²⁵This phrase, included in s. 104 of the 1839 Act, was omitted in s. 126 of the 1856 Act but was re-instated by s. 123 of the 1913 Act following the decision in *Monkhouse v. Mackinnon* (1881) 8 R. 454.

²⁶1913 Act, s. 123.

²⁷1913 Act, s. 123.

²⁸1913 Act, s. 47.

²⁹1913 Act, ss. 119, 127, 129, Goudy, p. 329.

³⁰*Crerar v. Clement's Trustee* (1905) 7 F. 939.

debt. We consider, however, that this provision can be safely omitted in the legislation to follow on this Report. The interim trustee or the permanent trustee with the consent of the commissioners will be entitled to dispense with any requirement relating to statements of claim and would be unlikely to reject a claim on account of a formal defect or of an insufficiency of evidence without giving the claimant the opportunity of remedying the defect.³¹

17.17 Under existing law the trustee, at any time after a claim has been lodged, may require further evidence in support thereof and, for this purpose, may examine the bankrupt, any creditor, or any other party on oath.³² Indeed, where the state of the proof is such that other evidence is necessary and the trustee fails to require it, he may be found liable in expenses³³ or instructed by the court to obtain it.³⁴ We recommend that the substance of section 123 should be retained. Where the trustee requires further evidence from the bankrupt and the latter does not come forward voluntarily, the trustee could under the present law³⁵ apply to the sheriff to compel the bankrupt to give information and assistance necessary to enable the trustee to perform his duties. The trustee has no power to compel third parties to give information except where he successfully applies for their examination in the course of the public examination of the bankrupt. Accordingly, we recommend that it be provided that where a person other than the bankrupt declines to give information in respect of the creditor's claim, the trustee may apply to the sheriff to require such a person to appear before him (the sheriff) for private examination. Under the present law a claim may also be referred to arbitration by the trustee.³⁶ This provision should be retained.

17.18 Once the trustee has decided to accept or reject a claim, it is hardly necessary that a creditor should receive formal intimation that his claim has been accepted. But it is essential that he should be notified of its rejection. We recommend, therefore, that when the permanent trustee rejects a creditor's claim for the purposes of ranking, he must notify the creditor giving reasons for the rejection. The trustee should also record his decision on the claim in the sederunt book with a specification of the particulars of the claim and, where he rejects a claim, the reason for rejection.

17.19 The acceptance or rejection of a creditor's claim would primarily affect the claimant, but it would also affect to a greater or lesser extent the other creditors and perhaps also the bankrupt. We recommend, therefore, that the bankrupt or any creditor dissatisfied with the acceptance or rejection

³¹*Cf. Oliver v. Orr's Trustee* (1869) 7 M. 407 and *Purvis v. Dowie* (1869) 7 M. 764. In the former case Lord President Inglis remarked: "When a trustee considers that evidence is required in support of a claim, he should give the claimant the opportunity of leading that evidence, for generally that can be done more easily and more cheaply before the trustee than here."

³²s. 123.

³³*A & B v. Tunnock's Trustee* (1865) 4 M. 83; *Purvis v. Dowie* (1869) 7 M. 764.

³⁴*Pilling v. Drake* (1857) 19 D. 938; *Oliver v. Orr's Trustee* (1869) 7 M. 407; *Martin's Trs. v. Wilson* (1904) 12 S.L.T. 112.

³⁵1913 Act, s. 77.

³⁶1913 Act, s. 172.

of a claim should be entitled to appeal against the acceptance or rejection to the sheriff. In every case there should be a minimum period of two weeks allowed for the lodging of an appeal. After an appeal had been disposed of, the trustee would record the result of the proceedings in the sederunt book. **Where no appeal has been lodged within the period for appeal a decision of the trustee rejecting a claim should become binding on the creditor after the lapse of the period allowed for appeal. The rejection of a claim should not exclude the claimant from submitting a claim on another ground but, if he does so, the acceptance of such a claim should have no effect upon decisions already taken at any meeting or upon dividends already paid.**

CHAPTER 18

DISTRIBUTION OF THE ESTATE

Introduction

18.1 The 1913 Act envisages that the whole of the bankrupt's estate should be converted as soon as possible into money¹ and that, after payment of the expenses of administration and a commission to the trustee, it should be divided as it becomes available among the creditors at the date of the sequestration in accordance with their respective rights and interests.² It is only where a surplus remains after payment of the bankrupt's debts and interest that any balance falls to be paid to the bankrupt or to his successors.³

18.2 When we refer above to the bankrupt's estate, we refer to that estate which is available after the independent claims of any secured creditors have been met to the extent of their security rights. A secured creditor may, and in the ordinary case will, rest upon his security rights and need not make any claim in the sequestration process unless, after realising the security subjects, they prove insufficient to meet his debt. In that event he ranks as an ordinary creditor for the balance of his debt. As we have already explained,⁴ the term "security" is widely defined in the 1913 Act⁵ and includes not only securities where the creditor has a completed title but securities constituted by actual possession (as in the case of a lien) or by a nexus without possession (as in the case of an arrestment which is effectual to secure a preference).

18.3 We propose the retention in substance of the provision in section 76 of the 1913 Act that empowers and requires the trustee to "take possession of the bankrupt's estate and effects, and of his title deeds, books, bills, vouchers, and other papers and documents". The result is that a trustee in sequestration may insist on the production of all papers relating to the bankrupt's estate, and the holder of a lien (such as a solicitor) cannot refuse to surrender them.⁶ But he does so under implied reservation of his lien,⁷ and the opinion has been expressed "that the preference of the law agent would be over the whole fund".⁸ Though this matter is not wholly clear, the variety of possible circumstances suggests that it is best left to resolution by judicial decision.

18.4 Secured creditors apart, the aim of the sequestration process is to secure, so far as possible, the just distribution of the bankrupt's estate among

¹See para. 10.8.

²1913 Act, s. 117.

³1913 Act, s. 155.

⁴Para. 16.15.

⁵s. 2.

⁶*Train & McIntyre Ltd. v. Forbes* 1925 S.L.T. 286; *Garden Haig Scott & Wallace v. Stevenson's Trustee* 1962 S.C. 51.

⁷*Garden Haig Scott & Wallace v. Stevenson's Trustee*, above.

⁸*Skinner v. Henderson* (1865) 3 M. 867, per Lord Justice-Clerk Inglis at 869.

his creditors. This does not mean that every creditor will get the same proportion of his debt or even that every creditor must receive at least some payment. In the first place, there are certain expenses, such as the expenses of the sequestration process, which must be met before there is any fund available for division among the unsecured creditors. Moreover, the debts of creditors who enjoy preferences without security must be paid in full before any of the estate becomes available for division among the general body of creditors. If the available assets do not permit payment of those preferred creditors in full, their debts generally abate in equal proportions,⁹ and, again, the question of payment of a dividend to the ordinary creditors does not arise. The existence of extensive statutory preferences without security, particularly those for taxes and other fiscal impositions, does in our view bear harshly upon the ordinary creditors, and we have already recommended that such preferences should be reduced in number and in extent.¹⁰ But it is not likely that there will ever be a complete abolition of preferences and, apart from the question as to what extent the present preferred debts should be retained, there remain questions relating to the order of ranking of those debts when the estate is insufficient to meet them in full, the procedure to be adopted by the trustee to ensure the distribution of the estate to the various classes of creditors in their proper order, and the payment to or re-vesting in the bankrupt of any surplus of the estate. These matters may now be considered in detail.

Order of distribution of the estate

The interim trustee's outlays and remuneration

18.5 Our scheme of bankruptcy administration requires that an interim trustee will be appointed in every sequestration. We have recommended, therefore, that a qualified person appointed to act in that capacity should not be entitled to decline to accept appointment by the court.¹¹ In these circumstances the interim trustee must clearly be assured that his outlays and remuneration will be paid in full. We have recommended, therefore, that his outlays and remuneration should form a first charge on the free funds of the bankrupt's estate after provision has been made for the redemption of securities and for the payment of other necessary outlays.¹² To meet the case where these funds are inadequate, we have recommended that the interim trustee's outlays and remuneration, or the balance of those outlays and remuneration, should be met out of public funds by the Accountant in Bankruptcy.¹² Where the interim trustee succeeds to the office of permanent trustee because (a) the creditors fail to elect a permanent trustee, or (b) the creditors are precluded from making an election (which would be the position in a small assets case), the interim trustee cannot decline to act.¹³

⁹1913 Act, s. 118(2). The principle of equal abatement applies only to the statutory preferences. It is not clear whether the common law preference for deathbed and funeral expenses take precedence over all other claims—see para. 18.7 below.

¹⁰Chapter 15, especially para. 15.5 and subsequent paragraphs.

¹¹Para. 4.12.

¹²Para. 4.15.

¹³Para. 9.12 (failure to elect a trustee); para. 7.33 (small assets cases).

He must take up the office of permanent trustee. Accordingly, in such cases his outlays and remuneration as permanent trustee should also form a first charge on the bankrupt's estate, and any deficiency should be met from public funds. It seems right that the outlays and remuneration of the interim trustee should take precedence over those of an elected permanent trustee. The availability or otherwise of funds for the outlays and remuneration of a permanent trustee will be clear from the interim trustee's report before the date of the first meeting of creditors and no-one need accept nomination as permanent trustee where he does not wish to act in this capacity. Moreover, the interim trustee might not feel safe to hand over any estate in his possession to the permanent trustee unless he clearly had a preferable claim. We recommend, therefore, that the interim trustee's claim on the estate should take precedence over that of an elected permanent trustee and over all other claims upon the bankrupt's estate other than those of secured creditors.

The permanent trustee's outlays and remuneration

18.6 Section 117 of the 1913 Act declares that the expenses of administration and the trustee's commission are to be paid before the estate is divided among the creditors. Section 40, however, provides that the trustee shall pay the expenses of the petitioning or concurring creditor "out of the first of the funds which shall come into his hands".¹⁴ There is some doubt also concerning the priority of the claim of the trustee in competition with a claim for deathbed or funeral expenses.¹⁵ In our view the claim of an elected permanent trustee for his outlays and remuneration should take precedence over all other claims apart from the claim of the interim trustee for his outlays and remuneration. The sequestration process cannot function without a trustee: it is reasonable therefore that his entitlement to his outlays and remuneration should be placed before the claims of creditors.

Deathbed, funeral and administration expenses

18.7 There is a common law preference for deathbed and funeral expenses, whose retention we have already recommended.¹⁶ Where an insolvent estate has been sequestrated there may, of course, also be the question of administration expenses incurred by an executor. It seems reasonable that such administration expenses should also be accorded priority: if it were otherwise, executors might be discouraged from taking up the administration of estates lest they prove to be insolvent. The relative priority of claims to deathbed and funeral expenses—which themselves rank *pari passu*¹⁷—in relation to other claims is not wholly clear, though there is some authority to the effect that they are preferable to all claims by unsecured creditors¹⁸ and to a landlord's claim for rent, secured by hypothec.¹⁹ It would remove uncertainty and would, we think, be entirely

¹⁴1913 Act, s. 40. See para. 18.8.

¹⁵See para. 18.7.

¹⁶See para. 15.24.

¹⁷*Peter and Munro* (1749) Mor. 11852.

¹⁸Wallace, p. 298.

¹⁹*Drysdale v. Kennedy* (1835) 14 S. 159.

reasonable that claims for deathbed and funeral expenses and for any expenses incurred by an executor in the administration of the estate of a deceased debtor should be given priority over the claims of the preferred and ordinary creditors (including the claim of a petitioning creditor for the expense of obtaining the sequestration). This would make the position in the sequestration of the estate of a deceased debtor approximately the same in this respect as where a judicial factor is appointed on a deceased person's estate under section 163 of the 1913 Act.²⁰ We have recommended, therefore, that claims for the expenses of administration should rank *pari passu* with claims for deathbed and funeral expenses, which as between themselves already rank *pari passu*.²¹

The petitioning creditor's expenses

18.8 In relation to the petitioning or concurring creditors' expenses, we have referred above²² to section 40 of the 1913 Act. We recommend that the petitioning or concurring creditor should continue to have a prior claim for the expense of obtaining sequestration.²³ It should, however, be postponed to the claims of the interim and permanent trustees for their outlays and remuneration and (in the case of a deceased debtor) to any claim for funeral, deathbed or necessary administration expenses.

The statutory preferred debts

18.9 Our proposals for the abolition or substantial reduction of the debts that enjoy a preference by statute, such as arrears to a specified extent of taxes and local rates and wages, are discussed fully in Chapter 15. If any of those debts, however, are to continue to enjoy a preference, they should rank after the claims discussed in paragraphs 5–8 above but before the claims of the general body of creditors. The statutory preferred debts at present rank equally among themselves in terms of section 118(2) of the 1913 Act. This rule should be applied to such statutory preferences as remain.

The ordinary debts

18.10 The next class of debts in order of precedence consists of the debts of the general body of creditors (that is those creditors whose debts are neither secured nor preferred). As we have already proposed, where interest accrues on a debt, whether conventional or *ex lege*, the creditor's claim may consist of both the principal debt and interest at the appropriate rate to the date of sequestration.²⁴

Post-sequestration interest

18.11 If any residue of estate remains after payment of all the foregoing debts, we have recommended that post-sequestration interest at a rate

²⁰See R.C. 201(n).

²¹*Peter and Munro*, above.

²²Para. 18.6.

²³This will now be the only expense incurred by the petitioning or concurring creditor, as the doing of "the other acts ... required prior to the election of the trustee" (referred to in s. 40 of the 1913 Act) will under our proposals be the responsibility of the interim trustee.

²⁴See paras. 16.44 and 16.48.

prescribed by statute—moratory interest—should then become payable on all the debts (other than the debts of postponed creditors) admitted for payment of a dividend by the trustee.²⁵ We have already discussed fully the question of a competition between the claims of the preferred and ordinary creditors to post-sequestration interest and the claims of the postponed creditors. Our conclusion was that the claims of the preferred and ordinary creditors to post-sequestration interest should take priority.²⁶ Preferred debts and ordinary debts would, of course, stand on the same footing as regards the payment of post-sequestration interest.

Claims of postponed creditors

18.12 The postponement of creditors' claims is discussed in Chapter 15.²⁷ The principal classes of postponed creditors are persons who have sold to the bankrupt the goodwill of a business or lent money to him in consideration of a share of the profits of his business and a spouse who has lent or entrusted monies to a bankrupt spouse which have become inmixed with his funds. The claims of postponed creditors should—if the estate so permits—include a claim to post-sequestration interest at the prescribed rate on the total amount of their debts, principal and interest, as at the date of the sequestration.

Claims of the bankrupt to any residue of the estate

18.13 Section 155 of the 1913 Act provides that:

“Any surplus of the bankrupt's estate and effects that may remain after payment of his debts, with interest, and the charges of recovering and distributing the estate, shall be paid to the bankrupt, or to his successors or assignees.”

It seems entirely appropriate that this rule should be retained. In view of the decision in *Gray's Executrices*,²⁸ however, the wording of the section should be altered to make it clear that payment of the surplus to the bankrupt or to his successors or assignees includes the conveyance or transfer to them of any kind of estate. The legislation to follow on this Report, moreover, should make it clear that the bankrupt obtains no residuary right to unclaimed dividends.²⁹

Procedure for distribution of the estate

Accounting periods

18.14 Under the present law the estate, as it becomes available from time to time, is distributed among the creditors whose claims are admitted by the trustee. Section 118(3) of the 1913 Act permits the trustee with the consent of the commissioners to pay preferred debts before the period for the payment of the first dividend. Otherwise, unless the time for payment is accelerated or postponed in terms of sections 130 to 132 of the 1913 Act, the procedure for

²⁵See para. 16.46.

²⁶See para. 16.47.

²⁷See paras. 15.28–15.31.

²⁸1928 S.L.T. 558.

²⁹See 1913 Act, s. 153 and para. 20.21.

payment of dividends to the creditors may broadly be described as follows. Immediately on the expiry of four months from the date of the deliverance actually awarding sequestration, the trustee makes up a state of the bankrupt's property, of the funds so far recovered, and of the property outstanding (specifying why it has not been recovered), together with an account of his intromissions.³⁰ Within 14 days thereafter the commissioners meet and examine the state and accounts, audit the accounts, fix the trustee's commission or fee, and certify in the sederunt book the balance due to or by the trustee in his account with the estate as at the expiry of the four months period.³¹ The commissioners also fix, after making a reasonable deduction for contingencies, the sum to be divided among the creditors as the first dividend.³² A second state and account is prepared as at the expiry of eight months from the date of the deliverance actually awarding sequestration, and a similar procedure of audit and of fixing the amounts of the trustee's commission and of the divisible fund is prescribed.³³ Thereafter a similar procedure must be followed out at three monthly intervals until the whole funds of the estate are divided.³⁴

18.15 In England, the trustee must declare and distribute the first dividend, if any, within four months after the first meeting of creditors, unless the trustee satisfies the committee of inspection that there is sufficient reason for its postponement.³⁵ Thereafter subsequent dividends, in the absence of reasons to the contrary, are to be paid at six-monthly intervals.³⁶ In liquidation procedure, the liquidator must send to the Registrar of Companies in Scotland a first statement of his intromissions after one year from the commencement of the winding-up and thereafter at intervals of six months, until the assets of the company have been fully realised and distributed, when the final statement must be sent forthwith.³⁷

18.16 Our Working Party received various representations relating to the trustee's duty to account and recommended that the trustee's accounts should be made up for periods of six months commencing with the date of the award, and should be submitted to the commissioners within one month of the end of the accounting period.³⁸ We agree, except that for convenience we consider that the period should be expressed in terms of weeks or, in other words, that the accounting period should be one of 26 weeks. We recommend, therefore, that the first accounting period should be one of 26 weeks from the date of sequestration and that the subsequent periods should be fixed similarly at 26 weeks immediately following the expiry of the previous period.

³⁰1913 Act, s. 121.

³¹1913 Act, s. 121.

³²s. 121 *ad finem*.

³³1913 Act, s. 127.

³⁴1913 Act, s. 129.

³⁵1914 Act, s. 62(2).

³⁶1914 Act, s. 62(3).

³⁷1948 Act, s. 342 and R.C. 213.

³⁸Memo. No. 16, p. 92.

18.17 Sections 130 to 132 of the 1913 Act make provision for the acceleration or postponement of the payment of dividends. Section 130 provides that the trustee and commissioners, with the consent of the Accountant of Court, may accelerate the payment of any dividend but that the date for payment of the first dividend shall not be earlier than four months from the date of the award of sequestration. Section 131 makes provision for the converse case where it is expedient to postpone payment of a dividend. In such a case payment of a dividend may be postponed "till the recurrence of another stated period for making a dividend". The commissioners may authorise the trustee to put notice of postponement in the *Edinburgh Gazette*. The possible need for greater flexibility in certain cases is recognised by section 132, which provides that "in cases where the sequestrated estate consists chiefly of land, and in any other cases where it may be necessary" the trustee and commissioners may obtain judicial authority for such alterations in the periods for payment of a dividend as may be appropriate to the circumstances of the case.

18.18 These provisions for the acceleration and postponement of dividends are useful. We would prefer the relevant rules to be as simple and flexible as possible, but we think it right, in order to safeguard creditors who may be late in becoming aware of the sequestration, that the payment of the first dividend should not be capable of acceleration. The trustee might, however, accelerate payment of any subsequent dividend where he and the commissioners (if any) consider that it is expedient to do so. Conversely, the trustee and commissioners should be able to defer, but not indefinitely, the payment of a dividend. We recommend, therefore, that where the trustee is not in an immediate position to make payment in respect of a particular accounting period he may be authorised by commissioners, or by the Accountant in Bankruptcy where there are no commissioners, to postpone payment to a time which is not later than the time for payment of the dividend in respect of the next accounting period. Such a provision would render section 132 virtually redundant,³⁹ and we recommend that it should not be re-enacted. Section 118(3) of the 1913 Act, as we have seen, permits the trustee with the consent of the commissioners to pay preferred debts before the first dividend falls to be paid. This provision is a useful one and we propose that it should be retained.

Procedure preparatory to the payment of dividends

18.19 The present procedure preparatory to the payment of each dividend is highly complex. There are six stages. In the first, the trustee makes up a state of the property of the bankrupt and an account of his intrusions and submits it to the commissioners for approval.⁴⁰ In the second, the commissioners meet and examine the state and account, fix the trustee's commission (which is subject to appeal by the trustee, the bankrupt or any creditor) and decide whether a dividend should be payable and the amount of any dividend.⁴¹ In the third, the trustee examines the creditor's

³⁹Goudy, at p. 335, suggests that little advantage is taken of this section in practice.

⁴⁰1913 Act, s. 121.

⁴¹1913 Act, ss. 121, 122.

claims, makes up a list of creditors entitled and a list of creditors disentitled to a dividend, and notifies each creditor of the amount of his claim and the proposed dividend thereon.⁴² In the fourth an opportunity is given to the creditors within a limited period to appeal the trustee's deliverance on any claim.⁴³ In the fifth, the trustee makes up a scheme of division of the funds, having due regard to the decision in any appeal, and sends notice to the creditors of the amount of the dividend to which they are entitled.⁴⁴ In the sixth and final stage, the dividends are paid, and those disputed or claimed by contingent creditors are lodged in a bank.⁴⁵ A different procedure is provided for summary sequestrations⁴⁶ but, though simplified, this procedure remains cumbersome.

18.20 If proper account is to be taken of the different interests involved it is perhaps inevitable that this procedure should be complex. We consider, nevertheless, that it could be considerably simplified. The first simplification arises from our proposal that, to entitle a creditor to a dividend in respect of any accounting period, he should have submitted his claim not later than eight weeks before the end of the period. It would then be examined by the trustee generally in the manner prescribed in section 123 of the 1913 Act, and the trustee would be required to accept or reject the claim, or call for further evidence in support of the claim, not later than four weeks before the end of the accounting period. Notification would be given by letter only to those creditors whose claims were rejected by the trustee or in respect of whose claims the trustee required further evidence, but the sederunt book with the trustee's deliverances on all the claims would be open to inspection by the bankrupt and any creditor. The bankrupt⁴⁷ or any creditor could appeal to the sheriff against any deliverance on any claim. A period of 14 days would be allowed for the lodging of an appeal against the trustee's deliverance upon a claim.

18.21 The procedure described in the foregoing paragraphs should enable the trustee to submit to the commissioners (or, where there are no commissioners, to the Accountant in Bankruptcy) a scheme of division of the estate at the same time as he submits his account of his intromissions with the bankrupt's estate and his claim for remuneration, that is, within two weeks after the end of an accounting period. After the audit of the trustee's accounts and the fixing of his remuneration by the commissioners or, as the case may be, by the Accountant (which must take place within six weeks from the end of the accounting period), the audited accounts, the scheme of division and the determination of the remuneration payable to the trustee would be made available by the trustee for inspection by the bankrupt and

⁴²1913 Act, ss. 123-124. Where there is an appeal against the amount of the trustee's commission, notification to the creditors is deferred until after disposal of the appeal.

