SCOTTISH LAW COMMISSION

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INSOLVENCY, BANKRUPTCY AND LIQUIDATION IN SCOTLAND

27th November 1971

The Scottish Law Commission will be grateful if comments are sent in by 31 March 1972. All correspondence should be addressed to:-

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The Report of the Working Party contained in this Memorandum is published with a view to eliciting comments upon and criticism of the proposals which it contains. The views of the Working Party are not necessarily those of the Scottish Law Commission.

SCOTTISH LAW COMMISSION

EXAMINATION OF THE LAW RELATING TO INSOLVENCY, BANKRUPTCY AND LIQUIDATION IN SCOTLAND

1. In presenting our Second Programme of Law Reform which was approved by Ministers on 25 June 1968 item No. 6 referred to the need for an examination of the law relating to insolvency, bankruptcy and liquidation to be carried out in the light of representations made to us pointing out anomalies and defects. In pursuance of this objective in November 1968 we set up a Working Party under the Chairmanship of Lord Kilbrandon and with Professor J.M. Halliday as Vice-Chairman with the following terms of reference:-

> "To examine the law relating to Insolvency, Bankruptcy and Liquidation in Scotland and to report."

2. The members of the Working Party were Mr. R.A. Bennett, Q.C., Mr. W.A. Cook, Solicitor, Glasgow, Mr. R.D. Gould, Sheriff-clerk, Edinburgh, Mr. R. McWhirter, W.S., Bank of Scotland, Edinburgh, Mr. C.R. Munro, Chartered Accountant, Edinburgh, Mr. D.G. Slidders, Chartered Accountant, Dundee and Mr. G. Wallace, S.S.C., Chairman and Managing Director, Wallace Cameron and Co. Ltd., Glasgow. Mr. J.B.S. Lewis, a member of the legal staff of the Commission, was its Secretary. The Working Party has now completed its work and has submitted a Report which forms the main text of this Memorandum. We would like to take this opportunity of recording our thanks to the members of the Working Party from outside the Commission.

3. Before we submit our own Report to the Secretary of State for Scotland and the Lord Advocate, we would welcome comments on the Working Party's proposals. Although comments are invited upon all or any of the proposals contained in the Report we mention particularly in the following paragraphs certain questions which have either occurred to members of the Commission or have been drawn to the attention of the Commission after the Working Party's Report was completed.

4. Gratuitous Alienations and Illegal Preferences. In relation to gratuitous alienations and fraudulent (or illegal) preferences the Working Party propose (in paragraphs 21 to 27 of their Report) a statutory amalgamation of the existing common and statute law. These proposals involve departures from the existing provisions both of the common law and of statute law. Some of these changes raise the question of how best to maintain a fair balance between, on the one hand, the interests of the bankrupt and those to whom he may have made alienations or given preferences and, on the other hand, those of his creditors, and we would particularly welcome views upon whether the Working Party have reached conclusions which are fair to both.

5. The Commission draw attention to certain problems in connection with these proposals:-

(a) How far should third parties who acquire property onerously and in good faith from an alienee of the bankrupt be protected from reduction of the alienation?

(b) Should the right of the trustee in bankruptcy to reduce the alienation not be limited to cases where there are creditors whose rights existed before the alienation?

(c) The existing law in effect requires proof by the person challenging an alienation that it was made in circumstances which point to fraud or collusion or, alternatively,

that it was made to a conjunct or confident person, in which latter event the bankrupt has to establish solvency or adequate consideration. The proposals of the Working Party would permit reduction of alienations to any person made within the prescribed periods merely on proof of insolvency and absence of consideration. Would the alterations proposed be unfair in certain circumstances to persons taking in good faith? In particular, should some exception to the rule be made for alienations (not excessive in amount) in implement of a natural obligation of provision or aliment?

(d) Are the periods of 1 year and of 3 years during which reduction of an alienation is competent too long where there was no element of fraud or collusion on the part of the alienee, or too short where fraud or collusion is established?

(e) Should it be a condition of the offence of making a gratuitous alienation that the debtor did so with the intention of prejudicing his creditors or at least that he acted in reckless disregard of their interests?

(f) Should it be sufficient to constitute an "illegal" preference, and the offence of granting one, merely to establish that the preference was conferred within 1 year of public insolvency? Should a preference be deemed to be illegal when it may have been granted for valid commercial reasons at a time when the debtor was solvent and had no reason to suppose that within a short period of time he would become insolvent, or even at a time when, though realising that he was insolvent, the debtor had reason to suppose that his condition of insolvency was merely temporary?