⁴³s. 124.

⁴⁴1913 Act, s. 125.

⁴⁵1913 Act, s. 126.

⁴⁶1913 Act, s. 176(4) to (11).

⁴⁷It is not clear that the bankrupt has a right of appeal at present. Section 124 of the 1913 Act gives him none but he may enjoy a right of appeal under section 165 of the Act.

the creditors.⁴⁸ In the event of an appeal against a deliverance of the trustee in respect of a claim, or an appeal against a decision as to the trustee's remuneration, it might—or might not—be necessary to defer payment of the dividends until the outcome of the appeal is known. The proposed time-table is, however, as follows—

Proposed time-table for adjudication upon claims and payment of dividends

Not later than—

18 weeks	after date of sequestration	Last date for creditors to submit claims.
22 weeks	after date of sequestration	Trustee to adjudicate upon claims and to intimate to creditors whose claims are rejected or in respect of which further evidence is required. A list of claims to be open to inspection by creditors.
24 weeks	after date of sequestration	Last date for appealing trustee's deliverance (except where further evidence has been required).
26 weeks	after date of sequestration	First accounting period.
28 weeks	after date of sequestration	Trustee to complete accounts and claim for remuneration and to submit them, with scheme of division, to commissioners.
32 weeks	after date of sequestration	Audited accounts, scheme of division and determination as to trustee's remuneration to be open to inspection by the bankrupt and creditors.
34 weeks	after date of sequestration	Last date for appealing commissioners' deliverance on trustee's remuneration.
As soon as convenient thereafter		First payment of dividends.

Subsequent dividends

18.22 A procedure similar to that outlined above should be followed in relation also to the second and subsequent accounting periods until the funds of the estate are exhausted. The theory of the existing law seems to be that creditors must present separate claims for each dividend period, and that these will be examined or be examined again by the trustee. We do not think that it should be necessary for the creditors to submit their claims anew for each dividend. If they have presented a claim timeously in respect of any dividend they should be deemed to have presented it timeously for any subsequent dividend. In other respects, we are disposed to recommend no change in the law. Moreover, as we have indicated above,⁴⁹ the deliverance

⁴⁸There will be provision for appeal to the Accountant in Bankruptcy and from him to the sheriff or the Court of Session against the decision of the commissioners as to the remuneration of the trustee—see paras. 20.6 and 20.7.

⁴⁹Para. 17.19.

of the trustee rejecting a claim in respect of one dividend, while final and conclusive as regards that dividend unless corrected on appeal, will not preclude the creditor concerned submitting a claim on another ground in respect of a later dividend.

Equalising dividends

18.23 The 1913 Act makes provision for equalising dividends. Section 119 provides that:

“... if a creditor has not produced his oath and grounds of debt in time to share in the first dividend, but has done so in time to share in the second dividend, he shall be entitled, on occasion of payment of the second dividend, to receive out of the first of the fund (if there be sufficient for that purpose) an equalising dividend corresponding to the dividend he would have drawn if he had claimed in time for the first dividend; and the same rule shall apply as to all subsequent dividends.”

The provision suggests two points for consideration. First, the creditor who has not produced his statement of claim timeously should receive not “a dividend corresponding to the dividend he would have drawn if he had claimed in time for a first dividend” but a dividend at the same rate per pound sterling as the other creditors of his class drew in respect of the first dividend. Secondly, there is some uncertainty about the meaning of the concluding words “and the same rule shall apply as to all subsequent dividends”. This probably means that a creditor who has submitted a claim only in time to share in (say) a third dividend would also receive an equalising dividend corresponding to the sum of the first and second dividends (and not merely a dividend corresponding to the second dividend). The position should, however, be made clear beyond argument. It should simply be provided that where a creditor has submitted a statement of claim after the latest time for submission of a claim in respect of the first or any subsequent dividend he shall, if his claim is accepted, be entitled to receive out of any available money in the hands of the trustee after making an allowance for contingencies an equalising dividend or equalising dividends corresponding to the dividend or dividends he may have failed to receive, before the money is applied to the payment of any future dividend or dividends.⁵⁰ He would, however, not be entitled to disturb the allocation or distribution of any dividend in relation to which his claim was submitted too late.

18.24 Section 120 of the 1913 Act makes special provision for creditors resident outside Great Britain and Northern Ireland and states that where such a creditor:

“... shall lodge his oath and grounds of debt fourteen days previous to any time fixed for payment of a dividend, though not in time to entitle such creditor to participate in such dividend, the trustee shall make such deduction from the divisible fund as shall be equal to the dividend which would have been payable to such creditor had his oath and

⁵⁰Cf. 1914 Act, s. 65.

grounds of debt been timeously lodged and his claim been sustained; and the sum so deducted shall form part of the fund for division on the occasion of payment of the next dividend.”

This provision seems to us to introduce an unnecessary complication into the law and to create potential problems for trustees in their organisation of the distribution of dividends to creditors. Having regard to our proposal that known creditors abroad should be notified of the debtor’s sequestration,⁵¹ we consider that section 120 should be discarded and we recommend accordingly.

Corrected claims

18.25 The 1913 Act makes provision for equalising dividends where a claim is not submitted timeously but makes no provision for the adjustment of dividends where a claim is corrected, for example, where a creditor revalues a security where the security subjects are realised, or where the value of an annuity is corrected. We recommend that the legislation to follow on this Report should provide that where a claim by a creditor falls for any reason to be revalued the trustee should be entitled to make such adjustment in a future payment to the creditor, or to require him to make such repayments of dividend, as are necessary to correct the effect of the previous over-valuation or under-valuation of the claim.

Special provisions for the ranking and division of claims out of the price of heritage

18.26 Where heritable property belonging to the bankrupt estate is sold, section 112 of the 1913 Act obliges the trustee 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; and such scheme of ranking and division shall be reported by him to the Lord Ordinary or the sheriff, and the judgment thereon shall be a warrant for payment out of the price against the purchaser of the heritable estate.”

The following section empowers the court to grant interim warrant for payment of preferable claims out of the price or to authorise an interim scheme of division as above.

18.27 It has been suggested to us that the requirement of the second part of section 112 for a judgment of the court approving of the scheme is superfluous.⁵² While not dissenting, we would go further and suggest that section 112 is unnecessary. In cases of any complication the trustee would make up such a scheme as a matter of good accounting practice, and the matter should be left to the trustee’s general duty to account. Nor do we consider that there is any need for specially accelerated provisions for the distribution of the proceeds of heritable as distinct from moveable estate. We consider, therefore, that section 113, like section 112, may safely be discarded.

⁵¹See para. 17.9.

⁵²Cf. *Callum v. Goldie* (1885) 12 R. 1137.

Dividends, unclaimed or contingent

18.28 The 1913 Act envisages that the trustee appoints a place at which and date on which he will pay dividends,⁵³ and that the creditors to whom allotments have been made in the scheme of division will proceed themselves to collect the dividend. In practice, we understand, trustees may pay creditors by cheque, and the language in which any new legislation is expressed should not be inconsistent with this practice. Dividends apportioned to claims under appeal and to contingent or other claimants not then entitled to uplift them must be lodged in a separate bank account.⁵⁴ We consider that express statutory directions as to the disposal of such dividends are unnecessary. It should suffice to direct the trustee, in deciding upon the amount of the dividend, to make an allowance for future contingencies and to retain funds to meet late claims and claims under appeal.

⁵³See 1913 Act, s. 124 and *Lipman & Co.'s Trustee* (1893) 20 R. 818.

⁵⁴1913 Act, s. 126.

CHAPTER 19

DISCHARGE OF THE BANKRUPT

Introduction

19.1 Scots law, in contrast with some European systems of law, has for long provided for the discharge of a bankrupt debtor from his antecedent debts. Debts to the Crown have been a notable exception and, in relation to creditors generally, the concurrence of a majority in number and four-fifths in value was formerly a prerequisite of the debtor's discharge without payment of a composition.¹ The exception relating to Crown debts still remains,² but under the 1913 Act the debtor may obtain a discharge from the court, either after the offer of a composition accepted by a majority in number and three-fourths in value of his creditors or in accordance with the provisions of the Act relating to discharge without composition. In the latter case, the debtor is not entitled to receive his discharge unless his estate has paid a dividend of not less than 25 pence in the pound or he shows that the failure in this respect arose "from circumstances for which the bankrupt cannot justly be held responsible".³ Where the petition, moreover, is presented before the expiry of two years from the date of the deliverance actually awarding sequestration the consent of varying majorities of the creditors is required.⁴ It is apparent that the underlying assumption of the law is that the discharge of the bankrupt is a privilege rather than a right.⁵

19.2 We discuss the termination of sequestrations by deeds of arrangement in Chapter 8.⁶ When such a deed has been consented to by a majority in number and three-fourths in value of the creditors, the court, on finding it reasonable, declares the sequestration to be at an end, and its judgement is recorded in the same manner as if the sequestration had been recalled.⁷ No statutory provision is made for the discharge of the debtor under deeds of arrangement, though he may, and usually would, stipulate for his discharge in the deed. Deeds of arrangement are seldom seen in current practice and we have proposed⁸ that the right to have recourse to them should be withdrawn. It is unnecessary, therefore, to consider the debtor's discharge in this context. Of the two current methods available to the debtor to obtain a discharge, discharge without composition is by far the commoner and it seems appropriate to consider it first.

Discharge without composition

Present law

19.3 The present provisions relating to the bankrupt's discharge

¹ Cf. 1839 Act, s. 122.

² 1913 Act, s. 147.

³ 1913 Act, s. 146(1).

⁴ 1913 Act, s. 143.

⁵ See Goudy, p. 375.

⁶ See paras. 8.20–8.27.

⁷ 1913 Act, ss. 37–39.

⁸ Para. 8.27.

without composition are somewhat complex. The bankrupt must petition for his discharge, and five different requirements relating to consent may apply.⁹ These consents may be set out in tabular form as follows—

- (1) at any time after the second statutory meeting with the consent of all the creditors.¹⁰
- (2) on the expiry of six months from the date of the deliverance actually awarding sequestration¹¹ with the consent of a majority in number and four-fifths in value of the creditors.
- (3) on the expiry of 12 months from that date with the consent of a majority in number and two-thirds in value of the creditors.
- (4) on the expiry of 18 months from that date with the consent of a majority in number and value of the creditors.
- (5) on the expiry of two years from that date without any consents of creditors.

In all cases, however, the court may entertain objections on the part of the creditors and must not grant the discharge until it has received a report by the trustee on the conduct of the bankrupt and is satisfied—

- (a) that the bankrupt “has made a full and fair surrender of his estate”;¹² and
- (b) that the bankrupt has made payment or provided for the payment to the satisfaction of the creditors of a dividend to them of at least 25 pence in the pound or that his failure to do so has arisen from circumstances for which he cannot justly be held responsible.¹³

It is evident that, where the debtor has paid a dividend of less than 25 pence in the pound, the court has a measure of discretion whether or not in the public interest to grant the debtor a discharge.

19.4 The public interest in the debtor’s discharge is further recognised in section 149, which declares that the court may refuse a debtor’s application for discharge:

“if it shall appear from the report of the accountant or other sufficient evidence that the bankrupt has fraudulently concealed any part of his estate or effects, or has wilfully failed to comply with any of the provisions of this Act.”

No provision is at present made for discharge of the bankrupt by operation of law at any stage, nor is any provision made for the automatic review of the bankrupt’s position by the courts. Sections 150 and 151 of the 1913 Act

⁹1913 Act, s. 143.

¹⁰*i.e.* the creditors who have submitted claims: see *Buchanan v. Wallace* (1882) 9 R. 621.

¹¹This date may coincide with or be later than “the date of the sequestration” as that expression is defined in the 1913 Act, s. 41.

¹²1913 Act, ss. 144, 149.

¹³1913 Act, s. 146(1), (2).

deal with secret or collusive payments to, or agreements with, creditors in connection with a debtor's discharge. Such payments are null and void, and provision is made for the payment to the trustee of double the amount of the secret or collusive payment. If the debtor has been personally concerned in or cognisant of the granting of such payments he is to forfeit all right to a discharge and any discharge already granted to him is to be annulled.

19.5 The discharge of the bankrupt in the course of the sequestration, unlike his discharge under a composition contract, does not terminate the sequestration or re-invest the bankrupt in his estate.¹⁴ Its principal effect is to operate as:

“a complete discharge and acquittance to the bankrupt in terms thereof, [which] shall receive effect within Great Britain and [Northern] Ireland and all His Majesty's other dominions.”¹⁵

In other words, no claim may be made against the bankrupt himself for any debt for which he was liable at the date of the sequestration. But this principle is qualified by certain exceptions. Section 147 provides that the 1913 Act does not extend:

“to discharge any person with respect to any debt due to His Majesty, or to any debt or penalty with which he shall stand charged at the suit of the Crown or any person for any offence committed against any Act or Acts relative to any branch of the public revenue, or at the suit of any sheriff or other public officer upon any bail bond entered into for the appearance of any person prosecuted for any such offence, unless the Treasury shall consent to such discharge.”

Moreover, the bankrupt's discharge does not extend to obligations incurred by him after the date of the sequestration and it does not extend, except in relation to arrears due at the date of the sequestration, to debts of an alimentary character.¹⁶

19.6 The bankrupt's discharge releases him from the personal disqualifications prescribed by the Bankruptcy Act 1883¹⁷ and other enactments. After his discharge, moreover, the bankrupt is no longer disabled from obtaining credit to the extent of £50 or more without disclosing that he is an undischarged bankrupt.¹⁸

Issues of policy

19.7 Until our Working Party reported, there was little or no criticism of the fundamental assumptions of the Scottish rules relating to discharge from bankruptcy. In England, however, public concern had for long been felt at the number of undischarged bankrupts, and the matter was considered in various official reports, culminating with the Report of the Blagden Committee in 1957. In the view of that Committee:

¹⁴*Aitken v. Robson* 1914 S.C. 224.

¹⁵1913 Act, s. 144.

¹⁶See *Marjoribanks v. Amos* (1831) 10 S. 79.

¹⁷(c. 52), s. 32, as applied by the 1913 Act, s. 183.

¹⁸See 1913 Act, s. 182 as amended by the 1976 Act, s. 1 and Sched. 1.

“The most unsatisfactory feature of the existing system is the fact that, whether or not any bankrupt obtains his discharge, depends, in the first instance, upon whether or not he makes application therefor, and this has led to the position that only one in every four or five bankrupts ever in fact does apply for his discharge.”¹⁹

We have no reason to suppose that the position today in Scotland is significantly different.²⁰

19.8 This situation is undesirable. An undischarged bankrupt commits an offence if he obtains credit to the extent of £50 or upwards without disclosing that fact; he remains subject to the disabilities imposed by the 1883 Act and other enactments;²¹ and his after-acquired estate, whether acquired by succession, gifts, or by his own exertions, in principle belongs to his creditors.²² It is true that the remedy lies in the bankrupt's own hands, but, as the Blagden Report states:

“It is so often the case that the more honest bankrupt does not apply for his discharge, owing either to ignorance of the procedure, to lack of funds to pay the small fees, or more often, to a desire to seek retirement and avoid any further publicity, with the result that he remains undischarged for many years often indeed for the remainder of his life.”²³

These considerations prompted the Blagden committee to recommend that:

“there shall be an automatic discharge of every bankrupt, independent of any application therefor, two years after the date of the order of the Court concluding the bankrupt's public examination but that this automatic discharge shall be operative only in those cases where no caveat against the discharge has been entered by the Court ... If the caveat is entered, then the bankrupt will remain undischarged unless and until he makes application for his discharge as under the existing law and the Court grants such discharge.”²⁴

This caveat would normally be entered by the court after the bankrupt's public examination, the retention of which was assumed by the Blagden Committee. Our Working Party favoured an approach similar to that advocated by the Blagden Committee.²⁵

¹⁹Blagden Report, para. 54.

²⁰The following statistics have been furnished to us by the Accountant of Court:

	1974	1975	1976	1977	1978	1979	1980
Number of awards	104	148	128	132	130	105	151
Number of discharges	11	19	8	15	12	21	29

²¹See para. 19.6.

²²1913 Act, s. 98.

²³Para. 55.

²⁴Para. 60.

²⁵Memo. No. 16, paras. 94-96.

19.9 A slightly different proposal was made by a non-official committee appointed by "Justice" to examine the law of bankruptcy in England. The "Justice" Report²⁶ envisaged a system of exempting debtors from public examination, and suggested that the debtor (where so exempted) should be granted an automatic discharge after the lapse of three years from the date of his adjudication as a bankrupt, unless the Official Receiver, the trustee or any creditor had successfully applied to a court for a caveat against the discharge. Where the bankrupt had been required to submit to public examination, the same system would apply, except that the relevant period was to be one of five years. Earlier applications for his discharge under the existing law should, the "Justice" Committee considered, remain competent in both cases.

19.10 The Insolvency Act 1976 altered the law of England relating to the bankrupt's discharge, but adopted in its entirety neither the approach of the Blagden Committee nor that of the "Justice" Committee. Section 6 of the Act provides a mechanism for dispensing with the public examination of the debtor. Section 7 provides that where the public examination has been concluded or dispensed with, the court may make an order which has the effect of causing the debtor, if he has not earlier received his discharge, to be discharged on the expiry of five years from the date of his adjudication as a bankrupt. This order, in turn, may be rescinded by the court on the application of the Official Receiver or the trustee at any time before it comes into effect. Where the court has made no order under section 7(1) of the 1976 Act and the bankrupt has not himself applied for his discharge, the Official Receiver is required by section 8(2) of the 1976 Act to apply to the court during the 12 months following the fifth anniversary of the date of the bankrupt's adjudication, in effect, to review the bankrupt's entitlement to a discharge.

19.11 The same problem has been faced in other jurisdictions. In Australia, without prejudice to an earlier application for his discharge,²⁷ the bankrupt is automatically discharged five years after the award of bankruptcy, provided that no objection has been raised by the trustee, the registrar or any creditor. If such an objection is lodged, the court inquires into the case and has a wide discretion whether or not to grant a discharge. It may take into account such matters as the bankrupt's conduct, trade dealings and affairs, including credit offences committed by him and his failure to comply with mandatory provisions of the bankruptcy legislation. The bankrupt, in addition, has a right to apply to the court for his discharge at any time after his public examination has been concluded or dispensed with. In Canada the Senate Bill S-11 of March 1978 respecting bankruptcy and insolvency provides for the automatic discharge of the bankrupt within six months of the date when he becomes a bankrupt, if the administrator has not filed a caveat. Where he has done so, the bankrupt may apply to the court for his discharge and, in that event, the administrator may either

²⁶Paras. 67-71.

²⁷[Australian] Bankruptcy Act 1966, ss. 149, 150.

submit a notice that he has no observations to make or make observations relating to the causes of the bankruptcy and the conduct of the bankrupt.²⁸ It is then for the court to decide on the evidence submitted to it whether or not to require the administrator to issue a certificate of the bankrupt's discharge.²⁹

19.12 On the other hand, the Irish Bankruptcy Law Committee considered that any relaxation of the conditions under which the bankrupt is discharged might encourage a bankrupt to withhold information regarding his assets and added that they had:

“considered the possibility of introducing automatic annulment after the lapse of a number of years but as many bankruptcies are brought about by either gross negligence, incompetence, sharp practice or petty fraud on the part of the bankrupt its introduction would release on the public a number of undesirable people who, under cover of limited companies or business names, could cause grave damage to the business community.”³⁰

Our proposals

Principle of automatic discharge

19.13 In our view, however, it would be desirable to fix a period after which, irrespective of action on his part, the bankrupt would normally be conceded a full and complete discharge. Whatever the conduct of the bankrupt prior to and during the course of the sequestration, his indefinite exclusion from the right to a discharge is not likely to benefit anyone. It seems harsh from the debtor's standpoint that the personal disabilities and disqualifications of a bankrupt should attach to him indefinitely. It is equally unsatisfactory from the standpoint of his post-sequestration creditors that the bankrupt should be shielded indefinitely from diligence on their part. It seems inappropriate, moreover, that the bankrupt's pre-sequestration creditors should retain indefinitely a right (which will usually not be exercised) to his post-sequestration estate. It would seem to be of advantage also to financial institutions to know that, after a specified period from the date of the sequestration, the bankrupt will normally be freed from restrictions on the obtaining of credit and no longer protected from diligence for debts contracted by him. There is no certain guide to what the period should be, but we consider that one of five years—the period of the short negative prescription in Scots law—would be appropriate.

19.14 To this extent we accept the principles adopted in England in the Insolvency Act 1976. We find it necessary, however, to depart from the detailed procedures laid down by that Act. The scheme of the 1976 Act relates the order of the court for discharge of the bankrupt to the time when

²⁸Clause 221.

²⁹Clause 222.

³⁰Budd Report, para. 38.5.2.

it dispenses with or concludes his public examination. This precedent could not be followed, because under our recommendations the court will be concerned only with applications for the holding of a public examination and will have no part in dispensation with examination. But there are, in any event, objections to the making of an order relating to discharge at any such early stage in the bankruptcy process; the full circumstances surrounding the insolvency may not yet have been disclosed, and review or alteration of the order might often become necessary at some later stage. We consider it would be simpler and more satisfactory to follow those systems which have enacted or proposed that the debtor should automatically receive a discharge by operation of law after the lapse of a specified period unless, on application and for cause shown, the court decides to defer that discharge.

19.15 Where a bankrupt has been discharged by operation of law it may, of course, be convenient or necessary for him to have documentary evidence of the fact of his discharge. We recommend, therefore, that every bankrupt who has been discharged by operation of law should be entitled to apply to the Accountant in Bankruptcy for a certificate that he has been so discharged, and that, on being satisfied of the fact of discharge and on payment to him of a prescribed fee, the Accountant should be bound to grant a certificate of discharge in prescribed form to the former bankrupt.

Deferment of discharge

19.16 We recognise that in certain cases it may be desirable to defer the bankrupt's discharge. The cases which we have in mind include cases where the debtor has not made a full or fair disclosure of his estate before or after the sequestration, has conveyed assets to a person who has a family or business relationship with him, or has failed to give reasonable assistance to the trustee in the administration of the sequestrated estate. It is clear that a power to defer the bankrupt's discharge must be vested in the court. We recommend, therefore, that it should be open to the permanent trustee (if still in office) or any creditor to apply to the court for the deferment of the bankrupt's discharge by operation of law. The application would have to be made not later than three months before the expiry of five years from the date of the sequestration. On such an application being presented to it the court would—

- (a) order the applicant to serve the application on the bankrupt and (where he is not himself the petitioner and not discharged) the permanent trustee;
- (b) order the bankrupt to lodge in court 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.

If, within 14 days of the date of service of the application, the bankrupt fails to lodge such a declaration in process, the court would defer the bankrupt's discharge without a hearing for a period of not more than two years.

19.17 If the bankrupt lodges such a declaration within the prescribed period, the court would fix a date for a hearing not earlier than 28 days after the date of the lodging of the declaration and order the petitioner to notify the debtor, the permanent trustee or, if he has been discharged, the Accountant in Bankruptcy of the date of the hearing. The permanent trustee or, if discharged, the Accountant in Bankruptcy should, not later than seven days before the date fixed for the hearing, 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. At the hearing the applicant, the debtor, any creditor and the permanent trustee (if still in office) would be entitled to make representations. After the hearing the court should either dismiss the application or make an order deferring the discharge for such specified period not exceeding two years as in all the circumstances it may consider appropriate. The applicant and the bankrupt should have a right of appeal against the court's decision within 14 days after its issue.

19.18 In the event of discharge being deferred, a certified copy of the court's order would be transmitted forthwith by the clerk of court to the Keeper of the Register of Inhibitions and Adjudications for registration therein. A copy of the order would also be transmitted to the Accountant and to the permanent trustee (if still in office) for recording in the sederunt book. The order would not impede in any way either a further application for deferment of the bankrupt's discharge by operation of law or an application by the bankrupt for his discharge (whether before or after the expiry of the period of five years from the date of his sequestration). Where the court makes an order deferring the bankrupt's discharge, the bankrupt shall be discharged at the expiry of the period of deferment unless the court has ordered a further deferment of his discharge.

19.19 We require, of course, to consider whether transitional provisions are necessary to deal with sequestrations which have not been concluded at the coming into force of the relevant legislation. Many of these sequestrations will have been in existence for some considerable time and it would be undesirable to defer the discharge of the bankrupt by operation of law in all those cases until the lapse of a period of five years after the coming into force of the legislation implementing this Report. On the other hand, it would obviously be wrong to provide simply for the discharge of the bankrupt in every existing sequestration on the expiry of five years from the date of its commencement, since there could be cogent objections in certain cases to such a summary and unchallengeable discharge. The relevant English legislation³¹ provides for applications to the court by the Official Receiver. We do not propose the introduction into Scottish bankruptcy procedure of any equivalent procedure. We recommend, instead, that any person whose estates have been sequestrated at a date before the coming into

³¹1976 Act, s. 8.

force of the legislation implementing our proposals for the discharge of a bankrupt by operation of law and who has not already received a discharge, in the absence of an order by the court deferring his discharge in terms of paragraphs 16 and 17 above, should be held to be discharged either—

(a) on the expiry of two years from the coming into force of the relevant legislation; or

(b) on the expiry of five years from the date of the sequestration,

whichever is the later. Anyone who might have cause to object to a bankrupt's discharge would thus have a minimum period of two years after the date of the coming into force of the proposed legislation to apply to the court for an order deferring the discharge. Where the sequestration was commenced later than three years before that date, applications for deferment would be competent during a period which would vary between just over two and just under five years according to the date of commencement of the sequestration in the particular case.

Interim summary of proposals

19.20 To sum up our proposals to this point, we recommend that a bankrupt, unless the court has previously made an order discharging him or deferring his discharge, should be held to be discharged (with certain exceptions to be later explained) of all debts and obligations contracted by him, or for which he was liable, at the date of the sequestration—

(a) in sequestrations commenced on or after the date of the coming into force of the legislation implementing our proposals relating to discharge (the "relevant date"), on the expiry of five years from the date of the sequestration, and

(b) in sequestrations in existence on the relevant date, on the expiry of two years from the relevant date or of five years from the date of the sequestration, whichever is the later.

We have also recommended that a bankrupt who has been discharged by operation of law should be entitled to receive from the Accountant in Bankruptcy a certificate evidencing the fact of his discharge.

Accelerated discharge

19.21 A debtor should not be precluded from presenting a petition to the sheriff court for his discharge during the currency of the period of five years on the expiry of which he would normally receive his discharge by operation of law or, indeed, at any time thereafter in the event of his discharge having been deferred beyond the end of the five-year period. It would be wrong to impose for any longer time than is necessary disabilities and restrictions upon a debtor whose insolvency was occasioned by misfortune rather than culpability. The present rules, however, governing petitions for discharge are complicated and, as we have seen, the consents required vary with the period which has elapsed from the date of the actual award of sequestration.

It may not be easy, moreover, for a bankrupt to obtain the necessary consents.³² Our Working Party in consequence proposed important changes in detail. It seems to us, however, that a more fundamental question is whether it remains appropriate for the creditors to be empowered, in effect, to bar the bankrupt's right at any time to petition the court for his discharge. We answer this question in the negative and propose, therefore, that the concurrence of creditors should no longer be required. Creditors rather should be entitled to make representations to the court when it considers the petition for discharge, as they may under the present law. The petitioner, of course, and the permanent trustee should also be entitled to make such representations.

19.22 There remain for consideration certain procedural questions. We do not think it appropriate to permit of the bankrupt's discharge (as distinct from the recall of the sequestration) until before the trustee has had time to complete his inquiries into the debtor's conduct and affairs. Perhaps for this reason, such applications are incompetent under the present law until the meeting held after the bankrupt's public examination. Such examination will no longer be mandatory under our proposals and, where it is held, no meeting will necessarily follow it.³³ The time required for the trustee to complete his investigation into the debtor's conduct and affairs will differ in different cases. We consider, however, that it would be not unreasonable to provide that a bankrupt may not petition the court for his discharge earlier than one year after the date of the sequestration. We so recommend. Along with his application for a discharge the bankrupt should lodge a declaration of the kind referred to in paragraph 16 of this Chapter. Similarly, a report of the kind described in paragraph 17 should be submitted. Neither the consents of creditors nor the payment of a dividend of a specified amount should be conditions of the debtor's discharge.

Effects of bankrupt's discharge

19.23 A number of subordinate issues of policy remain. Under section 147, the 1913 Act does not extend to discharge (unless with the consent of the Treasury) any person from any debt or penalty due to the Crown or in respect of a bail bond entered into for the appearance of any person prosecuted for a revenue offence. This approach replicates section 28(1)(a) of the 1914 Act, as to which the Blagden Committee stated:

"In our view there is no sufficient reason to exempt from release any debts other than those incurred by fraud or under an affiliation order."³⁴

In Canada, too, the present law exempts certain debts from the bankrupt's discharge. This position was criticised by the Canadian Study Committee³⁵ who remarked that:

³²See *Wylie and Lohead v. Young* (1859) 21 D. 577.

³³Paras. 14.21 (public examination) and 7.40 (meeting thereafter).

³⁴Blagden Report, paras. 77-78.

³⁵Tassé Report, paras. 3.2.085-3.2.088.

“in some cases, it may almost be regarded as a mockery of the bankruptcy system to take all the sizeable property of a debtor, distribute it among the creditors and then leave the debtor to cope with some of his largest creditors from whose debts he has not been released.”

Bill S-11, presented to the Senate of Canada on 21st March 1978, envisages that the Act to follow upon it should bind the Crown,³⁶ and no exemptions from the discharge in relation to Crown debts are provided for in the Bill. Like our Working Party,³⁷ we are firmly persuaded that any obligations remaining after a bankrupt's discharge should be kept to a minimum, and consider that there should be no general right of exemption in respect of Crown debts. The bankrupt's discharge, however, should not affect his continuing liability to pay fines and other penalties due to the Crown or his liability to forfeiture of a sum of money deposited in court under section 1(3) of the Bail etc. (Scotland) Act 1980.³⁸

19.24 Certain other obligations of the bankrupt should also subsist notwithstanding his discharge. Section 28(1)(b) of the 1914 Act provides that an order of discharge shall not release the bankrupt:

“from any debt or liability incurred by means of any fraud or fraudulent breach of trust to which he was a party, nor from any debt or liability whereof he has obtained forbearance by any fraud to which he was a party.”

There is no express provision to this effect in the 1913 Act, though the courts would be likely to reach a similar result. We recommend, however, that it should be expressly provided that the bankrupt's discharge does not release him from any liability resulting from fraud or breach of trust. We have already proposed³⁹ that the debtor's alimentary obligations and liabilities in relation to periodical allowances payable on divorce so far as relating to the period after the date of the sequestration should also be unaffected by his discharge. Again, we recommend that the bankrupt's (non-pecuniary) obligation to co-operate with and assist the trustee in the execution of his functions should subsist notwithstanding the bankrupt's discharge.

Matters of detail

19.25 The acceptance of our recommendations on the issues of policy discussed above would permit of some simplification of the legislation relating to the bankrupt's discharge, but a number of matters of detail require attention. Our task in this respect has been facilitated by the recommendations of our Working Party,⁴⁰ which, with certain modifications and additions, we have accepted and incorporated into the draft Bill annexed to this Report.

³⁶Clause 409.

³⁷Memo. No. 16, p. 99.

³⁸c. 4.

³⁹Para. 16.41.

⁴⁰Memo. No. 16, pp. 53-56.

Discharge on composition

The present law

19.26 The principle of discharge on composition is that the bankrupt or his friends may make an offer to the creditors, supported by a bond of caution, to pay to each ordinary creditor a rateable proportion of his debt. If a majority in number and three-fourths in value of the creditors present at one meeting resolve "that the offer and security shall be entertained for consideration", the fact will be advertised and the offer decided upon at a subsequent meeting.⁴¹ If at the second meeting the offer is accepted by a majority in number and three-fourths in value of the creditors present, the Lord Ordinary or the sheriff (as the case may be), after hearing objections on the part of non-assenting creditors, will pronounce a deliverance approving of the offer if he considers that it is reasonable.⁴² The court cannot approve of the offer unless it provides for security to the satisfaction of the creditors and for the payment to them of a composition of at least 25 pence in the pound, except where the court is satisfied that the failure to pay 25 pence in the pound arises from circumstances for which the bankrupt cannot justly be held responsible.⁴³ The bankrupt must then make a declaration, or, if required by the trustee or any creditor, an oath before the court that he has made a full and fair surrender of his estate, and has not granted or promised any preference or security, or made or promised any payment, or entered into any secret or collusive agreement or transaction, to obtain the concurrence of any creditor to the composition. If the court is satisfied with the declaration or oath, it then pronounces a deliverance discharging the bankrupt and re-investing him in his estate, reserving however the claims of the creditors against the bankrupt and his cautioner for payment of the composition.⁴⁴ These are the essentials and the 1913 Act contains various supporting provisions.⁴⁵

Proposals for reform

19.27 Composition contracts are at present little used: we are informed that discharge on composition has been granted on four occasions only in the last five years. It has been suggested to us that this may be a consequence partly of ignorance on the part of those concerned and partly of the complex requirements and unwieldy procedures which the 1913 Act prescribes. Among the possible obstacles to the use of the composition contracts, the following may be identified—

- (a) The rule that the offer must come before creditors at two distinct meetings.⁴⁶ At the first meeting the offer is merely entertained: it may be accepted only at a subsequent meeting. It may also be an

⁴¹1913 Act, s. 134.

⁴²1913 Act, s. 135.

⁴³1913 Act, s. 146(1).

⁴⁴1913 Act, s. 137.

⁴⁵See, in particular, ss. 138–142.

⁴⁶This requirement was first enacted in s. 48 of the Act 33 Geo. III c. 74. See now 1913 Act, ss. 134–136.

obstacle that the offer, as judicially construed, must be expressed as a dividend to each creditor rather than by way of a lump sum.⁴⁷ But some creditors may not as yet have submitted claims, or the amount of certain claims submitted may not as yet be finalised.

- (b) The rule that the offer must be accepted exactly in its terms, and cannot be adjusted in response to criticisms by individual creditors.⁴⁸
- (c) The rule that the offer must be accepted by a majority in number and three-fourths in value of all the creditors assembled, including preferential creditors.
- (d) The rule that if a creditor accepts a composition offer, his claim in any subsequent bankruptcy of the debtor is limited to the amount of the composition offer.
- (e) The rule that the debtor must find caution for the payment of the composition.

19.28 We consider that it would be practicable to remove all those potential obstacles to the utilisation of composition contracts other than the last. We concede that it may be difficult under present conditions for bankrupt debtors to find caution or other security or undertaking for the performance of the composition offer. The same point, however, was made to the Cullen Committee, which advocated the retention of a requirement for caution.⁴⁹ We consider that it should be retained for the protection of all the creditors, including those who vote against acceptance of the composition offer. We recommend, therefore, that there should accompany any offer of composition a specification of the caution or other security or undertaking to be provided for its payment.

19.29 The remaining obstacles identified above are of a procedural character. Following the general sense of a proposal made by our Working Party,⁵⁰ we recommend that an offer of composition may be made by or on behalf of the debtor to the permanent trustee at any time after he has been confirmed in office. We also recommend that, to avoid the need for the consideration of the offer of composition at meetings of creditors, the offer by or for the bankrupt should be submitted in the first place to the permanent trustee who would report upon it to the commissioners or, if there are none, to the Accountant in Bankruptcy. Our Working Party suggested that the trustee with the consent of the commissioners should be empowered to reject an offer "if he considers it so inadequate as not to merit consideration" and that an appeal should lie from the trustee to the sheriff.⁵¹ We consider, however, that since the interests most directly concerned are those of the creditors, the decision should be that of the commissioners, as representatives of the creditors. We recommend, therefore, that it should be provided that

⁴⁷1913 Act, s. 146(1) and Bell, *Comm.* ii. 351.

⁴⁸Goudy, p. 400.

⁴⁹Cullen Report, para. 38.

⁵⁰Memo. No. 16, p. 95.

⁵¹Memo. No. 16, p. 96.

the composition offer need not be placed before the creditors unless in the view of the commissioners, unanimous if more than one or, if there are no commissioners, in the view of the Accountant in Bankruptcy, there is reasonable assurance that the offer will be timeously implemented, that the caution or other security or undertaking offered is satisfactory, and that implementation of the offer would be likely to secure the payment of a dividend of at least 25 pence in the pound in respect of the ordinary debts.

19.30 Where the commissioners (or the Accountant in Bankruptcy) determine that an offer of composition should be placed before the general body of creditors, the permanent trustee should so advise the debtor and record the determination in the sederunt book. The trustee also should intimate to the creditors by advertisement in the *Edinburgh Gazette* that a composition offer has been made and where its terms may be inspected. He should invite the creditors known to him to accept or to reject the offer by completing a prescribed form and returning it to him. There should at the same time be sent to each creditor a report on the offer and on the caution or other security or undertaking for the payment of the composition. The report would also contain a summary of the present state of the bankrupt's affairs and the progress in the realisation of the estate, and an estimate (if the offer should be accepted) of the possible expenses to be met in concluding the sequestration proceedings and the amount likely to be available for payment of the ordinary debts.

19.31 After the return by the creditors of the prescribed forms, the permanent trustee should determine whether the offer had been accepted or rejected. It should suffice that the offer has been accepted by a majority in number and not less than two-thirds in value of the creditors known to him. The creditors should have 14 days within which to intimate their acceptances or rejections of the offer of composition. In computing the majority the trustee would be entitled to disregard any claims, or acceptances or rejections of claims, received by him after the lapse of the 14-day period. The trustee would intimate his determination in writing to the debtor and to any other person by whom the offer of composition was made, and would also record it in the sederunt book.

19.32 Where the trustee had determined that the creditors had accepted the offer of composition, he would submit to the sheriff—

- (a) a statement that he had so determined;
- (b) a copy of his report to the creditors on the offer of composition; and
- (c) a declaration by the debtor—
 - (i) that he has made a full and fair surrender of his estate;
 - (ii) that he had made a full disclosure of all claims which he was entitled to make against other persons; and
 - (iii) that he had delivered to the interim or permanent trustee all documents in his possession or under his control relating to his estate or to his business or financial affairs.

19.33 The sheriff would fix a date and time for a hearing for consideration of approval or otherwise of the composition. The trustee would then send to every creditor known to him notice in writing that he had determined that the creditors had accepted the offer of composition; that the sheriff would examine the offer with a view to approval or otherwise of the composition at a hearing to be held at the place, date and time specified in the notice; and that any creditor might make representations at the hearing regarding approval or otherwise of the composition. At the hearing the sheriff, after examining the documents submitted to him and hearing any representations, would pronounce an order approving or refusing to approve the composition. The sheriff would approve the composition where he was satisfied that the acceptance of the requisite majority of creditors had been obtained and that the terms of the offer and the caution to be furnished for payment of the composition were reasonable. He should be entitled to approve the composition notwithstanding that there had been some failure in the carrying out of the statutory procedure.

19.34 The sheriff's order approving or refusing to approve the composition would be appealable by the debtor or any creditor within 14 days of the issue of the order. Where the sheriff declined to give approval and there was no appeal or no successful appeal, the sequestration would continue as if no offer of composition had been made. Where the composition received approval, the permanent trustee would submit his accounts and his claim for his outlays and remuneration to the commissioners or, where there were no commissioners, to the Accountant in Bankruptcy. The permanent trustee (in a case where he was a different person from the interim trustee) would also ensure that the interim trustee had submitted, or would submit, his accounts for audit and his claim for his outlays and remuneration. The determinations as to the amounts payable to the interim trustee and the permanent trustee would be appealable in the usual way.

19.35 After these matters had been completed the permanent trustee would lodge with the sheriff clerk a declaration that all necessary charges in connection with the sequestration (including the expenses of the creditor who had petitioned, or concurred in the petition, for sequestration, his own outlays and remuneration and those of the interim trustee) had been paid or provided for to the satisfaction of the parties concerned. There would also be lodged with the sheriff clerk the bond of caution or other security or undertaking for the payment of the composition. The sheriff would then make an order discharging the bankrupt and re-investing him in his estate (under reservation of the claims of the creditors against the bankrupt and the cautioner for payment of the composition). He would at the same time discharge the trustee.

19.36 We envisage the retention of provisions similar to sections 139 and 141 of the 1913 Act. These provisions relate respectively to the continuation of a sequestration until approval of an offer of composition and to the

protection of cautioners for compositions. We do not consider it necessary to retain any equivalent to section 140 of the 1913 Act, which could operate unfairly in certain situations. The matter is best left to the law of personal bar.

19.37 the 1913 Act provides that, where an offer of composition has been rejected, no other such offer may be entertained unless nine-tenths in number and in value of the creditors shall assent in writing.⁵² The object of this provision is presumably to avoid troubling the trustee, the commissioners and the creditors with a series of offers which may be obviously unacceptable or merely intended to test the market. It is, however, unnecessarily draconian, especially against the background that an offer of composition must be accepted without amendment or rejected. We recommend instead that a bankrupt should be entitled to submit two, but no more than two, offers of composition for consideration by the creditors.

19.38 Under the present law discharge on composition terminates the bankruptcy and this has the effects (a) of completely re-investing the bankrupt in his estate to the same extent as if the sequestration had not been granted;⁵³ and (b) of discharging all debts which would be discharged on a discharge without composition⁵⁴ and converting the claims of creditors into claims for their due shares of the composition.⁵⁵ Existing law therefore allows reduction of the order approving the composition and revival of the sequestration only where there have been procedural irregularities or fraud, misrepresentation or other misconduct.⁵⁶ The remedy of creditors, where for any reason there is failure in payment of the composition, is to take action for payment or to rank (but only for the amount of the composition) in a second sequestration.⁵⁷ We think that the remedy of recall of the composition and revival of the sequestration should be available in any case where there has been default in payment of the composition or of any instalment thereof, or where for any reason the composition cannot be proceeded with or cannot be proceeded with without undue delay or injustice to the creditors. Recall of the composition on any such ground would, of course, be without prejudice to the validity of any transaction duly made under or in pursuance of the scheme of composition with a person acting in good faith. We consider, moreover, and recommend, that on recall of a composition the creditors' original debts (so far as unpaid) should revive.

⁵²s. 142.

⁵³See e.g. *Holmes v. Reid* (1829) 7 S. 535 and *Stevenson, Lauder & Gilchrist v. Dawson* (1896) 23 R. 496.

⁵⁴See paras. 19.23–19.24.

⁵⁵*Saunders v. Renfrewshire Banking Company* (1827) 5 S. 565.

⁵⁶See Goudy, p. 415.

⁵⁷See *Saunders* above.

CHAPTER 20

REMUNERATION, ACCOUNTABILITY AND DISCHARGE OF THE TRUSTEE

Introduction

20.1 In Chapter 4 we emphasise the importance of the role of the permanent trustee as proprietor in trust of the insolvent estate, as manager and administrator, and as judge (in the first instance at least) of the creditors' claims.¹ He must be properly remunerated for the onerous tasks he performs. But he must also be accountable to the creditors in respect of his intromissions with the estate and accountable also to the State in respect of his general duty to conduct the administration of the sequestration in accordance with the law. If, however, he has discharged his duties properly he should receive a complete discharge. To a large extent these questions are inter-related. Unless the trustee is properly remunerated, it may prove impossible to find persons with the requisite professional qualifications and experience who are willing to undertake the duties—often complex and exacting—of a trustee. In that case there is less assurance that the statutory duties of the trustee will, in general, be adequately carried out. At the same time, one of the compulsors for the trustee's adequate performance of his duties lies in the risk that, if he does not, he may not receive a discharge. These questions, therefore, are conveniently treated together.

Audit of accounts and fixing of remuneration

20.2 The role of the commissioners as the representatives of the creditors in the sequestration process makes it fitting that the trustee may take no remuneration save that approved by them.² The 1913 Act provides that, prior to the payment of each dividend, the commissioners will meet to audit the trustee's accounts, to settle the amount of his remuneration, and to authorise him to take credit for it in his accounts.³ After the commissioners have fixed the amount of the remuneration, the trustee intimates their deliverance by circular to every creditor and to the bankrupt. The trustee, the bankrupt and any creditor may appeal to the Accountant of Court against the deliverance.⁴ If there is an appeal and the Accountant does not concur with the commissioners, he intimates his objections to their deliverance and indicates the sum that he would suggest for the remuneration of the trustee. In the event of the trustee, the bankrupt, any creditor or the commissioners not acquiescing in the suggestion, the Accountant must report the matter to the Lord Ordinary or sheriff, whose decision is final.⁵ We are informed that little use is made of these appeal procedures.

¹Paras. 4.17–4.18.

²*Cf. Assets Co. Ltd. v. Guild* (1885) 13 R. 281 at 297.

³1913 Act, ss. 121, 127 and 129.

⁴1913 Act, s. 122.

⁵*Idem.*

20.3 The effect of the decided cases is that the remuneration of the trustee should be fixed by the commissioners simply as a percentage of the estate realised.⁶ But the commissioners are not always in a position to judge what in the circumstances is an appropriate percentage fee, and we understand that trustees may in some cases place before commissioners claims for remuneration on a time basis, and that the sum which they allow may later be expressed as a percentage of the assets realised.

20.4 The fixing of the trustee's remuneration has presented problems in other systems and it was pointed out to us that in some countries, notably in the United States and New Zealand, the trustee's remuneration is fixed on the basis of different percentages applied to different strata of the realised estate.⁷ While such a scheme has attractions, there will clearly be cases where the percentage allowed will be either inadequate or excessive in relation to the work involved. There is a vast difference between the case where a trustee has to nurse and sell at the best possible price a small factory running at a loss and the straightforward case where the debtor's assets consist simply of cash and securities. A sliding scale would also present difficulties where the estate is distributed to the creditors in a series of dividends and the remuneration of the trustee is paid in instalments. Accordingly, we are not in favour of the trustee's remuneration being fixed on this basis.