6. Unincorporated Associations. The Working Party propose (at page 59 of their Report) that the definition of "company" in section 2 of the Bankruptcy (Scotland) Act 1913 should be altered so as to exclude bodies corporate, politic or collegiate. This proposal may occasion difficulty where an association consists of less than 8 members and so cannot be wound up under the Companies Acts since it is not an unregistered company within the meaning of section 398 of the Companies Act 1948. It may be practicable to sue the Committee or the members of such an association individually, but that procedure may be unduly cumbersome. An alternative suggestion, on which the Commission invite comment, is to permit the process of sequestration to be available in the case of any association or other body which cannot be wound up under the provisions of the Companies Acts.

7. Jurisdiction in Sequestrations. The principal proposal made by the Working Party (at page 60 of their Report) is for extension of the jurisdiction of the Sheriff Court in bankruptcy on the lines of the recommendation of the Grant Committee (para. 96 of Cmnd. 3248). The Commission suggest that consideration should also be given to the basis of jurisdiction in Scottish sequestrations, namely, that within a year before the date of presentation of the petition the debtor resided or had a dwelling house or place of business in Scotland. In particular, difficult questions have arisen with regard to conflict of jurisdictions and the opportunity may be taken to clarify the criteria for determining the most convenient forum for sequestration in cases of concurrent jurisdiction of Scottish and other courts.

8. Power to Appoint a Receiver and Manager in Winding-up. Since the Working Party submitted their Report it has been

suggested to the Commission that there might be advantage in providing for the appointment of a receiver and manager in relation to the winding-up of companies incorporated in Scotland.

9. The Working Party (at para. 33 of their Report) considered the possibility of introducing the post of official receiver into the bankruptcy law of Scotland and decided against its introduction on the ground of cost and staffing difficulties. The Working Party did not, however, specifically refer to the introduction of the official receiver in relation to liquidation and, indeed, no proposals were received by them to that effect.

10. The draft Companies (Floating Charges and Receivers) (Scotland) Bill which is appended to our Report on the Companies (Floating Charges)(Scotland) Act 1961 (Cmnd. 4336) would make it competent under the law of Scotland for the holder of a floating charge over all or part of the property comprised in the property and undertaking of an incorporated company to appoint a receiver of such part of the property and undertaking of the company as is subject to the charge. The Bill would also give a receiver power to carry on the business of the company so far as he thinks that it is desirable to do so. This Bill would, however, only enable a receiver to be appointed in those cases where there is a floating charge in existence, and would allow the receiver to exercise his powers only over such property of the company as was attached by the charge. The question which has now been raised is whether, in circumstances where there is no floating charge by virtue of which a receiver can be appointed, it would be useful to confer upon the court a discretion in appropriate cases to appoint a receiver and manager instead of a provisional liquidator, on the petition of a creditor.

11. It has been suggested that the appointment of a receiver and manager might in certain cases enable the fortunes of the

company to be restored and obviate unnecessary liquidation, and that such an appointment would have a less damaging effect on the creditworthiness of the company than the appointment of a provisional liquidator. On the other hand it may be contended that the appointment of a receiver is justifiable where a floating charge authorises it, since companies are enabled to obtain finance more readily if the lender has the power to make such an appointment. Where no such power exists and a company is unable to continue trading profitably, the proper course is to liquidate its assets and distribute the proceeds amongst its creditors. Cases where the creditors would be willing to authorise, and a receiver would be prepared to undertake, the continuance of trading in circumstances where the directors had been unable to conduct the business of the company profitably might be so infrequent that statutory provision for them would not be justified.

12. We should be grateful if comments on any of the proposals in the Report of the Working Party and the observations in this Memorandum could be submitted to the Commission not later than 31 March 1972.

SCOTTISH LAW COMMISSION

REPORT

by

WORKING PARTY ON INSOLVENCY, BANKRUPTCY and LIQUIDATION

C O N T E N T S

Appendices

REPORT BY WORKING PARTY

PART I INTRODUCTION

1. We were appointed by the Scottish Law Commission in November 1968 to examine the law relating to insolvency, bankruptcy and liquidation in Scotland in the light of representations received by the Commission and to report. Our membership is as shown in Appendix A.

2. We have met as a Working Party on eleven days. Members of the Working Party have also consulted persons representing particular bodies or interests.

3. In December 1968 we published in the daily, legal and accounting press an invitation to interested persons to submit suggestions for reform. We also addressed invitations to various bodies to do so. The organisations and individuals from whom we received memoranda or letters or whose comments or suggestions were passed on to us are listed in Appendix B. We are grateful for their suggestions.