20.5 Other proposals were canvassed to us, and two merit attention. It was suggested to us, in the first place, that the trustee's accounts should be audited periodically as a matter of course by a professional auditor, who would recommend an appropriate fee for the trustee to the commissioners. The main objection to this proposal is that it would occasion disproportionate expense in cases where the assets are modest. Another proposal made to us was that in every case the Accountant, rather than the commissioners, should both audit the trustee's accounts and fix his fees.⁸ The rational basis of the proposal is that the Accountant must examine the accounts in any case to verify whether the trustee has properly carried out his duties in accordance with law.⁹

20.6 We have concluded, however, that both proposals should be rejected and recommend that there should be no substantial departure from the existing law under which the trustee's accounts are audited and his commission fixed by the commissioners. The periodic fulfilment of this duty by the commissioners has the advantage of compelling them to examine the actings of the trustee and, in consequence, of keeping under review the progress of the sequestration. We concede that not all commissioners will

⁶*Lindsay v. Hendrie* (1880) 7 R. 911 and *McGregor's Sequestration* 1955 S.L.T. 270.

⁷Such a scheme might be—to modify slightly that in use in New Zealand—15 per cent of the estate under £5,000 (subject to a specified minimum), 7½ per cent of the next £15,000, 3 per cent of the next £80,000 and 1½ per cent of any remaining estate.

⁸We note that, under clause 37 of the Canadian Bill, S-11 of 21st March 1978 respecting bankruptcy and insolvency, the trustee's accounts in respect of disbursements and professional services must in all cases be taxed by the Registrar.

⁹See para. 20.11.

possess the experience required to fix the trustee's remuneration, but under our proposals a dissatisfied person will be entitled to appeal against the deliverance of the commissioners to the Accountant and from him to the sheriff.

20.7 We propose, therefore, that the trustee should submit his accounts and his claim for remuneration to the commissioners within two weeks after the end of an accounting period (that is, at the same time as he submits his scheme of division), that the commissioners should have a further period of six weeks within which to audit the accounts and fix the remuneration, and that the period for appeal should be one of 14 days. Where there are no commissioners, the trustee should similarly submit his accounts and his claim for remuneration to the Accountant in Bankruptcy for the auditing of the accounts and for the fixing of the trustee's remuneration. The trustee, the bankrupt, or any creditor should have a right within 14 days of any determination of the commissioners to appeal it to the Accountant in Bankruptcy and thereafter to the sheriff. Any determination at first instance of the Accountant in Bankruptcy would similarly be appealable to the sheriff.¹⁰ In either case the decision of the sheriff should be final.¹¹ The permanent trustee would be required to insert in the sederunt book the audited accounts, the scheme of division and the final determination in relation to the permanent trustee's outlays and remuneration.

20.8 The basis of remuneration of trustees is not set out in current bankruptcy legislation but, as we have explained above, the cases show that the accepted basis is a percentage of the assets realised. The reasons we give above for rejecting a sliding scale scheme are at the same time reasons for rejecting a percentage basis as the sole method of calculating the trustee's remuneration. We recommend, again following the recommendation of our Working Party,¹² that the legislation following on this Report should make it clear that, in fixing the trustee's remuneration, the commissioners and the Accountant in Bankruptcy should 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.

20.9 A problem arises when it becomes clear at a later stage in sequestration proceedings that the trustee has been over- or under-remunerated for his earlier work.¹³ We recommend, therefore, that it should be expressly provided that, until the trustee's final accounts are submitted, any remuneration paid to a trustee should be treated as a payment to account and provisional only, and that a final determination of the trustee's remuneration should be made at the close of the sequestration.

¹⁰We consider it preferable to recommend procedure by way of appeal rather than the procedure by way of report by the Accountant to the court which is envisaged in section 122 of the 1913 Act.

¹¹*Cf.* 1913 Act, s. 122.

¹²Memo. No. 16, p. 95.

¹³*Lindsay v. Hendrie* (1880) 7 R. 911.

Discharge of the trustee

The present law

20.10 Section 152 of the 1913 Act deals with the procedure in ordinary sequestrations for the discharge of the trustee and directs him, after the final division of the funds, to call by advertisement in the *Gazette* a meeting of creditors. The trustee must also notify every creditor by post of the time, place, and purpose of the meeting. The purpose of the meeting is to enable the creditors to examine the sederunt book and the accounts of the trustee and to "declare their opinion of his conduct as trustee". Thereafter minutes of the meeting are prepared.

20.11 The trustee must, before his discharge, transmit his sederunt book to the Accountant of Court.¹⁴ The apparent purpose of this rule is to enable the Accountant to verify the amount of the unclaimed dividends for which the trustee must account. In practice, however, the Accountant of Court examines the sederunt book and the accounts to ensure that there has been no irregularity in the sequestration proceedings and that the sederunt book contains the documents necessary to give "a correct view of the management of the estate" as required by section 80 of the 1913 Act. Where there are errors in the procedure, or the book is incomplete, the Accountant issues a "special acknowledgement" for the sederunt book in which he details the deficiencies.

20.12 The trustee then presents his application to the court for his discharge and should send notice of his application to the court for discharge to the Accountant and to any creditor who objected at the meeting.¹⁵ The application and the minutes of the creditors' meeting are considered by the court who, after hearing any creditor, may pronounce or refuse decree of exoneration. If decree is granted, the clerk of court transmits forthwith to the Accountant a signed extract of the decree, which he enters in the Register of Sequestrations, and the bond of caution for the trustee is given up.

20.13 We are advised that the meeting of creditors is seldom attended and that, even if creditors do attend, there is no obligation on them to pass any resolution.¹⁶ A creditor who has objections may well feel that they may be better advanced at the court hearing on the trustee's application. We have, therefore, examined other possible procedures for discharge to see whether they might form a model of a simplified system, which would nevertheless afford to all interested parties an opportunity to make representations against the trustee's discharge. We have noted in particular the procedure in England¹⁷ for discharge of the trustee by an administrative act and the New Zealand procedure,¹⁸ which is similar except that the discharge is granted by the court.

¹⁴1913 Act, s. 153.

¹⁵*Milne v. McCallum* (1878) 5 R. 546.

¹⁶*Milne v. McCallum*, above.

¹⁷1914 Act, s. 93.

¹⁸The [New Zealand] Insolvency Act 1967, s. 133.

Scottish procedure in summary sequestrations

20.14 Scottish procedure, however, in summary sequestrations itself provides the model for a simpler system. Section 176(14) of the 1913 Act declares that, after the final division of the funds, or in any case where the sheriff has in writing dispensed with further procedure in a summary sequestration, the trustee may apply to the Accountant for a certificate that he is entitled to his discharge. He must at the same time deliver to the Accountant the sederunt book and accounts with a list of unclaimed dividends (if any). The Accountant may then, if he is satisfied that the statutory requirements have been met, grant the trustee a certificate that he is entitled to obtain his discharge. The trustee orally reports the receipt of this certificate to the sheriff who fixes a diet for hearing objections, and such diet is advertised in the *Gazette*.¹⁹ At the diet the bankrupt and any creditor who appears are heard *viva voce*, and the sheriff disposes of any objections summarily by granting or refusing the trustee his discharge. If he grants the discharge, the sheriff is directed to issue "an interlocutor exonerating and discharging the trustee of all his actings and intromissions". If the sheriff refuses the trustee's application, the trustee has a right of appeal to the Court of Session.²⁰

Proposals for reform

20.15 We consider that it would be desirable to adopt a procedure for discharge of the permanent trustee which is in effect a development of the discharge procedure in a summary sequestration. In a summary sequestration the Accountant may grant a certificate of entitlement to discharge but the actual discharge is granted (or refused) by the sheriff. Our policy is to reduce formalities (and consequently expense) by substituting administrative for judicial procedures wherever this can be done without harm to the sequestration process. Accordingly, we propose that the Accountant should be empowered not merely to grant a certificate of entitlement of discharge but to grant the actual discharge to a permanent trustee, there being a right of appeal to the sheriff against the decision of the Accountant to grant or to refuse to grant a discharge. The details of this scheme are explained in the following paragraphs.

20.16 We propose that, after the permanent trustee has made a final division of the bankrupt's funds, he should be required (1) to deposit any unclaimed dividends and any unapplied balances in a bank or other institution currently exempted from the prohibition in section 1(1) of the Banking Act 1979²¹ on the acceptance of deposits, and (2) to send to the Accountant in Bankruptcy the sederunt book, a copy of his audited accounts and the receipt for the deposit of the unclaimed dividends and unapplied balances. He would then be entitled to apply to the Accountant in Bankruptcy for a certificate of discharge. Notice of the application should be sent by the trustee to the bankrupt by letter. Creditors should be informed of this

¹⁹s. 176(15).

²⁰s. 176(16).

²¹c. 37.

application either, as the trustee may elect, by notice in the *Edinburgh Gazette* or by notice posted to each creditor. The notice would inform the recipients of their right to submit written representations relating to the application to the Accountant in Bankruptcy within a period of 14 days from the date the copy application was sent, and that the sederunt book and the trustee's accounts are available for inspection at the office of the Accountant. On the expiry of the period within which representations might be made the Accountant, after examining the documents sent to him by the trustee and considering any representations made by the bankrupt or any creditor, would grant or refuse to grant a certificate of discharge. The trustee, the bankrupt and any creditor would be entitled to appeal to the sheriff against a grant or refusal of a discharge within a period of 14 days from the issue of the Accountant's decision, and could avail themselves of normal further rights of appeal to the Court of Session. Where a certificate of discharge is granted by the Accountant, he should make an appropriate entry in the Register of Insolvencies and in the sederunt book after the lapse of the days of appeal. In a case where the discharge was granted by the court, the clerk of court after the lapse of the days of appeal should send an extract of the decree to the Accountant so that he may make similar entries. The sheriff clerk should deliver up to the trustee his bond of caution when the discharge becomes final.

20.17 The 1913 Act does not specify the effect of the decree of exoneration and discharge. The position, however, appears to be that the trustee cannot thereafter be called to account for intromissions covered by the discharge, which can be challenged only in an action of reduction.²² It has been said that the proceedings in an application by the trustee for discharge "are of the most public nature" and that "a very specific statement, and that made within some reasonable time" will be necessary to make an action of reduction relevant.²³

20.18 The law is not unsatisfactory, but we consider that it would be helpful if the precise effects of a discharge were stated, as is done in bankruptcy legislation in England and New Zealand.²⁴ In England, the 1914 Act²⁵ provides that:

"An order of the Board releasing the trustee shall discharge him from all liability in respect of any act done or default made by him in the administration of the affairs of the bankrupt, or otherwise in relation to his conduct as trustee, but any such order may be revoked on proof that it was obtained by fraud or by suppression or concealment of any material fact."

It was held in *Re Harris ex parte Hasluck*²⁶ that the reference to the "suppression or concealment of any material fact" must contain some element of fraud, and the New Zealand legislation merely excepts fraud. We

²²*Macpherson v. Macpherson* (1841) 3 D. 1242.

²³*Robertson v. Scott* (1834) 12 S. 875, per Lord Moncrieff at 877.

²⁴The [New Zealand] Insolvency Act 1967, s. 133(6).

²⁵s. 93(3).

²⁶[1899] 2 Q.B. 97.

recommend, therefore, that the certificate of discharge of the Accountant or the decree of discharge of the court should have the effect of discharging the trustee from all liability to the creditors or to the bankrupt in respect of any act or omission of the permanent trustee in the exercise of his functions as trustee, other than any liability arising from fraud.

20.19 The 1913 Act, although it alludes to the exoneration and discharge of the trustee when a sequestration terminates by virtue of the judicial approval of a composition contract, provides no special mechanisms to deal with this and other situations where the trustee's functions have come to an end before the final division of the estate, for example, where he has died, or resigned office or has been removed by the creditors. In cases where the trustee has died in office, the Court of Session has held, following the practice of the day, that the trustee's representatives may apply for his discharge in the ordinary way. We suggest that it should be made clear that in all these cases the usual procedures for the trustee's discharge may be followed out *mutatis mutandis* by the former trustee or by the executors of a deceased trustee. In any such case, however, the former trustee or executor might not be in possession of the sederunt book, audited accounts and other documents that a trustee in office would possess, and the obligation upon the former trustee or executor should therefore not extend beyond sending to the Accountant such documents only as it is reasonably practicable for him to send.

20.20 Section 154 of the 1913 Act provides that:

"All accounts for law business incurred by the trustee shall, before payment thereof by the trustee, be submitted for taxation to the auditor of the Court of Session, or to the auditor of the sheriff court of the [sheriffdom] in which the sequestration was carried on, as may be directed by a general meeting of the creditors."

The Accountant of Court, nevertheless, is prepared to waive this requirement in certain cases, for example, where there is a sale of heritage and the fact that the appropriate scale fee has been charged may be readily checked. Our Working Party, following a suggestion by the Accountant of Court, proposed that the Accountant might be expressly authorised to waive the requirement of taxation where the amounts involved were small.²⁷ We agree in principle with this proposal but consider that it would be preferable not to restrict the Accountant's discretion to cases where the amount involved is small. We recommend, therefore, that, while accounts for law business incurred by the trustee should normally be taxed by the auditor of the Court of Session or the auditor of the sheriff court before payment, the trustee may nevertheless pay such accounts without taxation when so authorised by the Accountant in Bankruptcy.

20.21 We have recommended that the trustee, before applying for discharge, must deposit any unclaimed dividends and any unapplied balances in a bank authorised to take deposits and send the receipt for the deposited

²⁷Memo. No. 16, pp. 100-101.

sums to the Accountant in Bankruptcy.²⁸ We recommend that after the discharge of the trustee it should be competent to any person claiming a right to a deposited dividend to apply to the Accountant in Bankruptcy for payment of that dividend, within the period of seven years beginning with the date of the deposit.²⁹ It would, of course, be necessary for the claimant to produce evidence of his right, and the Accountant in Bankruptcy, if satisfied of the claimant's right to the dividend, would authorise the bank or other institution to pay to the claimant the dividend and any interest which may have accrued thereon. After a period of seven years from the date of deposit of the unclaimed dividends and any unapplied balances in the bank, the Accountant in Bankruptcy would hand over the deposit receipt or other voucher relating to the deposited sum to the Secretary of State for Scotland, who would thereupon obtain payment of the amount due (both principal and interest) from the bank in which the deposit was made.³⁰

²⁸See para. 20.16.

²⁹*Cf.* 1913 Act, s. 153(2).

³⁰*Cf.* 1913 Act, s. 153(3) as amended by the Transfer of Functions (Treasury and Secretary of State) Order 1974 (S.I. 1974/1274).

CHAPTER 21

DECEASED DEBTORS' ESTATES

The present law

Introduction

21.1 The 1839 Act¹ rendered competent the sequestration of the estates of deceased debtors and that Act and subsequent Bankruptcy Acts contained appropriate provisions for that purpose. In addition, the 1856 Act provided for the appointment, at the instance of the creditors of a deceased debtor or of persons having an interest in the succession, of a judicial factor on the estate of the deceased.² These facilities are retained in the 1913 Act and it is the purpose of this Chapter to examine them. We deal elsewhere with the case where the debtor dies after the presentation of a petition, but before the award of sequestration.³

21.2 A creditor may also be entitled to confirm to the whole or to any part of the deceased's estate as an executor-creditor. This facility forms part of the law of diligence rather than that of bankruptcy,⁴ and enables property forming part of the estate of a deceased person to be attached in security and for payment of debts due by the deceased or by those with an interest in his estate. The diligence is competent only where no executor comes forward to confirm to the deceased's estate.⁵ The prior confirmation of an executor-creditor does not preclude a subsequent sequestration of the debtor's estates though, subject to section 106 of the 1913 Act, the rights of the executor-creditor under his confirmation are preserved.⁶ On the other hand, section 29 provides that no confirmation as executor-creditor can be granted after the date of the first deliverance on a petition for sequestration and section 106 provides that, where the estates of a deceased debtor are sequestrated within seven months of his death, an executor-creditor who confirms after the deceased's death cannot take in competition with the trustee. Though confirmation as an executor-creditor is now rarely sought,⁷ in certain circumstances such confirmation provides an inexpensive remedy for an individual creditor and we assume its continued competence throughout the remainder of this Chapter.

¹ss. 4, 14, 84. Cf. *Macdonald v. Auld* (1840) 2 D. 1104.

²s. 164. Cf. *Newall's Trs. v. Aitchison* (1840) 2 D. 1108.

³See para. 7.4.

⁴See generally Graham Stewart, p. 441.

⁵Graham Stewart, p. 441. Graham Stewart qualifies this proposition by reference to the failure of the executor to confirm to the whole estate, but partial confirmations, except in relation to executor-creditors, were rendered incompetent by the Confirmation of Executors (Scotland) Act 1823, ss. 3, 4.

⁶*Macdonald v. Auld* (1840) 2 D. 1104.

⁷For the reasons, see McLaren, *Wills and Succession*, 3rd ed. (Edinburgh, 1894), Vol. II, pp. 1161-1162.

Sequestration of a deceased person's estate

21.3 Section 11 of the 1913 Act contemplates that a petition for the sequestration of the estates of a deceased person may be presented only—

- (a) by a mandatory to whom the deceased had granted a mandate to apply for sequestration, or
- (b) by a qualified creditor or creditors.

Where the petition is presented by a mandatory under head (a) above it would appear that the petition may be presented and an award of sequestration made at any time after the debtor's death.⁸ No provision is made for petitions for the sequestration of a deceased debtor's estate at the instance of the deceased's executors.

21.4 Section 13 of the 1913 Act provides that a petition at the instance of a creditor for the sequestration of the estates of a deceased debtor may be presented at any time, but that sequestration may not be awarded until the expiry of six months from the debtor's date of death, unless he was notour bankrupt at that date or unless his "successors"⁹ concur in the petition or renounce the succession. The interval of six months presumably has regard to the fact that executors cannot be compelled to make payment of the debts of the deceased within the period of six months after his death. The sequestration, however, once awarded will take effect retroactively to the date of the first deliverance on the petition.¹⁰ In a case where the debtor is not notour bankrupt at the time of his death, the creditor can obtain an immediate award of sequestration only with the co-operation of all the deceased's "successors". But it may not be easy to obtain this co-operation because of the extensive meaning given to the expression "successors" by section 2 of the 1913 Act. There are certain practical difficulties inherent in lengthy deferment of an award after presentation of a petition.¹¹

21.5 Where the conditions for the sequestration of the estate of a deceased debtor are satisfied, the court has no discretion in the matter and must award sequestration. The rule has been applied even where a judicial factor has been appointed under section 163 and has already entered into the administration of the estate.¹²

21.6 The 1913 Act contains various supporting provisions, notably the provisions relating to executor-creditors in sections 29 and 106 and the

⁸See ss. 11(2)(A) and 13 of the 1913 Act. Such petitions are exceptions to the general law that a mandate falls on the death of the granter. See para. 21.13.

⁹1913 Act, s. 2: "successors' shall include all persons who have succeeded to any property which was vested in a party deceased at the time of his death, whether as heirs, heirs apparent, trustees under voluntary conveyances, representatives by deed or otherwise, executors, administrators, or nearest of kin, or as assignees, or legatees, and shall also include singular successors where they have acquired the right."

¹⁰1913 Act, s. 41.

¹¹See *Taylor and Kirkland v. Esplin* (1849) 11 D. 1016, a decision reached in the context of the somewhat different language of s. 4 of the 1839 Act.

¹²*Newall's Trustees v. Aitchison* (1840) 2 D. 1108; *Simpson v. Myles* (1881) 9 R. 104; *Arthur, Petr.* (1903) 10 S.L.T. 550.

provision in section 14 relating to measures for the interim preservation of the estate. These provisions are discussed below.

Appointment of a judicial factor under section 163 of the 1913 Act

21.7 An alternative method of securing the administration of the insolvent estate of a deceased person, available where no person is managing it under powers derived from the deceased, is for the creditors or for any person interested in the succession to apply for the appointment of a judicial factor under section 163 of the 1913 Act. The court has a discretion whether or not to appoint a judicial factor under this section.¹³ The section is couched in very general terms and does not require that the deceased's estate should be insolvent. Lord Justice-Clerk Inglis has pointed out that the corresponding provision of the 1856 Act:

“does not contemplate insolvency as a necessary element in the cases to which it relates ... any party interested in the estate of a person who has died without appointing trustees is entitled to make application under this section, though the deceased may have left no debts at all, or although they may be quite insignificant.”¹⁴

In its original form, indeed, the provision made no reference to insolvency and the judicial factor had to divide up the estate according to the common law rules for ranking.¹⁵ Under the 1913 Act,¹⁶ however, the judicial factor is directed:

“in the case of an insolvent estate [to] divide the same among the creditors thereof in accordance with the rules as to ranking obtaining in sequestrations in virtue of the provisions of this Act.”

Proposals for reform

Introduction

21.8 We considered whether it would not simplify the law if the procedure for the appointment of a judicial factor under section 163 were abandoned and the law was built around an amended system for the sequestration of the insolvent estates of deceased persons. Informal consultation, however, persuaded us that it would be unwise to discard a procedure which is available to deal with cases where it may not initially be clear whether the estate is solvent or insolvent. Moreover, if the estate proves to be solvent, the judicial factor, unlike a trustee in a sequestration, will be entitled to distribute any estate that remains after payment of the creditors among those entitled to succeed to it.¹⁷ Since the state of the deceased's affairs may not be clear until its administration has commenced, this

¹³N.M.L. Walker, *Judicial Factors* (Edinburgh, 1974), p. 44.

¹⁴*Alexander, Petitioner* (1862) 24 D. 1334, at 1339.

¹⁵*Wight's Trustees v. Jamieson* (1863) 1 M. 815.

¹⁶s. 163.

¹⁷R.C. 201(0).

provision is a useful one and recourse to it is not infrequent.¹⁸ We recommend, therefore, the retention of the options of petitions for sequestration and for the appointment of a judicial factor on the deceased's estate. Section 163, therefore, together with section 164 (which merely empowers the court to regulate the factor's duties by act of sederunt) should remain for the present on the statute book as unrepealed provisions of the 1913 Act.

Sequestration

21.9 We believe, however, that there is room for improvement in both procedures. In the first place, the present law, as we have seen,¹⁹ makes no provision for petitions for sequestration of a deceased debtor's estate at the instance of the deceased's executors. We consider that this is a deficiency in the scheme of the 1913 Act and, in consonance with our earlier proposals relating to trustees,²⁰ we recommend that an executor of a deceased debtor (or a person entitled to be appointed as executor) should have a right to petition for the sequestration of the deceased's estate. It should be provided, moreover, that such a petition may be presented and sequestration thereon awarded to any time after the death of the debtor.

21.10 It was suggested to the Cullen Committee²¹ that executors, on discovering that a deceased's estate is insolvent, should be bound to apply for its sequestration. Although self-interest would normally impel executors to take such a step even in the absence of a requirement to do so, we consider that it would be desirable to ensure that, upon ascertaining that the deceased's estate is insolvent, executors will petition the court either for the sequestration of the estate or for the appointment of a judicial factor to administer it. We recommend, therefore, that if an executor does not petition for sequestration of the deceased debtor's estate or for the appointment of a judicial factor to administer the estate within a reasonable period after the date when he knew or ought to have known that the estate was insolvent and was likely to remain so, any subsequent intromission by him with the estate shall be deemed to be an intromission without a title.

21.11 We have referred above to the practical difficulties associated with the application of section 13 of the 1913 Act. In the first place, where the deceased was not our bankrupt at the date of death, section 13 appears to say that a creditor's petition for sequestration is competent at any time after that date and that the award may be made at any time thereafter. We have already noted in our discussion of reduction of unfair preferences²² that

¹⁸The following appointments were made in recent years:

1975	1976	1977	1978	1979	1980
9	7	8	5	9	5

¹⁹Para. 21.3.

²⁰Paras. 5.4-5.6.

²¹Minutes of Evidence, paras. 613, 617 and 4633-4635.

²²See para. 12.41.

notour bankruptcy persists after its constitution “until insolvency cease”—with the result that it may last for an indefinite period and its continuation may be a matter of doubt. We have recommended, therefore, that in the case of a living debtor, a creditor’s petition can be presented only within the period of four months after the date of constitution of apparent insolvency. It would be reasonable to introduce a similar limitation in the case of the sequestration of the estate of a deceased debtor, that is, a creditor’s petition should be competent during the six months immediately after the debtor’s date of death only where the apparent insolvency of the debtor was constituted within the period of four months before his death. We recommend accordingly. Where the apparent insolvency of the deceased debtor was not constituted within the period of four months before his death, the existing law allows presentation of the petition at any time after the debtor’s death, although it does not permit the award to be made before the expiry of six months from the debtor’s death. It would conduce to simplicity if this provision were so expressed that a petition for sequestration of the deceased’s estate were incompetent before the expiry of the six-months period. We so recommend.

21.12 In the second place, section 13 permits of the presentation of petitions for the sequestration of a deceased person’s estate at any time if “his successors shall concur in the petition or renounce the succession”. This provision is difficult to invoke by reason of the breadth of the definition of the word “successors” in section 2 of the 1913 Act. We consider, however, that it becomes redundant in view of our proposals to deter executors from intruding with an insolvent estate²³ and to permit them to apply for its sequestration.²⁴ We recommend, therefore, that this provision should be discarded.

21.13 We have considered whether it is necessary to retain any provision analogous to section 11(2)(A) of the 1913 Act for sequestration at the instance of a person to whom the deceased has granted a mandate to that effect. This provision is of utility mainly in the context of trust deeds for creditors which may empower the trustee, where he considers it appropriate, to apply for the sequestration of the estate. It is, however, inconsistent with the general principle that a mandate falls on the death of a mandant and unnecessary in the context of the proposals in this Report. We envisage that a trustee under any voluntary trust deed for creditors should be entitled, notwithstanding the terms of the deed, to apply at any time for the sequestration of the debtor’s estate, whether or not the debtor is a living debtor. We have also recommended that an executor or any person entitled to be confirmed as executor on a deceased person’s estate should be entitled to apply for the sequestration of that estate. We recommend, therefore, that the provision in section 11(2)(A) of the 1913 Act be discarded.

21.14 The proposed alterations of the law described in the preceding paragraphs are designed to create a more rational scheme to regulate

²³Para. 21.10.

²⁴Para. 21.9.

petitions for the sequestration of the estates of insolvent deceased debtors than that provided by section 13 of the 1913 Act, with its potential for delay between the presentation of a petition by a creditor and the making of an award. Our proposed scheme is completed, in effect, by section 163 of the 1913 Act which, we have recommended, should remain in operation.²⁵ Section 163 will deal with cases where, though the deceased's estate did not become apparently insolvent immediately prior to his death, there is a risk of it turning out to be insolvent in an absolute sense. In this situation a creditor, though not entitled under our proposed scheme to petition for sequestration until the lapse of six months from the date of death, could invoke the essentially discretionary remedy²⁶ afforded by section 163.

21.15 Section 11 of the 1913 Act requires that the deceased "at the date of his death was subject to the jurisdiction of the supreme courts of Scotland". The simplicity of this expression obscures problems of interpretation. Its intended meaning becomes apparent from section 23 of the Act, which provides:

"When a petition is presented for sequestration of the estates of a deceased debtor, the petitioning creditor shall, in his oath, or in a separate oath, specify the place where the debtor resided or had a dwelling house or carried on business in Scotland at the time of his death, and whether he was then owner of estates in Scotland."²⁷

We note that the draft E.E.C. Bankruptcy Convention provides in Article 9 that in the bankruptcy of the estate of a deceased person the jurisdictional conditions for bankruptcy²⁸ must have been satisfied at the date of the deceased's death. We consider that this rule is sound in principle and we recommend that a petition for the sequestration of the estate of a deceased debtor should be competent only where, immediately prior to the date of his death, the court would have possessed jurisdiction to sequester his estate, in accordance with the rules which we have proposed in Chapter 6 of this Report.

21.16 Where the several requisites for the sequestration of the estate of a deceased debtor are satisfied, the court has apparently no discretion in the matter but must award sequestration. This rule has been applied even where a judicial factor has been appointed under section 163 of the 1913 Act and has already entered into possession of the estate.²⁹ This result may occasion considerable expense to all concerned. We consider in Chapter 6 the problems occasioned by competing proceedings for sequestration and for analogous remedies and we propose to deal with them by imposing duties to give notice of competing proceedings and competing awards and by giving the court a power whether of its own motion or at the instance of a creditor

²⁵Para. 21.8.

²⁶See para. 21.7.

²⁷Cf. also the terms of the 1913 Act, s. 163.

²⁸See paras. 6.17-6.21.

²⁹*Newall's Trustees v. Aitchison* (1840) 2 D. 1108; *Simpson v. Myles* (1881) 9 R. 104; *Arthur, Petr.* (1903) 10 S.L.T. 550.

or any other person with an interest to allow the proceedings for sequestration to proceed or to sist or dismiss those proceedings.³⁰ These provisions, we recommend, should be applied in the context of petitions for the sequestration of the estate of a deceased person.

21.17 We have already recommended that the facility for the appointment of a judicial factor under section 14 of the 1913 Act should be withdrawn in relation to the estates of living debtors.³¹ Where there is an award of sequestration of the estate of a deceased debtor, an interim trustee will have been appointed. Accordingly, the facility provided by section 14 could safely be discarded in this context, and we so recommend. We considered the case where a petition for the sequestration of the estate of the deceased debtor could not competently be presented by a creditor until six months after his death, and yet there might appear to be an urgent need for his estate to be safeguarded in the intervening period. We concluded that it would be open to the creditor or other interested parties to present a petition for the appointment of a judicial factor under section 163 of the 1913 Act.

21.18 The Insolvency Committee of the Law Society suggested to us in effect that the date of death should be deemed to be the date of sequestration for all purposes. We agree that the date of death should be the relevant date for the purpose of calculating what preferred debts (if any) in the form of salary or wages are payable to the deceased's employees. We have also recommended³² the retention of the present rule³³ that, where sequestration occurs within a period of seven months after the date of the debtor's death, any preference acquired by diligence or by the voluntary act of the debtor within a specified period before the date of death should be of no effect in a question with the trustee. It seems logical and consistent to extend the right of challenge given to the trustee by this provision to gratuitous alienations by the deceased debtor and to orders for the payment by him of a capital sum on divorce. We have recommended accordingly.³⁴ In other respects, however, practical difficulties, particularly in the context of the vesting of the estate, could arise from drawing back the effect of sequestration to a date which may lie some considerable distance in the past, and we do not recommend that the deceased's date of death should be deemed to be the date of the sequestration for all purposes.

21.19 We have referred above³⁵ to section 29 of the 1913 Act, which makes it incompetent after the date of the sequestration for any creditor to be confirmed as executor-creditor on the estate, or for any creditor to raise or insist in any adjudication against the estate of a deceased debtor. We

³⁰Paras. 6.24–6.31.

³¹See paras. 4.38–4.39, and *cf.* paras. 7.18–7.20.

³²See paras. 12.45 and 13.11.

³³See 1913 Act, s. 106. The limitation of the application of the section to sequestrations occurring within seven months after death ensures that its retrospective effect will not be unduly extended.

³⁴See paras. 12.19 and 12.32.

³⁵Para. 21.2.

propose that the substance of these rules should be retained. We also recommend retention of the provision in section 106 of the 1913 Act, whereby a creditor whose diligence or confirmation is frustrated by the operation of the section can recover the expenses of the diligence or confirmation.

Judicial factories under section 163 of the 1913 Act

21.20 We have already proposed that section 163 should be retained as an unrepealed provision of the 1913 Act. It is true, however, to say that it contains certain ambiguities and, although some have been resolved by judicial decisions, other remain.³⁶ Its ambit, moreover, is somewhat restricted and it is arguable, for example, that petitions under section 163 should be competent whether or not the deceased made provision for the administration of his estate and whether or not the persons whom he designated to administer his estate have assumed its administration. We consider, however, that such questions are outwith the scope of the present Report, although we propose to return to them if, as seems likely, the Commission turns to examine the law relating to judicial factors. But there are questions relating to the application of section 163 in insolvency situations which must be considered.

21.21 In *Reid's Judicial Factor v. Reid and others*³⁷ it was held that a judicial factor did not possess the rights of a trustee in a sequestrated estate to challenge the debtor's gratuitous alienations under the common law or under the Bankruptcy Act 1621. Although this decision has been criticised on various grounds,³⁸ it must be treated as an authoritative statement of the law. Its ratio, moreover, would appear to apply to the challenge of fraudulent preferences. It seems to us in principle that, if in insolvency situations a judicial factor must divide the estate in accordance with the rules obtaining in a sequestration, the estate to be divided should be ascertained in a similar way. We recommend, therefore, that, where the deceased's estate was insolvent at the date of death, a judicial factor appointed under section 163 of the 1913 Act should have the same powers as a trustee in sequestration of a deceased person's estate to challenge gratuitous alienations, unfair preferences, and orders for financial provision on divorce, whether these powers derive from common law or from statute. It follows that we propose a restriction of the statutory challenge to cases where the judicial factor is appointed within seven months of the deceased's date of death. We recommend, likewise, that when the deceased's estate is insolvent and the judicial factor is appointed within seven months of the debtor's date of death, the rules governing the effect of the sequestration on diligence in relation to the estate of a deceased debtor should be applied.

³⁶See N.M.L. Walker, *Judicial Factors* (Edinburgh, 1974), pp. 42-43.

³⁷1959 S.L.T. 120.

³⁸Walker, above, at pp. 45-46.

CHAPTER 22

REGISTRATION AND THE PROVISION OF INFORMATION REGARDING INSOLVENCY PROCEEDINGS

Introduction

22.1 The 1913 Act makes provision for the publication of the award of sequestration and of the subsequent stages in the sequestration process. It requires the advertisement in the *Edinburgh Gazette* of an award of sequestration and of the more important incidents of the subsequent proceedings (such as the election of the trustee and the time and place of the bankrupt's public examination). It requires individual notification to the bankrupt's creditors of the matters most directly affecting them (such as the arrangements for meetings and the amount of any dividend proposed to be paid). It also requires the registration in the Register of Inhibitions and Adjudications of "abbreviates" or summaries of judicial deliverances that disclose *inter alia* the commencement of the sequestration and the discharge of the bankrupt. The award of sequestration must be advertised in the *London Gazette* as well as in the *Edinburgh Gazette*.¹ The reason for this requirement is that an award of sequestration affects the bankrupt's moveable estate wherever situated and his real estate *inter alia* in England. Creditors living in England may have an interest in many Scottish sequestrations. If the advertisement in the *London Gazette* makes them aware of the existence of the sequestration, they can thereafter follow its progress through the advertisements in the *Edinburgh Gazette*.

22.2 The 1913 Act also makes provision for the keeping of records relating to sequestration proceedings. The Accountant of Court is required to keep a book called "The Register of Sequestrations", in which there are recorded for every sequestration particulars relating to the petition and the award, the trustee and commissioners, and the discharges of the bankrupt and of the trustee.² The Register is to be "patent to all concerned".³ The Accountant of Court is also required to "frame an annual report to the Court of Session, showing the state of each depending sequestration returned to him".⁴

22.3 Advertisement in the *Gazette*, registration in the Register of Inhibitions and Adjudications and maintenance by the Accountant of Court of the Register of Sequestrations are clearly designed to serve a number of purposes. The primary purpose of advertisement in the *Gazette* is to bring an award of sequestration to the notice of the bankrupt's creditors and to the public generally, so that the sequestration will become known so far as possible not only to those persons with whom the bankrupt has transacted but also to those who might otherwise continue to transact with him or

¹See 1913 Act, s. 44.

²1913 Act, s. 156.

³*Ibid.*

⁴1913 Act, s. 159.

might have transacted with him in the future. The first and most important requirement relating to the Register of Inhibitions and Adjudications is that the party applying for sequestration must deliver to the Keeper of the Register of Inhibitions and Adjudications an abbreviate of the petition and of the first deliverance thereon.⁵ The Keeper is directed to record the abbreviate forthwith, and the effect of this recording is to make litigious the heritable property of the debtor.⁶

22.4 The Register of Sequestrations maintained by the Accountant of Court and the annual report framed by him have a more general function. The Register of Sequestrations is to be "patent at all concerned",⁷ and the statistics contained in the annual report are utilised in the Civil Judicial Statistics for each year. These records, therefore, give information about sequestrations for the benefit of the general public as well as of Government.

22.5 We recognise that the *Edinburgh Gazette* is not widely read, but through trade and other publications it serves to inform those most likely to be concerned about bankruptcies. Advertisement, however, in the *Gazette* is expensive and our general approach has been to retain the requirement of publication in the *Gazette* of notices relating to the more important steps in the sequestration process,⁸ and to allow the trustee a discretion in relation to notices of less important steps, including meetings called for various purposes. Our concern in this Chapter is rather with the public records to be maintained by the Accountant in Bankruptcy and with the requirements for registration in the Register of Inhibitions and Adjudications. We commence by considering the contents of the public register to be maintained by the Accountant in Bankruptcy and to be made available by him for inspection by the public.

The Register of Insolvencies

22.6 The present Register of Sequestrations does not, and cannot, give information about all insolvency administrations, because there is no machinery for ascertaining the number of insolvent estates which are administered under voluntary trust deeds for creditors. We did consider making the registration of such trust deeds a condition of their validity, but concluded that the proposed sanction was disproportionate to the case. We have recommended,⁹ however, that if a trust deed is to secure the advantages of a "protected" trust deed it must be submitted for registration in the proposed Register of Insolvencies which would replace the Register of

⁵1913 Act, s. 44.

⁶*Ibid.*

⁷1913 Act, s. 156.

⁸e.g. the making of the award of sequestration (which must also be advertised in the *London Gazette*); the place, time and date of any public examination; and any application by a bankrupt for his discharge.

⁹See Chapter 24 for a full discussion of our proposals regarding voluntary trust deeds for creditors. A trust deed becomes "protected" when it fulfils certain specified requirements. It then enjoys comparative safety from being superseded by a sequestration, and the trustee under the deed will be entitled to challenge gratuitous alienations and unfair preferences.

Sequestrations.¹⁰ We hope, therefore, that notice of a significant proportion of trust deeds for creditors will appear in the Register of Insolvencies.¹¹ Among the purposes served by such a Register would be the following—

- (1) persons who might otherwise contract with an insolvent, or who have in fact contracted with him, may be alerted as to his condition;
- (2) persons who might otherwise do diligence against an insolvent may discover that it will be purposeless; and
- (3) persons who might otherwise extend credit to an insolvent may be forewarned.

22.7 The new Register, therefore, should disclose (a) the various stages in the history of a sequestration from its commencement to its termination, and (b) relevant background information such as the occupation of the bankrupt and whether the petition was presented by him or by a creditor. Parallel provision with suitable modifications should be made for recording information about the sequestrated estates of deceased debtors. The new Register would also contain information—which would inevitably be more limited in its scope—about trust deeds that had become protected trust deeds.¹² The Register would, as we have indicated, be maintained by the Accountant in Bankruptcy and would be called the “Register of Insolvencies”. A suggested form for the proposed Register is contained in Appendix 4 to this Report, but the actual form of the Register should be prescribed by, and be capable of variation by, Act of Sederunt. We recommend accordingly.

22.8 The existing Register of Sequestrations is to be “patent to all concerned”.¹³ It is unnecessary to consider what limitation, if any, is introduced into that formula by the word “concerned”. We consider that any person should be entitled to inspect the Register of Insolvencies, or to be provided with an extract of any entry in the Register, on payment of the appropriate fee. Any other course would be impracticable. The usefulness of a record of any particular insolvency process will inevitably decline with the passing of time, and it might well be undesirable to impose upon the Accountant in Bankruptcy a duty to maintain in perpetuity all the insolvency records compiled by him. We also think that it would be undesirable to maintain indefinitely for public inspection records of information which may be prejudicial to the bankrupt long after his discharge. These matters are, however, regulated by the Public Records (Scotland) Act 1937 (c. 43), which makes provision for the transmission of public records after an appropriate interval to the Keeper of the Records of Scotland for custody and disposal in accordance with the provisions of that Act.

¹⁰Discussed further in this and the next paragraph.

¹¹If and when debt arrangement schemes are introduced in Scotland, it would be for consideration whether the Register should also contain particulars of such schemes.

¹²See para. 22.12.

¹³1913 Act, s. 156.

22.9 To ensure that the Register may provide a useful and up-to-date record of insolvencies, the relevant particulars should be reported to the Accountant in Bankruptcy without delay. This raises a number of questions, namely, (1) when should information about an insolvency first be sent to the Accountant, (2) on whom should responsibility for transmission of information fall, and (3) within what period should the various stages in the sequestration process be reported to the Accountant. We think it easier, in dealing with these questions, to consider first their application to a formal process of sequestration and then to the different case where an insolvent estate is the subject of a protected trust deed for creditors.

22.10 Our Working Party recommended that registration of a petition for sequestration should take place on presentation of the petition.¹⁴ We consider, however, that registration in the Register of Insolvencies should be deferred until an award of sequestration has actually been made. There is always the possibility that a petition, even although it has been presented to the court, may subsequently be abandoned or dismissed. So that the Accountant in Bankruptcy may have a reasonably complete record of every sequestration process, we recommend that the clerk of any court to which a petition for sequestration is presented, or in which a sequestration process is current, should be directed to send to the Accountant in Bankruptcy a copy of the first order¹⁵ and of every subsequent order or other determination in the process. The Accountant would obtain from these documents much of the information required for the entries in the Register of Insolvencies, such as (a) the name and address of the bankrupt, (b) whether the petition was presented by him, (c) the name and address of the petitioner for sequestration, (d) the court by which sequestration was awarded, (e) the date of the first order and the date of the award of sequestration, (f) the names and addresses of the interim trustee and the permanent trustee, and (g) the date of discharge of the bankrupt. Any further information that might be required by the Accountant would be obtainable by him from the trustee in the sequestration.¹⁶

22.11 The copy accounts required to be submitted to the Accountant of Court under section 80 of the 1913 Act provide much of the statistical information relating to sequestrations contained in (a) the annual report by the Accountant to the Court of Session under section 159 of the 1913 Act, and (b) the Civil Judicial Statistics compiled annually by the Scottish Courts Administration. There is no prescribed form for the accounts submitted by trustees and we are informed that the accounting methods used by trustees vary considerably. While it might well be undesirable to prescribe a standard form for the accounts, the professional bodies concerned might, we think, usefully consider whether a greater measure of uniformity could be

¹⁴Memo. No. 16, p. 16.

¹⁵The first court order will award sequestration where the petition is presented by the debtor, but not where the petition is presented by the creditor—see para. 22.14(3).

¹⁶We have recommended that the Accountant should be empowered to require a trustee to supply him with such information as the Accountant considers necessary to enable him to discharge his statutory functions—see para. 10.35.

introduced into the forms which are used by trustees. Apart from this suggestion, we make no proposal for alteration in substance of the requirement as to submission of accounts contained in section 80.

22.12 The Register of Insolvencies will, as we have stated, also contain information about trust deeds for creditors. We later propose that a trust deed by a debtor in favour of his creditors generally should, where certain requirements are fulfilled, become what we refer to as a protected trust deed.¹⁷ These requirements are that the trustee under the deed would not be disqualified on personal grounds from acting as a trustee in a sequestration of the debtor's estate; that the granting of the deed should have been published in the *Edinburgh Gazette*; that a majority in number and two-thirds in value of the creditors should have acceded to the deed; and that within a specified period there should have been sent to the Accountant in Bankruptcy for registration purposes a copy of the trust deed, with a certificate that it is a true copy and that the requisite accession of creditors has been obtained. The Accountant would extract from the trust deed for entry in the Register of Insolvencies information as to (a) the granter of the deed, (b) the trustee under the deed, (c) the date of execution of the deed, and (d) the date on which the copy of the deed was received by the Accountant for registration purposes.

Registration in the Register of Inhibitions and Adjudications

22.13 Sections 44, 75, 101 and 145 of the 1913 Act make provision for the registration of "abbreviates" in the Register of Inhibitions and Adjudications. These sections are concerned respectively with the registration of abbreviates in relation to the first deliverance on a petition for sequestration, the appointment of the trustee, the transfer to the trustee of the heritable property of a person who is declared bankrupt after his death, and the discharge of the bankrupt. In addition to these provisions, sections 30 and 39 make provision for the registration of abbreviates of deliverances recalling sequestrations or declaring them to be at an end. We now examine these provisions separately.