4. We have now completed our examination of the subject and submit this Report to the Commission for consideration and comment.

22 July 1971

C O'Shaw (Chairman)

(Vice-Chairman)

R.A. Brunett (Member)

(Member)

(Member)

(Member)

(Member)

(Member)

(Member)

John B. S. Lewis (Secretary)

Part II HISTORICAL BACKGROUND

5. At the outset we think it is desirable to re-state briefly the objectives which the law of bankruptcy should and does seek to attain. These are:-

(1) To promote commercial morality by providing, in a situation of insolvency, adequate safeguards against alienation of the debtor's property to the disadvantage of his creditors or the creation of preferences for the benefit of particular creditors, and by making information as to undischarged bankrupts available for the protection of persons who might otherwise enter into transactions with them.

(2) To provide efficient machinery, available in all circumstances of insolvency, whereby a debtor or his creditors may secure the transfer of the debtor's assets to an impartial person for realisation and distribution amongst the creditors.

(3) To adjudicate fairly amongst the creditors inter se by providing for equalisation of diligences, the protection of security and other rights and preferences lawfully obtained or created and the recognition of claims which may properly be treated as preferential and, subject thereto, the distribution of any remaining assets amongst the general creditors in proportion to the amounts of their respective claims.

(4) To enable a bankrupt who has made a full disclosure of the state of his affairs to obtain, with the minimum of humiliation and delay, a discharge of his liabilities and the opportunity to make a fresh start.

Bankruptcy

6. The term "bankruptcy" has no precise technical significance in Scotland and is often used indiscriminately in relation to insolvency, notour bankruptcy and the judicial process of sequestration. We consider its historical background under the broad headings of insolvency, comprehending the common law

and statute law governing such matters as gratuitous alienations and fraudulent preferences, and sequestration, in which we include the formal judicial process of sequestration of persons or unincorporated bodies and the procedure under voluntary trust deeds for creditors. We use the term "liquidation" to denote formal processes of liquidation of incorporated bodies under the Companies Acts.

Insolvency

7. The common law imposes restraints upon a debtor from depleting his estate to the prejudice of his creditors by alienating it gratuitously or for inadequate consideration. Such alienations are reducible at the instance of creditors but the burden of proving the absence or inadequacy of consideration and the fact of insolvency rests upon the creditor who challenges the transaction. The common law relating to gratuitous alienations was strengthened by the Bankruptcy Act 1621 (c. 18), which annulled alienations by a debtor to conjunct or confident persons if made without true, just and necessary cause and without a just price truly paid; the burden of establishing the onerosity of the transaction or the solvency of the debtor at the time rests upon the debtor. Special statutory provisions relating to particular kinds of transactions are contained in the Married Women's Policies of Assurance (Scotland) Act 1880 s. 2 and the Married Women's Property (Scotland) Act 1920 s. 5.

8. The common law also restrains transactions by a debtor which have the effect of conferring unfair preferences upon particular creditors over assets which at the time are insufficient to satisfy all creditors. In general any transaction which favours a particular creditor in such circumstances is reducible as an illegal preference, but the onus of proving insolvency and the debtor's awareness of it rests upon the creditor who makes the

challenge. Again, the common law is still in force, but has in practice been superseded by the Bankruptcy Act 1696 (c. 5), as amended by the Companies Act 1947 s. 115(3), which make statutory provision for the reduction of such illegal preferences if made within six months of notour bankruptcy. Whether the challenge is made at common law or under the statute it can be met by a defence that the transaction was a payment in cash of a debt actually due, or one carried out in the usual course of trade, or was a novum debitum.

Sequestration

9. The judicial process of sequestration has been developed by a series of statutory enactments. The earliest provision was made by the Act of 1772 (12 Geo. III c. 72), which was limited in its application to the moveable estate of a living debtor. The Act of 1783 (23 Geo. III c. 18) re-enacted the provisions of the Act of 1772 and extended its scope to heritage, but restricted the process to debtors engaged in trade. The Sequestration Act of 1839 extended the procedure to deceased debtors, whether traders or not. This Act, after amendment in 1853 (16 & 17 Vict. c. 53), was superseded and repealed by the Bankruptcy (Scotland) Act 1856, which made sequestration applicable to all debtors, conferred jurisdiction on the Sheriff to award sequestration and made various other amendments of the law and practice. There followed a series of amending statutes, viz: the Bankruptcy and Real Securities (Scotland) Act 1857, the Bankruptcy (Scotland) Amendment Act 1860, the Bankruptcy (Scotland) Act 1875, the Debtors (Scotland) Act 1880, the Bankruptcy and Cessio (Scotland) Act 1881 and the Bankruptcy, Frauds and Disabilities (Scotland) Act 1884. The Bankruptcy (Scotland) Act 1913 repealed a substantial part of the prior statutory provisions and introduced a comprehensive code of procedure in sequestrations. It also introduced a special procedure designated "summary sequestration" which