22.14 Section 44 of the 1913 Act requires the party applying for sequestration to present to the Keeper of the Register of Inhibitions and Adjudications "before the expiration of the second lawful day after the first deliverance if given by the Lord Ordinary, or [to] present or transmit by post before the expiration of the second lawful day after the said deliverance if given by the sheriff, an abbreviate of the petition and deliverance". The form of the abbreviate is set out in Schedule A to the 1913 Act. The Keeper is directed to register the abbreviate forthwith, and the effect of the registration is that the heritable property of the debtor is rendered litigious. The effect does, however, expire on the lapse of five years from the date of registration and the trustee, unless he has been discharged, is required to register before the lapse of the five-year period a memorandum renewing the

¹⁷See paras. 24.22–24.26.

effect of the registered abbreviate.¹⁸ We recommended the retention of a provision similar in principle to section 44 of the 1913 Act, but the bankruptcy scheme recommended in this Report makes it necessary or desirable to introduce certain procedural alterations. These are as follows—

- (1) We recommend that there should be sent to the Keeper of the Register of Inhibitions and Adjudications, not an abbreviate of the petition and first deliverance, but simply a copy (which would be certified as a true copy) of the first order following presentation of the petition. This would avoid the need to prepare an abbreviate, and the registered order would give more information than the abbreviate that is at present registered.¹⁹
- (2) The abbreviate of the petition for sequestration and of the first deliverance must, under existing law, be presented by the “party applying for sequestration”.²⁰ It would seem more satisfactory that the duty of forwarding the copy order should be placed upon the clerk of court. We have already recommended that he should have the duty of sending a copy of every order or other determination in a sequestration process to the Accountant in Bankruptcy.²¹ It would be consistent with that approach if the clerk of court were also to become responsible for transmitting copies of orders or other determinations to the Keeper of the Register of Inhibitions and Adjudications, and we so recommend.
- (3) The first deliverance on a petition for sequestration awards sequestration where the petition is brought by or with the concurrence of the debtor,²² but merely grants warrant for citation of the debtor “to appear within a specified period ... to show cause why sequestration should not be awarded” when it is brought without the debtor’s consent.²³ In either case, however, the abbreviate of the petition and first deliverance (or, under our proposals, the copy order itself) will be registered in the Register of Inhibitions and Adjudications immediately after its issue. The 1913 Act makes no provision for the cancellation of the effect of the registration in the event of a creditor’s petition being withdrawn or dismissed without an award of sequestration. If a creditor’s petition is dismissed, a copy of the interlocutor dismissing the petition will in practice usually be sent to the Keeper of the Register of Inhibitions and Adjudications so that it may be registered there. The practice

¹⁸Failure to maintain the effect of the abbreviate will enable the bankrupt or his successors to grant a title to his heritable property preferable to that of the trustee unless the trustee has already completed his own title to the property—1913 Act, s. 44 and Conveyancing (Scotland) Act 1924 (c. 27), s. 44(4).

¹⁹The abbreviate of the petition and first deliverance which is at present registered in the Register simply specifies the petition and the date of the first deliverance. In particular, it does not disclose whether sequestration has or has not been awarded by that deliverance—see 1913 Act, s. 44 and Sched. A, No. 1.

²⁰1913 Act, s. 44.

²¹See para. 22.10.

²²1913 Act, s. 28.

²³*Ibid.*, s. 25.

should be given statutory recognition. We recommend, therefore, that it should be expressly provided that in any case where the presentation of a petition for sequestration has been followed by refusal of an award of sequestration, the clerk of court should be required to send a certified copy of the relative order to the Keeper of the Register of Inhibitions and Adjudications.

- (4) We recommend that the memorandum renewing the effect of the registration in the Register of Inhibitions and Adjudications of the first order in a sequestration process should be in a form to be prescribed by Act of Sederunt instead of, as at present, in the form set out in a Schedule to the statute. In other respects there would be no change in the law, that is, the trustee in every sequestration process would be required to register a memorandum of renewal before the expiry of every period of five years while the sequestration process subsisted.

22.15 Sections 30 to 43 of the 1913 Act deal in an unmethodical way with recall of sequestrations and with other issues (for example, the payment of the expenses of a creditor petitioning for, or concurring in a petition for, sequestration). The provisions relating to registration in the Register of Inhibitions and Adjudications of abbreviates of deliverances granting recall are incomplete and imprecise.²⁴ In accordance with the view which we have already expressed,²⁵ we recommend that in every case where a sequestration is recalled there should be a duty upon the clerk of the court to transmit to the Keeper of the Register of Inhibitions and Adjudications a copy of the order of recall for registration in that register.

22.16 Section 75 of the 1913 Act provides that the trustee, within 10 days after the confirmation of his election, shall present an abbreviate to the Keeper of the Register of Inhibitions and Adjudications, the Keeper being directed to register the same in that Register. The abbreviate (which is in a prescribed form) records that the bankrupt's heritable and moveable estate is transferred to the trustee designated in the abbreviate. Failure to register the abbreviate within the statutory period does not destroy the trustee's right, the only effect of failure being apparently that the trustee is liable personally for the expense of obtaining authority from the court to register the abbreviate out of time.²⁶ The registration of the abbreviate serves no purpose beyond giving information that the estate and effects of the bankrupt are transferred to the trustee named. It seems to us that advertisement in the *Gazette* is a more effective way of publishing the name

²⁴S. 30 provides for recording of an abbreviate of a deliverance of recall, but does not place a duty upon any person to forward the extract to the Keeper of the Register of Inhibitions and Adjudications. S. 43 (which relates to recall on special grounds) says nothing about registration in the Register of Inhibitions and Adjudications. In *Brandon v. Stephens* (1862) 24 D. 263, where there was a recall under s. 2 of the Bankruptcy (Scotland) Act 1860 (c. 33) (the predecessor of s. 43 of the 1913 Act), the court expressly ordered registration of the recall in the Register of Inhibitions.

²⁵See para. 22.14(2).

²⁶*Munro v. Fraser's Trustee* (1851) 13 D. 1209; *Martin, Petitioner* (1857) 20 D. 55. For the personal liability of the trustee, see *A.B., Petitioner* (1855) 18 D. 286.

of the trustee, and that the registration of the abbreviate under section 75 of the 1913 Act serves no purpose that justifies its continuation. We recommend, therefore, that it be dispensed with.

22.17 Section 101 of the 1913 Act makes provision for the case where sequestration is awarded against the estate of a person after his death, and his "successor"²⁷ has made up a title to his heritable estate. In such a case the trustee may petition the court for transfer of the estate to him. If the petition is successful and the court orders the estate to be transferred to the trustee he must, within eight days thereafter, "cause an abbreviate of [the] petition and deliverance to be recorded" in the Register of Inhibitions and Adjudications. Under the different scheme recommended by us for the vesting in a trustee of the property of a deceased debtor²⁸ this provision is no longer necessary and we recommend that it should be omitted.

22.18 Section 145 of the 1913 Act makes provision for the registration in the Register of Inhibitions and Adjudications of an abbreviate of the deliverance of the discharge of a bankrupt, whether following on a composition or not. It provides that the abbreviate shall be issued by the clerk of court and shall be registered in the Register of Inhibitions and Adjudications. We have proposed a scheme for the discharge of a bankrupt by operation of law on the expiry of five years from the date of sequestration²⁹ unless he has successfully applied for earlier discharge³⁰ or, conversely, there has been a successful application for deferment of a discharge³¹ beyond the expiry of the five-year period. In the case of discharge by operation of law there will be no judicial process, and the discharge of the bankrupt in that way can be demonstrated only negatively, that is, by the absence of any record of a judicial order granting earlier discharge or deferring discharge. We recommend, therefore, that the clerk of the court should be required to send to the Keeper of the Register of Inhibitions and Adjudications for registration there a certified copy of any order granting or deferring the bankrupt's discharge.

22.19 There is a lack of consistency in the statutory provisions relating to the periods within which extracts of deliverances in a sequestration process must be sent to the Keeper of the Register of Inhibitions and Adjudications. Some of the provisions impose a time-limit in this respect,³² whereas others say nothing at all.³³ We consider that it is unnecessary to specify any time-limit within which the clerk of court must send copies of orders or other determinations to the Keeper of the Register of Inhibitions and Adjudications. This will be done as a matter of course immediately after issue of the court's judgment.

²⁷This term is widely defined in the 1913 Act, s. 2.

²⁸See para. 11.9.

²⁹Para. 19.13.

³⁰Paras. 19.21-19.22.

³¹Paras. 19.16-19.18.

³²See, e.g., 1913 Act, ss. 44, 75.

³³See ss. 30, 145.

CHAPTER 23

BANKRUPTCY OFFENCES

Introduction

23.1 Scots law has gradually progressed from a period when the mere fact of insolvency might warrant imprisonment to the present day when imprisonment is a punishment, rarely enough applied, not for insolvency as such but for specific offences connected with insolvency and sequestration. The right of a creditor to imprison his debtor for non-payment was gradually restricted by the process of *cessio bonorum*, under which the bankrupt might liberate or save himself from imprisonment by making his whole assets available to his creditors. The process of *cessio bonorum* lingered on until 1913, but became virtually obsolete when civil imprisonment for most forms of civil debt was abolished by the Debtors (Scotland) Act 1880.¹

23.2 At common law the crime of fraudulent bankruptcy consists of any act by a debtor for the purpose of deceiving his creditors or depriving them of their just rights. In practice, the crime usually takes the form of the concealment or putting away of property or funds by a debtor with intent to defraud his creditors. The crime will usually be committed by a person who is insolvent or on the verge of insolvency, but it may be committed by a solvent person if the concealment or putting away is done for the purpose of defeating the claims of his creditors by a pretence of insolvency. The relevancy of an indictment will be sustained only if it makes clear which of these alternatives the prosecutor elects to pursue.²

23.3 The common law applicable to fraudulent bankruptcy was supplemented at an early date by the bankruptcy statutes. The boundaries between the common law crimes and specific statutory offences were at first ill-defined. The Bankruptcy Act 1621, whose principal purpose was to render voidable gratuitous alienations to conjunct and confident persons, was largely couched in the language of the criminal law and declared that debtors, interposed persons, and all others who give them assistance in “the dewysing and praktiezing of thair saidis fraudis and godles deceittis to the preiudice of thair trew Creditoures Salbe reputed and holden dishonest fals and Infamous persones”. The Bankruptcy Act 1696, which defined “notour bankruptcy” and struck at deeds granted by the debtor within 60 days before its constitution, also provided that a person found by the Lords of Session to be a fraudulent bankrupt should not only be held to be infamous, but liable

¹c. 34.

²In *Clendinnen v. Rodger* (1875) 3 R. (J.C.) 3, the court held as irrelevant an indictment which referred to the wicked, fraudulent and felonious putting away of his funds and effects “by an insolvent or other debtor”.

to "be by them Punished by Banishment or otherwayes (death excepted) as they shall see cause".³

23.4 Bankruptcy offences became an important category of offences only with the introduction of sequestration in 1772. There was an early difficulty in reconciling the process of sequestration with the penal provisions of the Acts of 1621 and 1696. In *Aitken v. Rennie*⁴ a trustee in sequestration, after obtaining the concurrence of the Lord Advocate, attempted to prosecute the bankrupt for fraudulent bankruptcy under the 1696 Act. The form of process chosen was ordinary action in the Court of Session. The court held that the trustee had no title to pursue the bankrupt for fraudulent bankruptcy *ad criminalem effectum*, and that in any event the appropriate process for prosecution was a petition and complaint. The latter difficulty, however, was soon resolved by the Fraudulent Bankrupts (Scotland) Act 1827⁵ which, for the removing of doubt, declared that bankruptcy offences might be prosecuted before the High Court and Circuit Courts of Justiciary "according to the same form and course of proceedings as is used in regard to other offences". Petitions and complaints to the Court of Session in bankruptcy frauds have long been in desuetude.⁶

23.5 The concept of fraudulent bankruptcy was extended by section 33 of the Payment of Creditors (Scotland) Act 1814⁷ which declared with reference to examinations, "that if the bankrupt shall wilfully fail to exhibit a fair state of affairs, or to make oaths [in terms specified in the Act], he shall be considered as a fraudulent bankrupt and punished accordingly". The punishments for fraudulent bankruptcy were severe.⁸ In practice the majority of fraudulent bankruptcies appear to have been prosecuted under the common law, which was also invoked to deal with specific acts which were prejudicial to the administration of bankruptcy.⁹ Alison, therefore, was justified in saying that "the common law, of its own native vigour, is competent to repress any fraudulent invasion" of the rights vested in creditors by the bankruptcy statutes.¹⁰

³Elchies (Notes, "Bankruptcy" No. 23) reports the case of *McKinnie v. Forresters*, 19th and 23rd July, 1747 as follows:

"We found the charge of fraudulent bankruptcy against George Forrester, and that Robert was partaker with him in his fraud proved, and the 23rd July declared them infamous in terms of the act 1621, ordered them to be pilloried at Glasgow the 10th day of August, with a paper on their breast, 'Infamous fraudulent bankrupt' and then banished to the Plantations for seven years."

⁴11th December 1810 F.C.

⁵c. 20.

⁶The penal provisions of the Bankruptcy Acts 1621 and 1696 were repealed by the Statute Law Revision (Scotland) Act 1964 (c. 80).

⁷(c. 137). This Act was repealed by the 1856 Act, s. 2.

⁸In *McLaren* (1836) 1 Swin. 219 the accused was convicted of perjury and fraud and of failing to make a fair and full disclosure of his affairs as required by the Payment of Creditors (Scotland) Act 1814. He was sentenced to 14 years transportation.

⁹In *Malcolm* (1834) 1 Broun 620 an insolvent debtor was convicted of mutilating a pass-book with intent to defraud or injure his creditors.

¹⁰Alison, *Principles of the Criminal Law of Scotland* (Edinburgh, 1832), Vol. 1, p. 567.

Statutory offences

23.6 The present scope of the common law and its inherent powers of development raise the question whether there is any justification for the existence of specific bankruptcy offences. The common law, however, requires proof of intent, usually intent to defraud creditors, and difficulty in establishing such intent may be one reason why charges for bankruptcy offences under the common law are so rare. Moreover, in some cases the civil law of bankruptcy requires the support of the criminal law irrespective of whether the debtor's act or omission was motivated by intent to defraud. In others, it may be desirable either to reverse the onus of proof of intent or even to substitute a different species of *mens rea*. Apart from these considerations, there is a case for including specific provisions relating to offences in bankruptcy legislation to indicate clearly to persons who are insolvent or verging upon insolvency the limits of their permissible conduct, and to those who are dealing with their estates their obligation to report certain facts to the prosecuting authorities.

23.7 While certain bankruptcy offences were created by the 1621 and 1696 Acts and the Bills of Exchange (Scotland) Act 1772,¹¹ it seems clear that it was the difficulty of proof of intent under the common law that led to the introduction of a comprehensive code of bankruptcy offences in sections 13 and 14 of the Debtors (Scotland) Act 1880.¹² This code, with minor modifications, was restated in sections 178 and 179 of the 1913 Act. The provisions of the 1880 Act were derived in great measure from those of sections 11 and 12 of the (English) Debtors Act 1869.¹³ This may help to explain both the departures in the 1880 Act from the language of the Scots criminal law and the fact that it struck at certain acts which were already crimes under the common law of Scotland. Apart from this, however, the provisions of sections 178 and 179 of the 1913 Act present many difficulties both of a general character and in respect of their details. Since we are persuaded that the scheme is unsatisfactory as a whole, we confine ourselves to referring to the principal difficulties—

- (a) Section 178 establishes as statutory offences certain acts which are already offences at common law.¹⁴
- (b) Section 178 applies only to debtors "in a process of sequestration". Bankruptcy offences, however, may not come to light or may not be fully investigated until after the process of sequestration has been completed. There should be no doubt that in such a case the debtor's prosecution remains competent.
- (c) The treatment of *mens rea* and excuses in section 178 is unsatisfactory. The offences listed in section 178(A), for example, are a curious mixture whose gravamen in some instances is that the debtor's conduct amounted to fraud or attempted fraud, in others merely that it interfered with or obstructed the administration of the

¹¹c. 72.

¹²c. 34.

¹³c. 62.

¹⁴See in particular s. 178(A)(4).

sequestration process. Yet in every case the bankrupt may exculpate himself by proving "to the satisfaction of the court that he had no intent to defraud". This is hardly appropriate for offences resulting from interference or obstruction with the sequestration process.

We recommend, therefore, that the legislation to follow on this Report should set out the *mens rea* or defence appropriate to each offence or make it clear that in the particular case there is absolute liability.

23.8 These considerations, and the many special difficulties presented by the detailed provisions of the 1913 Act, have persuaded us that new provisions for bankruptcy offences are desirable. In considering their substantive content we have been greatly assisted by current bankruptcy legislation in other countries, particularly in England, Australia, Canada and New Zealand. Our main concern, however, has been to formulate provisions which will cohere with the criminal law of Scotland and with the proposed structure of bankruptcy law and administration. Our recommendations are set out in the draft Bill which forms Appendix 6 of this Report. We refer the reader to the Explanatory Notes on the Bill.

23.9 We think it appropriate, however, to refer briefly to certain provisions in the 1913 Act which are omitted from our draft Bill. There is no precise analogue to section 180 of the 1913 Act (which requires a trustee who has reasonable grounds to suspect that the bankrupt has been guilty of an offence under the Act to report that to the Lord Advocate). We understand that in practice few reports are submitted by trustees. In our view it is appropriate that the statutory duty of reporting the possible commission of offences to the Lord Advocate should fall exclusively upon the Accountant in Bankruptcy, a public official, rather than upon the trustee, whose main pre-occupation is necessarily with the interests of the creditors. We recommend, however, that 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, he should report the matter to the Accountant in Bankruptcy. The latter would also have available to him the interim trustee's written comments on the debtor's statement of affairs. The interim trustee, moreover, is bound to supply the Accountant with further information. Where a public examination takes place, the permanent trustee must send a record of the examination to the Accountant in Bankruptcy. We recommend, therefore, that, without prejudice to the right at common law of any person to inform the police or prosecuting authorities of the possible commission of an offence, a specific duty should be imposed upon the Accountant in Bankruptcy, where he has information which leads him to suspect that a bankrupt has committed an offence in respect of his business or financial affairs or his conduct in relation thereto, to report the matter to the Lord Advocate.

23.10 there is no provision in the draft Bill corresponding to section 181 of the 1913 Act. It is always open to the Crown in Scotland to proceed as it thinks fit under the common law, even when a statutory provision applies to the *species facti* of the offence.

23.11 There is also nothing in the draft Bill corresponding to section 186 of the 1913 Act. A false statement on oath in the course of sequestration proceedings would constitute a contravention of section 1 of the False Oaths (Scotland) Act 1933.¹⁵ Moreover, the trustee's entitlement under section 186 to prosecute with the concurrence of the Lord Advocate is out of keeping with current practice, and the provision for automatic forfeiture by an offender of his interest in the sequestrated estate may well be too harsh in the circumstances of a particular case.

23.12 Lastly, we recommend that the bankruptcy offences specified in the draft Bill may be prosecuted summarily before the sheriff or on indictment before the sheriff or the High Court of Justiciary. On summary conviction the debtor would be liable to imprisonment for a term not exceeding three months, or where he has previously been convicted of an offence inferring dishonest appropriation of property or an attempt thereat, to imprisonment for a term not exceeding six months. On conviction on indictment before the sheriff the debtor would be liable to imprisonment for a term not exceeding three years, and on conviction on indictment before the High Court of Justiciary to imprisonment for a term not exceeding five years. In any of the foregoing cases it would be open to the court to impose a fine of an appropriate amount in substitution for imprisonment where the circumstances make this appropriate.¹⁶

¹⁵c. 20.

¹⁶See Criminal Procedure (Scotland) Act 1975 (c. 21), ss. 193, 394.

CHAPTER 24

TRUST DEEDS FOR CREDITORS

The present law

Nature of the trust deed

24.1 The voluntary trust deed for creditors has traditionally provided an alternative to sequestration. It will usually take the form of a unilateral deed by the debtor containing a conveyance of his whole property to a trustee for behoof of the debtor's creditors generally. It will contain powers relating to the collection of assets, their realisation, the ranking of claims and the distribution of the estate among the creditors according to their respective rights and preferences. Trust deeds will also contain clauses relating to the practical and convenient administration of the trust, to the discharge of the debtor, and to the restoration to him of any estate that remains after payment of his debts and the expenses of the administration. There will be provisions for the assessment of the remuneration of the trustee and the audit of his accounts. The trust deed will usually authorise application for the sequestration of the debtor's estate, if the trustee considers this course to be desirable.

24.2 It is competent in a trust deed for creditors to provide against the lapse of the trust by the death or disability of the trustee; and the provisions of sections 22 and 23 of the Trusts (Scotland) Act 1921¹ for the appointment of new trustees by the court and the removal of trustees are applicable to trustees under trust deeds for creditors.² No other provision, however, is made by the law or, in practice, by trust deeds for the removal of a trustee at the instance of the creditors. Apart from the powers specified in the trust deed, the trustee—being a trustee for the purpose of the Trusts (Scotland) Acts 1921³ and 1961⁴—has the power to perform such acts as may be specified by those Acts where they are not at variance with the terms or purposes of the trust.

24.3 The attractions of voluntary trust deeds to creditors and debtors alike are such that they are understood to be the preferred method of winding-up the insolvent estates of individual debtors. We have no reliable statistics on the matter. The Accountant of Court has noted that 299 trust deeds were advertised over the period 1974–80. There is no duty, however, to advertise and it is thought that many are not advertised. There were 752 ordinary and 146 summary sequestrations during that period. We are advised by several insolvency practitioners that, in their experience, voluntary

¹c. 58.

²See, e.g. *The Royal Bank of Scotland* (1893) 20 R. 741; *Mitchell* 1937 S.L.T. 474.

³c. 58.

⁴c. 57.

trust deeds are more frequent than sequestrations.⁵ We explain below the probable reasons for this situation.⁶ We think it right, however, to consider first the principal disadvantages of trust deeds.

Disadvantages of trust deeds

24.4 A major disadvantage of voluntary trust deeds lies in the fact that, to make the estate secure against diligence by non-acceding creditors, the trustee must complete his title to the individual items of the debtor's estate by the appropriate method, as by infertment in the case of heritable property, by intimation in the case of debts and by taking possession in the case of corporeal moveables.⁷ The trustee must be clothed with such possession independently of the debtor.⁸ It is clear that a trust deed will be less effective in preventing a race of diligence than a sequestration.

24.5 A second disadvantage of a trust deed under the present law is that it may be challenged as an illegal preference and so is vulnerable to the attack of non-acceding creditors. The common law saw nothing objectionable in a trust deed granted by an insolvent for the impartial benefit of all his creditors, such a deed being regarded merely as enabling the debtor to do voluntarily what the law would otherwise compel him to do.⁹ But after the passing of the Bankruptcy Act 1696, it was held that a trust deed might be challengeable thereunder as an illegal preference.¹⁰ Today, a non-acceding creditor may seek the reduction of the trust deed as an illegal preference if notour bankruptcy occurs before, or within six months after, the granting of the deed.¹¹

24.6 A third disadvantage is that if, as will commonly be the case, a non-acceding creditor has evidence that the notour bankruptcy of the debtor occurred within the preceding four months, that creditor may apply for the sequestration of the debtor's estate.¹² Indeed, there seems to be nothing to prevent the debtor himself changing his mind and applying for the sequestration of his own estate.¹³ A supervening sequestration completely supersedes a private trust deed, and the trustee under the trust deed must hand over the estate to the trustee in sequestration,¹⁴ subject to the right of the trustee under the trust deed to refuse to do so until his legitimate outlays and expenses are repaid to him. The trustee in the sequestration is entitled to

⁵The Cullen Report, p. 11 stated: "It is moderately estimated that three or four estates are wound up under trust deed for every estate wound up under sequestration."

⁶Para. 24.13.

⁷Bell, *Comm.* ii. 386.

⁸*Doughty v. Wells* (1906) 14 S.L.T. 299.

⁹Bell, *Comm.* ii. 387 *et seq.*

¹⁰See *Peters v. Dunlop's Trustees* (1767) Mor. 1218 and Hailes, 179; *Johnston & Colquhoun v. Fairholm's Trustees* 1770 Mor. App. Bankrupt No. 5.

¹¹*Mackenzie v. Calder* (1868) 6 M. 833.

¹²Bell, *Comm.* ii. 391.

¹³*McAlister v. Swinburne* (1874) 1 R. 958.

¹⁴Bell, *Comm.* ii. 391.

receive from the trustee under the trust deed a full accounting of his intrusions.¹⁵

24.7 There are, in the fourth place, certain other disadvantages attached to private trust deeds for creditors. There are no statutory provisions for giving notice that a trust deed for creditors has been granted. Though in practice there may be an advertisement in the *Edinburgh Gazette* or in local newspapers, such advertisement is not always given, and not all creditors may be aware of the granting of a trust deed. It would be desirable, therefore, as far as practicable, to ensure that appropriate publicity is given to voluntary trust deeds.

Voluntary bankruptcy: the proposals of our Working Party

24.8 Though our Working Party recognised that voluntary trust deeds provided a simple, informal and commonly used method for winding-up insolvent estates, they were persuaded that their disadvantages were such that they should be superseded by a system of "voluntary bankruptcy" initiated by the debtor.¹⁶ The process was to be initiated by the debtor without the concurrence of any creditor, but the ingathering and distribution of the estate were to be carried out to a great extent under the same rules as in a sequestration, although with fewer formalities.

24.9 The main features of this process of "voluntary bankruptcy" may be summarised as follows—

- (1) The debtor would initiate the process by the execution, and submission to the sheriff clerk, of a "declaration of insolvency" in prescribed form, including a statement of the debtor's assets and liabilities.
- (2) An interim trustee would be nominated by the debtor or, in the event of his not doing so, by the sheriff clerk from a register maintained by him of persons willing to act as interim trustees.
- (3) The interim trustee would register the declaration of insolvency in a proposed Register of Bankruptcies and in the Register of Inhibitions and Adjudications, and registration in the Register of Bankruptcies would have the effect of vesting the whole estate of the debtor in the interim trustee.
- (4) The interim trustee would summon by notice and advertisement the first meeting of creditors, who would either accept as trustee in bankruptcy the interim trustee or appoint a trustee in bankruptcy of their own choice.
- (5) An abbreviate of bankruptcy designating the trustee accepted or appointed at the meeting would be registered in the proposed Register of Bankruptcies, and this registration would confirm the vesting of, or (as the case might be) operate to vest, the debtor's estate in the trustee named in the abbreviate.

¹⁵*Salaman v. Rosslyn's Trustees* (1900) 3 F. 298.

¹⁶pp. 22–26.

- (6) The trustee would be empowered without a court warrant to summon the bankrupt, his wife and employees to attend for examination by the trustee. The date and place of the examination would be advertised and notified to the creditors. The bankrupt would be required to make a statutory declaration at the examination. It would be open to the trustee, if he considered it to be necessary, to insist upon the examination taking place upon oath before the sheriff.
- (7) Otherwise the procedure in a creditor's bankruptcy in relation to matters such as meetings of creditors, the appointment of commissioners, the gathering in of the assets, the ranking of claims, the payment of dividends and the discharge of the bankrupt would be applied.

24.10 As we saw it, this process had interesting and useful features which could with advantage be incorporated into the ordinary system of sequestration. This applied particularly to the proposal to appoint an interim trustee at an early stage of the sequestration, and to the subsidiary proposals relating to the early submission of a statement of assets and liabilities by the bankrupt, a statutory form of claim, and the simplification of the system of submission of claims. Quite early in the course of our examination of the law we decided to make recommendations which would give substantial effect to these proposals. The principal issue which remained was whether, as was implicit rather than explicit in the "voluntary bankruptcy" scheme, it should replace private trust deeds for creditors.

The case for retaining private trust deeds

24.11 In 1974, therefore, we circulated to interested bodies a Consultation Paper in which we raised the question whether private trust deeds should henceforth be banned, or whether they should be retained with or without further regulation in the public interest. If they were to be retained, the difficulty appeared to be that of deciding what degree of regulation was desirable. The comments which we received were varied. The Law Society of Scotland were opposed to the retention of trust deeds but argued that, if they were to be retained, a substantial degree of control should be introduced. The Institute of Chartered Accountants of Scotland thought that priority should be given to the simplification of statutory bankruptcy procedures to encourage their use, but agreed with the Commission "that the banning of voluntary trust deeds would constitute an unreasonable interference with freedom of contract" and felt "that they still have a useful function to perform in appropriate circumstances in their present largely unregulated form". Other bodies, however, while considering that the trust deed system should be retained, had different views as to the extent of the regulation required.

24.12 These issues seemed so important that we engaged in further informal consultation and, in the light of all the comments received, we have come to the firm conclusion that the case for banning voluntary trust deeds

for creditors has not been made out. We note that in 1910 the Cullen Committee commented as follows:

“The distribution of insolvent estates by way of private trust deed granted by the debtor in favour of a trustee to whom he conveys his whole estate for division among his creditors according to their just rights, has for long been a favourite course of procedure in Scotland. The favour accorded to it is shown by the fact that, notwithstanding the excellence of the sequestration system, by far the larger number of insolvent estates are annually wound up under trust deeds, the proportion being moderately estimated by witnesses of experience as three or four to one.”¹⁷

Indeed the Cullen Committee went further, and in response to criticisms of alleged defects in the system of private trust deeds said this:

“To enact that all windings up under trust deed must in future lose their voluntary character by being subject to a variety of statutory regulations, providing, *inter alia*, for the coercion of a minority of creditors by a majority, appears to us to be inexpedient. The assumption of the witnesses who support such proposals, is that, notwithstanding the making of so radical a change in their character, trust deeds would maintain their present popularity, while acquiring an enhanced effectiveness. We feel unable to accept this assumption.”¹⁸

24.13 The fact that the trust deed has been, and may continue to be, the preferred method of winding-up an insolvent person's estate is itself a strong argument for its retention. A voluntary trust deed has the attraction of avoiding the formalities, the compliance with strict time-limits, and some at least of the expense of a sequestration under the present law. Though certain formalities are indispensable in a system which is designed to divest a debtor compulsorily of his estate and to provide for its distribution among his creditors according to their different rights and preferences, we have endeavoured in our revised procedures for sequestration, to eliminate unnecessary formalities and to reduce expense. For this reason, we believe that the voluntary trust deed would still have attractions for creditors and that it would remain attractive to debtors, because they would be subject neither to the disabilities of bankrupts nor to the stigma of bankruptcy. It would seem wrong, even if it were practicable, to disallow recourse to such a procedure for these reasons—

- (a) To disallow it contrary to the wishes of creditors and debtors would constitute an unreasonable interference with freedom of contract.
- (b) Its relative flexibility and informality and its potential for reducing the expense of winding-up an estate all argue for its retention. The expense of a formal sequestration is not merely to be measured by its expense to the creditors: there must be considered, additionally, the expense occasioned to the State in the course of the procedure, and in the supervision of the conduct of the trustee and other persons concerned.

¹⁷Cullen Report, p. 3, para. 12.

¹⁸*Ibid.* p. 11, para. 61.

- (c) While there is a risk of the abuse of private trust deeds, the creditors have their own remedy in refusing accession. The practical advantages of the system in the general case more than counterbalance its potential disadvantages in particular cases.
- (d) It would not be an easy matter either to discover cases where debtors and creditors have had recourse to voluntary trust deeds or to devise sanctions adequate to discourage recourse to them. There is a risk that the threat of sanction, while insufficient to deter recourse to voluntary trust deeds, would cause them to take the form of private arrangements between the debtor and a chosen few of his creditors. What is required, rather, is greater publicity for trust deeds so that all creditors may submit claims and participate in the distribution of the estate.

We propose, therefore, that debtors and creditors should continue to be entitled to utilise voluntary trust deeds for the winding-up of the estates of insolvent personal debtors.

Should private trust deeds be the subject of detailed regulation?

24.14 It was suggested to us that, for the greater protection of creditors, a variety of provisions should be applied mandatorily to all voluntary trust deeds. For example, it was suggested that the trustee should be required to find caution, that the bankruptcy rules relating to the valuation of securities and ranking of claims should be applied irrespective of the terms of the trust deed, and that the debtor might be required to submit to public examination. It was also proposed that where there was failure to register a trust deed, the deed should be invalid. We cannot accept these proposals. A trust deed is likely to be preferred to a sequestration because of its flexibility, informality and freedom from fixed rules and time-limits, and to depart from these advantages would be to risk the fate of deeds of arrangement in England. These, we understand, are used much less frequently than private trust deeds are used in Scotland.¹⁹ Alternatively, attempts might be made to circumvent the statutory requirements by resort to procedures which might or might not incur the statutory penalty of invalidation. Either result would be unfortunate, the one because a useful facility would be substantially lost and the other because problems of enforcement would arise.

Our proposals

Introduction

24.15 If, as we believe to be desirable, recourse to private trust deeds

¹⁹The Annual General Reports of the Department of Trade on Bankruptcy for the years 1974-8, Table 1(b) give the following figures respectively for receiving orders and orders for the administration of deceased debtors' estates on the one hand and for deeds of arrangement on the other hand—

	1974	1975	1976	1977	1978
Receiving orders, etc.	5208	6698	6700	4095	3540
Deeds of arrangement	106	123	96	82	70

for creditors²⁰ is to be encouraged rather than discouraged, restraint in their statutory regulation seems imperative. We propose, therefore, to allow private trust deeds to operate freely in their existing form and, subject to minor qualifications, without formal regulation. We further propose to confer upon trust deeds which comply with certain conditions a number of advantages, in particular that of substantial protection from the risk of supersession by sequestration. Compliance with the conditions should not prove onerous and we hope that the advantages offered to such trust deeds (which we will describe as "protected trust deeds") will frequently ensure such compliance. These conditions and the related advantages are discussed in the following paragraphs.

Private trust deeds generally

24.16 We suggest only one mandatory provision for the regulation of the conduct of trustees. We propose to strengthen section 185 of the 1913 Act to make possible the audit of the trustee's accounts whether or not the trust deed expressly provides for this. Otherwise, we propose merely to confer certain powers on trustees, namely that they should in all cases be entitled to apply for the sequestration of the debtor's estate and to register in the Register of Inhibitions and Adjudications a notice having the effect of an inhibition. We also propose that the lodging of a claim with a trustee under a trust deed should have the effect of interrupting any prescription or statutory limitation under Scots law and of suspending the effect of any limitation under the laws of England and Wales or of Northern Ireland. We now explain these proposals in detail.

24.17 Section 185 of the 1913 Act makes provision for the audit of the trustee's accounts and the fixing of his remuneration by the Accountant of Court in a case where the trust deed makes no provision for those matters to be undertaken by a committee of creditors or where such a committee does not act. We consider, however, that it would be more satisfactory to substitute a provision modelled upon section 18 of the Companies (Floating Charges and Receivers) (Scotland) Act 1972.²¹ We recommend that even when a trust deed provides for the auditing of the trustee's accounts and the fixing of his remuneration or when the trustee and the creditors have agreed upon an auditing procedure and the method of fixing the trustee's remuneration, the debtor, the trustee or any creditor may require the Accountant in Bankruptcy at any time before the final division of the estate among the creditors to audit the accounts and fix the remuneration of the trustee. We so recommend.

24.18 In a few cases the administration of a private trust deed for creditors may be impeded by a lack of co-operation on the part of the

²⁰When we speak of a private trust deed for creditors in this Report we intend to refer to a trust deed granted by an insolvent debtor for the benefit of his creditors generally. Cf. s. 185 of the 1913 Act which refers to a voluntary trust deed granted "... by an insolvent for behoof of his creditors generally".

²¹c. 67.

debtor. In such a case it may be appropriate that the debtor's estate should be sequestrated, but there may be no non-acceding creditors sufficiently interested to take steps to apply for the sequestration. For this reason we recommend that, irrespective of the terms of the trust deed, the trustee in any trust deed should be entitled to apply at any time for the sequestration of the debtor's estate. The concession of such a right to the trustee may also be thought desirable to cater for any case where the trustee, having examined the state of the debtor's affairs, considers that the statutory procedure of sequestration is more appropriate to the circumstances of that case.

24.19 It was suggested to us that the trustee under a trust deed should be empowered to register in the Register of Inhibitions and Adjudications a notice that would have the effect of an inhibition, that is, it would have the effect of preventing the debtor in the trust deed from granting any voluntary deed affecting his heritable property to the prejudice of his creditors. It was thought that a notice of inhibition might be a useful safeguard for both the creditors and any person who might otherwise transact with the debtor in relation to his heritable property. We agree, and accordingly recommend that the trustee under a trust deed, at any time after the deed has been delivered to him, may register in the Register of Inhibitions and Adjudications a notice, in a form prescribed by Act of Sederunt. Such registration would have the same effect as the registration in that register of Letters of Inhibition against the debtor and would render the debtor's heritable property litigious for a period of five years.²² The trustee, however, should be entitled to record a notice of recall of the original notice at any time.

24.20 It is likely that the granting by a debtor of a trust deed for his creditors will interrupt the running of prescription on a debt if it contains an unequivocal acknowledgement that the debt still subsists or even where it merely specifies the creditor by name.²³ But a trust deed in general terms with no specific acknowledgement of a debt will not interrupt the running of prescription on the debt.²⁴ Nor would the lodging of a claim with the trustee under a trust deed have that effect either under the present law embodied in the Prescription and Limitation (Scotland) Act 1973²⁵ or, it appears, under the law in force before the coming into operation of that Act.²⁶ We recommend, therefore, that the lodging of a claim with the trustee under a trust deed should have the effect of interrupting prescription, and that the lodging of the claim should therefore be regarded as the making of a "relevant claim" for the purposes of sections 6 and 7 of the Prescription and Limitation (Scotland) Act 1973. We also recommend that the lodging of a claim with a trustee under a trust deed for creditors should (as would be the case where a claim is lodged in a sequestration) bar the effect of

²²See s. 44(3)(a) of the Conveyancing (Scotland) Act 1924 (c. 27), which provides that inhibitions will cease to be effective after a period of five years from their commencement.

²³See Prescription and Limitation (Scotland) Act 1973 (c. 52), s. 10(1).

²⁴*Blair v. Horn* (1859) 21 D. 1004.

²⁵(c. 52), s. 9.

²⁶Bell, *Principles*, para. 598.

any statute of limitations whether in Scotland or elsewhere in the United Kingdom. This recommendation does not involve the textual amendment of any enactment.

24.21 We have already explained that the statutory rules for the ranking of claims in a sequestration, and in particular the rule that requires the valuation and deduction of securities, do not apply where an insolvent estate is distributed under a trust deed for creditors unless the trust deed so provides. These statutory rules are generally considered to be fairer than the rules of the common law for the valuation of creditors' claims, and we therefore recommended that they should be applied in relation to trust deeds except in so far as the deed expressly provides otherwise.²⁷

Protected trust deeds

24.22 Our proposals for unfair preferences are such that the question of challenge of trust deeds for creditors as an unfair preference will not arise. Nevertheless, private trust deeds would still suffer from some of the disadvantages to which we have referred²⁸ and, in particular, they would be open to supersession by a sequestration at the instance of a non-acceding creditor. The estate conveyed to the trustee would also be open to diligence by non-acceding creditors until the trustee had completed his title to the estate. If, therefore, a trust deed for creditors complies with certain criteria, both internal and external to the deed, which demonstrate that an appropriate person has been appointed as trustee, that a substantial majority of the creditors have acceded to the deed and that appropriate publicity has been given to it, we consider that the trust deed should be less vulnerable to supersession by the sequestration of the debtor's estate. The trustee under such a trust deed should be placed in the same position as a trustee in a sequestration in relation to the challenge of gratuitous alienations and unfair preferences. Individual creditors, too, should have the same right to challenge alienations and preferences as, under our proposals, they will have in the event of the sequestration of the debtor's estate. The debtor, moreover, in a protected trust deed should receive protection from further claims by non-acceding creditors. Creditors would not in any way be bound to place themselves within the framework of a protected trust deed, but we hope that the clear advantages given to such trust deeds will render them attractive to those concerned.

Eligibility of persons to act as trustee under a protected trust deed

24.23 We have considered whether the proposed personal disqualifications applicable to trustees in sequestration and the proposed professional qualifications required to be possessed by them²⁹ should also be applicable in the case of trustees under private trust deeds if these deeds are to attract the statutory benefits. In relation to personal disqualifications it seems to us most desirable that the trustee should not be (a) the debtor

²⁷See para. 16.18.

²⁸See paras. 24.4–24.7.

²⁹See paras. 4.20 and 4.21.

himself, (b) a person who has a family or business relationship with the debtor, (c) a person who holds an interest opposed to the general interests of the creditors, or (d) a person who resides outwith the general jurisdiction of the Court of Session. We recommend, therefore, that a trust deed should enjoy the advantages we propose to confer on protected trust deeds only where the trustee would not be personally disqualified from appointment as a trustee in a sequestration of the debtor's estate. In relation to professional qualifications, while we would hope that in the majority of cases the trustees selected in private trust deeds for creditors would possess those professional qualifications, we do not consider that this should be a necessary feature of a protected trust deed. It may, on occasion, be convenient to select as trustee a person who, although not professionally qualified, is thoroughly conversant with the debtor's affairs. We make, therefore, no recommendation that the trustee under a private trust deed should require to possess any professional qualifications in order that the deed may attract the statutory benefits.

Publication of the granting of a trust deed

24.24 We think it appropriate to provide that a trust deed will attract the benefits of our proposed legislation only where the fact of the granting of the trust deed has been published. To secure the benefits of the Act conferred upon protected trust deeds the trustee appointed under the deed would require to publish in the *Edinburgh Gazette*, forthwith after delivery to him of the deed, a notice—

- (i) stating that the debtor has granted in his favor as trustee a trust deed for the benefit of his creditors generally; and
- (ii) inviting creditors to accede to the trust deed within four weeks of the date of the *Gazette* notice so that it may have the advantages of a protected trust deed.

Publication of the deed in this way will serve the dual purpose of alerting creditors to the fact of the granting of the trust deed and of informing them generally of the procedure for accession.

Accession to the trust deed

24.25 No trust deed should, in our opinion, receive the statutory benefits unless it is acceptable to a clear majority of the creditors. Indeed, since we envisage the curtailment of the right of non-acceding creditors to apply for the sequestration of the debtor's estate, we consider that only a trust deed acceded to by a substantial number of the creditors should attract those statutory benefits. We suggest that there must be accession by at least a majority in number and two-thirds in value. We recommend accordingly. Accession might, as under existing law, be obtained in a number of ways and we make no proposals for alteration of the law in that respect. It is necessary, however, to fix a time-limit for the obtaining of the requisite accessions if, as we propose, non-acceding creditors should have a limited period within which to apply for the debtor's sequestration. We recommend, therefore, that the benefits which we propose for protected trust deeds should apply only where such accession has been obtained in a period of four weeks

from the date of publication in the *Edinburgh Gazette* of the notice relating to the granting of the deed.

Registration of a trust deed

24.26 The proposed register of insolvencies will be incomplete to the extent that it does not contain particulars of all trust deeds for creditors. There is at present a lack of statistical information relating to the number of trust deeds granted. We propose, therefore, that a trust deed should attract the benefits of our proposed legislation only when, forthwith after the expiry of the period of four weeks specified in the preceding paragraph, the trustee sends to the Accountant in Bankruptcy a copy of the trust deed, with a certificate endorsed thereon that it is a true copy and that the requisite accession of creditors to the deed has been obtained.

Benefits accruing to protected trust deeds

(i) Reduced risk of supersession by sequestration

24.27 Under existing law a trust deed for creditors is subject to the risk of being superseded by sequestration. The main advantage which, we propose, should be conferred upon protected trust deeds is that they should be binding in principle on acceding and non-acceding creditors alike. The right, therefore, of a non-acceding creditor to apply for sequestration should be limited. In the first place, subject to the qualification we mention below, he should be entitled to present a petition for sequestration of the debtor's estate only within a period of six weeks after the date of publication in the *Edinburgh Gazette* of the notice of granting of the trust deed. In any such case the court should not be bound to award sequestration simply because the statutory conditions have been complied with, but should have a discretion, in accordance with what it considers to be in the best interests of the creditors. In the second place, as an additional safeguard, a non-acceding creditor should be entitled to present a petition for the sequestration of the debtor's estate outwith that period where he avers that the provision for the distribution of the estate is or is likely to be unfairly prejudicial to a creditor or class of creditors. In the event of the creditor establishing such prejudice or the likelihood of such prejudice, the court should be bound to make an award of sequestration. We recommend accordingly.

24.28 Under the present law, moreover, even the debtor may have the right during the subsistence of the trust to apply for the sequestration of his estate. He unquestionably has the right where all the creditors have not acceded.³⁰ This places the trustee and the creditors in an invidious situation. We recommend that the granter of a protected trust deed during its subsistence should not be entitled to apply for the sequestration of his own estate.

³⁰Goudy, p. 485; *Thomson v. Broom* (1827) 5 S. 468 and *McAlister v. Swinburne & Co.* (1874) 1 R. 958.

24.29 It was suggested that there should be a statutory duty upon the debtor to give every assistance and information to the trustee under a trust deed. We think it unnecessary to include any provision to this effect because we have recommended³¹ that, irrespective of the terms of the deed, the trustee in any trust deed for creditors should be entitled to petition for the sequestration of the debtor's estate.

24.30 In the event of sequestration being awarded in any of the foregoing cases, the trustee under the trust deed, after payment of his claim for remuneration and expenses in connection with his administration of the debtor's estate, would be required to make over the bankrupt's estate so far as in his possession and to account for his intromissions to the trustee in the sequestration.

(ii) *Power to challenge alienations and preferences*

24.31 A trustee under a trust deed has at present no power to challenge gratuitous alienations or unfair preferences, whether at common law or under statute, unless, as usually happens, he derives such power from creditors having a title to challenge.³² It seems desirable, however, that a trustee under a protected trust deed should be entitled in all cases to seek reduction of alienations and preferences that are voidable at statute or at common law. We recommend, therefore, that a trustee under a protected trust deed should be placed in the same position as a trustee in a sequestration in relation to the challenge of gratuitous alienations or unfair preferences, either under the statutory provisions proposed by us in replacement of the 1621 and 1696 Acts or at common law. This would imply that he had a right of challenge whether or not he represented prior creditors and whether or not power to challenge was expressly conferred by the trust deed. We also recommend that in the case of a protected trust deed an individual creditor should have the same rights of challenge of gratuitous alienations and unfair preferences as he would in a sequestration.

(iii) *Protection of the debtor*

24.32 One of the unsatisfactory features of the present system of voluntary trust deeds is the absence of provision, other than such provision as may be made by the trust deed, for the eventual discharge of the debtor. A provision in the deed in any case will not bind non-acceding creditors to the effect of discharging their claims against the debtor. Even after the trust deed has been wound up, the debtor remains exposed to diligence on the part of non-acceding creditors. The recommendation that we make in the immediately following paragraph will have the beneficial effect from the stand-point of the debtor in a protected trust deed of placing him in exactly the same position in a question with a non-acceding creditor as if that creditor had in fact acceded to the trust deed—subject, of course, to the limited right of the non-acceding creditor to apply for sequestration. Non-

³¹See para. 24.18.

³²*Fleming's Trustees v. McHardy* (1892) 19 R. 542.

acceding creditors will therefore be prevented from pursuing their claims after the administration under the trust deed has been concluded.

(iv) Protection of acceding creditors from preferences acquired by diligence

24.33 As we have explained,³³ a trust deed may provide that any acceding creditor will surrender any preference acquired by him by an arrestment or poinding executed within the period of 60 days immediately before the granting of the deed. We envisage as one of the features of a protected trust deed that a non-acceding creditor should be in no better (or worse) position than an acceding creditor as regards the recovery of his debt. We recommend, therefore, that (except in so far as he might retain a right to apply for the sequestration of the debtor's estate) a creditor who has not acceded to a trust deed that has become a protected trust deed should have no higher right to recover his debt than an acceding creditor.

³³See para. 13.6.

APPENDIX 1

List of Members of the Working Party

The Rt. Hon. Lord Kilbrandon (Chairman)

Professor J. M. Halliday (Vice-Chairman)

R. A. Bennett, Esq., Q.C.

W. A. Cook, Esq.

R. D. Gould, Esq.

R. McWhirter, Esq., W.S.

C. R. Munro, Esq., C.A.

D. G. Slidders, Esq., C.A.

G. Wallace, Esq., S.S.C.

Secretaries

R. Brodie, Esq.

J. B. S. Lewis, Esq.

APPENDIX 2

Summary of relevant statistics*

	1974	1975	1976	1977	1978	1979	1980
Awards of sequestration, ordinary and summary	104	148	128	132	130	105	151
Awards in Court of Session	18	23	18	23	24	11	29
Awards in sheriff court	86	125	110	109	106	94	122
Summary sequestrations	37	47	26	43	43	37	34
Awards recalled	—	2	4	—	2	2	1
Sequestrations concluded by final discharge	37	43	40	36	31	32	60
Sequestrations concluded by composition	—	2	—	—	—	2	2
Estimated no. of sequestrations in which no trustee is appointed	42	59	46	52	46	35	38
Discharges granted to bankrupts	11	19	8	15	12	21	29
No. of "appeals" to Accountant under s. 122 of the 1913 Act	—	—	—	—	—	—	1
No. of "reports" to Lord Ordinary or sheriff under s. 122	—	—	—	—	—	—	—
Appointments of judicial factors under s. 163 of the 1913 Act	6	9	7	8	5	9	5
No. of private trust deeds for creditors coming to knowledge of Accountant	41	49	34	50	46	27	52

*Furnished by the Accountant of Court.

APPENDIX 3

Suggested form of statement of claim
BANKRUPTCY (SCOTLAND) ACT
STATEMENT OF CLAIM

Sequestration of Estate of

[Name]

NAME OF CREDITOR

ADDRESS

¹AMOUNT OF CLAIM

²PARTICULARS OF CLAIM

³PARTICULARS OF ANY SECURITY

I declare, to the best of my knowledge and belief, that the amount claimed is due and that the above particulars are correct.

⁴Signature Date.....

¹State total amount claimed, and see footnote 3 below.

²State nature of debt, date when incurred and date when payment is due. If interest is claimed, show separately. Wherever possible, a receipt or any other voucher for the debt should be attached.

³Specify nature and value of each security over the bankrupt's estate. (Where more than one security is held, each security and its value should be separately specified.) The claimant must either deduct the value of a security from his debt or surrender it to the bankrupt's trustee.

⁴A statement of claim may be signed by the claimant himself, by any person authorised by him (for example, his solicitor) or entitled to act for the claimant (for example, the partner of a firm or a secretary, director, manager or other person representing a company or association). A signatory other than the actual claimant should state the capacity in which he signs.

APPENDIX 4

Suggested form of register of insolvencies

A. *Sequestrations*

Name of bankrupt
Bankrupt's residence and his principal place of business (if any) at date of sequestration or date of death
Date of death in case of deceased debtor
Occupation of bankrupt
Name and address of petitioner for sequestration
Court by which sequestration awarded
Sheriff court to which sequestration remitted (where applicable)
Date of first order
Date of award of sequestration
Date of recall of sequestration (where applicable)
Name and address of interim trustee and date of appointment
Name and address of permanent trustee and date of confirmation of appointment
Date of bankrupt's discharge and whether on application (specifying whether with or without composition) or by operation of law
Date of trustee's discharge

B. Protected Trust Deeds for Creditors

Name and address of grantor of trust deed	
Name and address of trustee under the deed	
Date (or dates) of execution of deed	
Date on which copy deed and certificate of accession were received by Accountant in Bankruptcy for registration purposes	

APPENDIX 5

Summary chart of proceedings in sequestration

Presenting of petition

1. Petitions may be presented for sequestration of—
 - (1) a living debtor's estate—
 - (a) only within 4 months after debtor became apparently insolvent —by qualified creditor or creditors (cl. 8(1)(b)).
 - (b) at any time —(a) by the debtor with concurrence of qualified creditor (cls. 5(2)(a) and 8(1)(a)).
(b) by a trustee under a trust deed (cl. 8(1)(a)).
—petition falls (cl. 5(7)(a)).

but if before award of sequestration, petitioning debtor dies
 - (2) a deceased debtor's estate—
 - (a) at any time — (i) by an executor or person qualified to be appointed as an executor (cl. 8(3)(a)).
(ii) by a trustee under trust deed (cl. 8(3)(a)).
(iii) by qualified creditor or creditors if debtor became apparently insolvent within 4 months before death (cl. 8(3)(b)(i)).
 - (b) not earlier than 6 months after debtor's death —by a qualified creditor or creditors where debtor did not become apparently insolvent within 4 months before death (cl. 8(3)(b)(ii)).

Award of sequestration

2. When petition brought by the debtor
 - (1) sequestration awarded forthwith where petition duly presented (cl. 12(1))
 - (2) clerk of court sends copy of court order—
 - (a) for registration in register of inhibitions and adjudications (cl. 14(1)(a))
 - (b) to Accountant in Bankruptcy (cl. 14(1)(b))
 - (3) the date of sequestration is the date on which sequestration is awarded (cl. 12(4)(a)).

3. When petition presented by creditor or trustee under trust deed
 - (1) court grants warrant to cite debtor to appear (cl. 12(2))
 - (2) interim trustee may be appointed before award of sequestration if—
 - (a) debtor consents, or
 - (b) Accountant in Bankruptcy, the trustee under the trust deed or any creditor shows cause (cl. 13(1) proviso)
 - (3) clerk of court sends copy of order granting warrant—
 - (a) for registration in register of inhibitions and adjudications (cl. 14(1)(a))
 - (b) to Accountant in Bankruptcy (cl. 14(1)(b))
 - (4) on expiry of induciae if—
 - (a) debtor appears, or court is satisfied that debtor has been properly cited, the petition has been duly presented, and in a creditor's petition apparent insolvency has been constituted, the court shall award sequestration forthwith unless cause is shown why sequestration cannot be awarded or debtor discharges his indebtedness to petitioning creditor etc. (cl. 12(3))
 - (b) court refuses to award sequestration, clerk of court sends copy of order of refusal for registration in register of inhibitions and adjudications (cl. 15(5)(a))
 - (5) The date of sequestration is the date on which the court grants the warrant citing the debtor to appear (cl. 12(4)(b)).
4. As soon as possible after debtor learns that he may derive benefit from an estate —he shall notify the person administering that estate that an award of sequestration has been granted (cl. 15(8)).

Recall of sequestration

5. Not later than 10 weeks after date of sequestration —if petition for recall not presented on any of grounds specified in clause 17(1)(a) to (c) (cl. 16(4)(a)).
6. At any time —where petition for recall is presented on any of above grounds (cl. 16(4)(b)).

Interim trustee in office

Appointment of interim trustee

7. Where petition for sequestration presented by creditor or trustee under trust deed —interim trustee appointed before award of sequestration if—
 - (a) debtor consents, or
 - (b) Accountant in Bankruptcy, the trustee under the trust deed, or any creditor shows cause (cl. 13(1) proviso).

8. In other cases

—interim trustee appointed on sequestration being awarded (cl. 13(1)).

Preliminary duties of interim trustee

9. As soon as may be after interim trustee's appointment

—interim trustee notifies debtor and Accountant in Bankruptcy of appointment (cl. 13(7)).

10. As soon as award of sequestration made

- (1) interim trustee publishes notice to that effect in Edinburgh and London Gazettes and invites submission of claims (cl. 15(6))
- (2) interim trustee may give general or particular directions to debtor relating to management of his estate (cl. 18(1))
- (3) interim trustee may take possession of estate or adopt other measures (cl. 18(2) and (3)).

11. Within 7 days of

- (a) appointment of interim trustee in a debtor's petition
- (b) interim trustee notifying debtor of appointment in a petition by a creditor or trustee under a trust deed.

—debtor shall deliver to interim trustee a statement of affairs (cl. 19(1)).

12. On receipt of statement of affairs

—interim trustee determines whether assets are unlikely to be sufficient to meet in whole or in part the preferred debts or, if no preferred debts, the ordinary debts (cl. 20(1)).

13. Within 21 days after his appointment

—interim trustee sends to Accountant in Bankruptcy—
(a) a copy of the statement of affairs
(b) written comments thereon (cl. 20(2)).

Statutory meeting of creditors

14. Within 28 days, or such longer period as sheriff on cause shown may allow, after date of award of sequestration

—statutory meeting of creditors to be held for electing permanent trustee and commissioners (cl. 21(1)).

15. Not less than 7 days before statutory meeting —interim trustee
 (a) takes reasonable steps to notify creditors, and
 (b) notifies Accountant of the date, time and place of the meeting (cl. 21(2)).
16. Not less than 4 days before statutory meeting —interim trustee sends to every creditor known to him and to the Accountant summary of statement of affairs and observations (cl. 21(3)).

Proceedings at statutory meeting

17. At statutory meeting of creditors—
- (1) creditors will submit claims to the interim trustee for the purpose of voting (this can be done before the meeting) (cl. 22(1))
 - (2) creditors may continue meeting to date not later than—
 - (a) 28 days after award of sequestration, or
 - (b) date allowed by sheriff (cl. 21(4))
 - (3) interim trustee as chairman accepts or rejects in whole or in part creditors' claims for voting purposes (cl. 23(1)(a))
 - (4) creditors invited to elect chairman: if they fail to do so interim trustee remains in chair (cl. 23(1)(b))
 - (5) interim trustee arranges for record of proceedings to be made (cl. 23(1)(c))
 - (6) interim trustee makes statement of affairs and observations available and answers questions (cl. 23(3))
 - (7) where interim trustee remains satisfied as to correctness of determination that assets are unlikely to be sufficient to meet in whole or in part the preferred debts or, if no preferred debts, the ordinary debts, Schedule 2 to the Bill has effect (cl. 23(4))
 - (8) unless Schedule 2 applies, the creditors proceed to elect permanent trustee. In default of election by creditors, interim trustee deemed to be elected permanent trustee (cl. 24(1) and (4))
 - (9) unless Schedule 2 applies the creditors proceed to elect the commissioners (cl. 29(1)).

Confirmation of permanent trustee

18. On election or deemed election of permanent trustee —interim trustee reports proceedings at statutory meeting to sheriff (cl. 25(1)(a)).
19. Within 4 days after meeting —any interested person may object to the sheriff as to any matter connected with election (cl. 25(1)(b)).

20. If no timeous objection to election —sheriff declares that the elected person is permanent trustee (cl. 25(2)).
21. If there is timeous objection to election —(1) sheriff hears parties (cl. 25(3)) and
(2) (a) sheriff rejects the objection and declares person elected to be trustee, or
(b) sustains the objection and orders interim trustee to arrange a new meeting for election of a permanent trustee (cl. 25(4)).
22. Within 7 days or such longer period as sheriff allows after date of declaration of election by sheriff —permanent trustee lodges with sheriff clerk bond of caution for amount fixed by creditors or, failing them, by Accountant in Bankruptcy (cl. 25(6) read with cl. 24(5)).
23. After bond of caution lodged —(1) sheriff clerk issues act and warrant and sends copy to Accountant (cl. 25(2))
(2) permanent trustee (if he has not been interim trustee) publishes notice of appointment in Edinburgh Gazette (cl. 25(8)(b)).
- Interim trustee's final functions*
24. After permanent trustee has been confirmed in office (1) interim trustee hands over everything in his possession to the permanent trustee (cl. 26(1))
(2) interim trustee sends to Accountant in Bankruptcy—
(a) his accounts of his intromissions
(b) claim for his outlays and remuneration for audit and determination respectively (cl. 26(2) and (3)).
25. Within 14 days of Accountant determining amount of interim trustee's outlays and remuneration —interim trustee, debtor or any creditor may appeal to the sheriff against the determination (cl. 26(4)).

Permanent trustee in office

Administration of estate

26. As soon as may be after permanent trustee's appointment—
(1) he takes possession of estate (cl. 37(1)(a))

- (2) he makes such entries in the sederunt book as will provide an accurate record of the sequestration process (cl. 26(5))
- (3) he makes up inventory and valuation of estate (cl. 37(1)(b))
- (4) he sends copy of inventory and valuation to Accountant in Bankruptcy (cl. 37(1)(c))
- (5) he consults commissioners or, where there are no commissioners, the Accountant regarding exercise of his functions (cl. 38(1)).

- 27. At any time after 12 weeks from date of sequestration —the permanent trustee may require a secured creditor to discharge a security or convey or assign it to permanent trustee on payment of value which the creditor has placed upon the security (Sched. 1, para. 5(2)).
- 28. Within 28 days of receipt by permanent trustee of request from a party to a contract with the debtor or within such longer period as court may allow —trustee shall adopt or refuse to adopt the contract. If he does not indicate his intention, he is deemed to have refused to adopt the contract (cl. 39(2) and (3)).

Examination of debtor

- 29. Where debtor, or the debtor's spouse or other person who a trustee believes can give information about debtor's assets or business or financial affairs, refuses to give information to interim trustee or permanent trustee —trustee may apply to sheriff for a warrant for private examination of debtor or other person (cls. 20(4) and 41(1)).
- 30. Not later than 8 weeks before the end of first accounting period *i.e.* not later than 18 weeks after date of sequestration —permanent trustee may apply to the sheriff for the public examination of the debtor. Examination must be held not earlier than 8 days nor later than 16 days thereafter (cl. 42(1) and (2)).

Claims for voting at meetings arranged by permanent trustee

- 31. A creditor in order to obtain an adjudication as to his entitlement to vote at a meeting of creditors shall submit a claim to the trustee at or before that meeting (cl. 45(1)).
- 32. A claim accepted in whole or in part by the interim or permanent trustee for the purpose of voting at a meeting shall be deemed to have been resubmitted for the purposes of voting at any subsequent meeting, and of drawing a dividend in respect of any accounting period (cl. 45(2)).

33. At the commencement of every meeting of creditors the trustee shall for the purposes of voting accept or reject in whole or in part the claim of each creditor (cl. 46(1)).

34. Within 2 weeks after trustee accepts or rejects a claim for voting purposes —debtor or any creditor may appeal against that decision to the sheriff (cl. 46(6)(a)).

Accounting periods

35. Permanent trustee makes up accounts of intromissions with estate in respect of periods of 26 weeks, the first accounting period commencing with the date of sequestration. Any accounting period after the first may be shortened where the permanent trustee and the commissioners consider it expedient to accelerate payment of a dividend and the next accounting period runs from the end of the shortened period. Payment of a dividend in respect of any accounting period may also be postponed (cl. 49(1), (5) and (6)).

Submission of claims for ranking

36. Not later than 8 weeks before the end of an accounting period —a creditor whose claim is not deemed to have been re-submitted under cl. 45(2) must submit a claim if he wishes to qualify for a dividend in respect of that period (cl. 45(1)).
37. Not later than 4 weeks before the end of an accounting period —(1) permanent trustee accepts or rejects claims for dividend (cl. 46(2))
(2) if rejection, notifies creditor (cl. 46(4)).
38. Not later than 2 weeks before the end of an accounting period —debtor or any creditor can appeal to sheriff against acceptance or rejection of any claim (cl. 46(6)(b)).

Accounts and payment of dividends

39. Within 2 weeks after end of an accounting period —permanent trustee submits accounts, scheme of division, and claim for outlays and remuneration to commissioners or, where there are no commissioners, to Accountant in Bankruptcy (cl. 50(1)).

40. Within 6 weeks after end of an accounting period
- (1) commissioners or Accountant in Bankruptcy—
 - (a) audit accounts, and
 - (b) determine permanent trustee's outlays and remuneration (cl. 50(3)(a)).
 - (2) permanent trustee makes audited accounts etc. available for inspection by debtor and creditors (cl. 50(3)(b)).
41. Not later than 8 weeks after end of accounting period
- permanent trustee, debtor or any creditor may appeal against determination by commissioners or Accountant in Bankruptcy (cl. 50(6)).
42. As soon as any appeal against determination is disposed of
- permanent trustee pays dividends to creditors in accordance with scheme of division (cl. 50(7)).
- Debtor's discharge on application to court*
43. After one year from date of sequestration
- (1) debtor may petition sheriff for his discharge; declaration by debtor as to surrender of estate and delivery of documents to trustee to be lodged with petition (cl. 51(1) and (2))
 - (2) sheriff fixes date for hearing and orders publication in the Edinburgh Gazette and intimation to be made to creditors and permanent trustee (or Accountant in Bankruptcy if permanent trustee discharged) (cl. 51(3)).
44. Not later than 7 days before the date of hearing of petition
- permanent trustee or, if he has been discharged, Accountant in Bankruptcy, lodges with sheriff clerk a report relating to the debtor's assets, to his financial and business affairs, and to the debtor's conduct (cl. 51(4)).
45. Not earlier than 28 days after the date of presentation of petition for the debtor's discharge
- hearing of petition (cl. 51(3)(a)).
46. Within 14 days after determination by sheriff granting or refusing to grant discharge
- debtor or any creditor may appeal (cl. 51(7)).

- On issue of order granting discharge
- sheriff clerk to send copy of court order granting discharge to the keeper of the register of inhibitions and adjudications (cl. 51(8)).
- Debtor's discharge by operation of law*
47. On expiry of 5 years from date of sequestration
- debtor discharged by operation of law if not already discharged or unless discharge is deferred (cl. 53(1)).
48. Not later than 4 years and 9 months after date of sequestration
- the permanent trustee or any creditor may apply to sheriff for deferment of debtor's discharge by operation of law (cl. 53(3)).
49. Within 14 days of order of sheriff following on any such application
- debtor to lodge declaration as to surrender of estate and delivery of documents to trustee. If declaration is *not* lodged discharge of debtor is deferred without a hearing for period not exceeding 2 years (cl. 53(4)).
50. Not later than 7 days before the date of hearing of application
- permanent trustee or, if he has been discharged, Accountant in Bankruptcy to lodge with sheriff clerk a report relating to the debtor's assets and his financial and business affairs and the debtor's conduct (cl. 53(5)).
51. Not earlier than 28 days after lodging of declaration by debtor
- hearing of application for deferment (cl. 53(5)(a)).
52. Within 14 days after order of sheriff deferring discharge (for a period not exceeding 2 years) or dismissing application
- applicant or debtor may appeal against order (cl. 53(6) proviso).
53. Where discharge of debtor is deferred
- clerk of court to send copy of order to
- (a) Accountant in Bankruptcy;
 - (b) keeper of register of inhibitions and adjudications; and
 - (c) the permanent trustee (if not discharged)
- (cl. 53(7)).

54. Where discharge has been deferred, further applications either for accelerated discharge or for further deferment of discharge remain competent —See cl. 53(8) and (9).
55. 2 years from coming into force of legislation or 5 years from date of sequestration, whichever is later —provisions of clause 53 (discharge of debtor by operation of law) apply for discharge of debtor in sequestration under the 1913 Act (cl. 53(10)).

Debtor's discharge on composition

56. At any time after the issue of the permanent trustee's act and warrant —an offer of composition may be made by or on behalf of the debtor (Sched. 3, para. 1). For subsequent procedure, see Sched. 3.

Resignation or removal of permanent trustee

57. Permanent trustee may resign office if—
- (1) a majority in number and value of creditors present at a meeting called for the purpose accept his resignation and elect a new permanent trustee, or
 - (2) on an application by the permanent trustee, the sheriff is satisfied that he should be permitted to resign (cl. 27(1)).

For further procedure, see clause 27.

58. Permanent trustee may be removed from office by—
- (1) a majority in number and value of the creditors present at a meeting called for the purpose if they also elect forthwith a new permanent trustee, or
 - (2) order of the sheriff, on the application of the Accountant in Bankruptcy or a person representing not less than one quarter in value of the creditors, on cause shown (cl. 28(1)).

59. Within 14 days after order of the sheriff relating to removal —the trustee, the Accountant in Bankruptcy or any creditor may appeal (cl. 28(4)).

For procedure where trustee not acting for any reason see clause 28.

Resignation or removal of commissioners

60. A commissioner may resign office at any time (cl. 29(3)).
61. A commissioner may be removed from office—
- (1) if he is a mandatory of a creditor, by the creditor recalling the mandate and intimating the recall to the permanent trustee.

(2) by a majority in number and value of the creditors at a meeting called for the purpose (cl. 29(4)).

For further procedure see clause 29.

Permanent trustee's discharge

62. After the final division of the debtor's funds
- (1) permanent trustee deposits unclaimed dividends and unapplied balances in appropriate bank or institution (cl. 56(1)(a)).
 - (2) permanent trustee sends to the Accountant in Bankruptcy, the sederunt book, copy of the audited accounts and the receipt for deposit of unclaimed dividends and unapplied balances (cl. 56(1)(b)).
 - (3) permanent trustee may apply to the Accountant in Bankruptcy for a certificate of discharge (cl. 56(1)(c)).
63. On making application for discharge
- trustee to give notice to debtor and take reasonable steps to notify creditors that they may make written representations relating to application to Accountant in Bankruptcy within period of 14 days (cl. 56(2)).
64. Within 14 days after Accountant in Bankruptcy grants or refuses to grant certificate of discharge
- trustee, debtor or any creditor may appeal to sheriff (cl. 56(4)).
65. Where discharge of the trustee is granted
- bond of caution delivered up to trustee (cl. 56(6)).

Unclaimed dividends

66. Not later than 7 years after unclaimed dividends deposited in bank or other institution
- any person producing evidence of his right may apply to the Accountant in Bankruptcy for unclaimed dividend (cl. 57(1) and (2)).
67. On the expiry of such period of 7 years
- Accountant in Bankruptcy to hand over receipt for unclaimed dividends and unapplied balances to Secretary of State (cl. 57(3)).