applies where the debtor's assets do not exceed £300 and which was intended to take the place of the older process of cessio bonorum abolished by the 1913 Act. We refer to summary sequestration in detail in paras. 57 to 60.

10. The 1913 Act, which is the modern bankruptcy code, was set in its historical perspective, and the principles underlying the law as it had been developed were explained, by Lord Dunedin in Caldwell v Hamilton 1919 S.C. (H.L.) 100 at pp. 106 to 107, and we venture to quote a passage from his speech:-

> "The methods by which a creditor can make available for himself a debtor's means by the law of Scotland are enumerated by Mr Bell in the opening chapter of his Commentaries. They are four in number:- (1) adjudication against heritable estate (the older form of apprising had, by the time Mr Bell wrote, been superseded and was extinct); (2) poinding of the moveable estate, which was a judicial seizing of corporeal moveables; (3) arrestment, which was a judicial embargo laid on all moneys or moveable rights payable or prestable to the debtor by third parties - followed by furthcoming which made the moneys or rights available; and (4) imprisonment of the debtor. It is worthy of notice, because it is in direct contradistinction to the view of the law in England, that imprisonment was in no sense a satisfaction of the debt. It was only a compulsitor to make the debtor disclose unadmitted assets, and consequently it proceeded along with, and not in substitution for, other methods. Its rigour was mitigated by the right of liberation under cessio, and it is now obsolete under statutory provision. But it must be kept in view in taking a comprehensive view of the law of creditor and debtor and the concomitant law of sequestration. So far, these remedies were all for the individual creditor,

and he who outstripped his fellows in the race of diligence enjoyed the fruits thereof. The principle of sequestration is that it is a process by which the whole property of a bankrupt person is ingathered by a trustee for the purpose of division pari passu among the creditors.

I do not propose to refer to the historical developments of this process. They will be found detailed in Bell's Commentaries. I pass at once to the Act of 1856, which was really an amended edition of the Act of 1839, just as the ruling Act at present, i.e., that of 1913, is an amended edition of the Act of 1856. I need not pause to examine the conditions precedent to the issuing of a deliverance awarding sequestration. The conditions being fulfilled, a deliverance may be pronounced. This is the effect of the 29th section of the Act of 1856 which is repeated totidem verbis in the 28th section of the Act of 1913. As to this section, there has, I think, been some confusion. It has been appealed to by some, including the respondent in this case, as the section which transfers the property of a bankrupt. In one sense that is so, but it must be observed that the section is purely declaratory and not operative. It declares a state of sequestration, and affirms as a general proposition that the property of the bankrupt belongs to his creditors. This really is the counterpart of the common law doctrine that after insolvency a man is truly, quoad his property, a trustee for his creditors - the doctrine which is the root of the cutting down of preferences at common law, a doctrine to which the statutes of 1621 and 1696 were merely aids. But the creditors as a body have no active title. The next step is to elect a trustee, and that being done and his election signified by act and warrant, sections 102 and 103 of the 1856 Act (sections 97 and 98 of the Act of 1913) are the operative sections, and ipso jure

transfer the bankrupt's property to his trustee. Now sections 102 and 97 are really tantamount to making the act and warrant under the sequestration equivalent to a congeries of all the diligences competent to creditors at common law, omitting only the compulsitor depending on imprisonment. So far as moveables are concerned they effect, in the case of moveables attachable for debt, an ipso jure transference of all corporeal moveables to the same effect as if delivery had been made on an instrument of transfer, i.e., have the same effect as an executed poinding, and also operate as an assignation intimated of all moveable rights which are capable of assignation, that is to say, have the same effect as an arrestment."

Liquidations

11. Liquidation of incorporated companies, whether by way of members' or creditors' voluntary winding-up or winding-up by the court or subject to the supervision of the court, is governed by the provisions of the Companies Acts. The procedure and rules of ranking have been developed through a series of statutes and are now incorporated in the Companies Act 1948.

Trust Deeds for Creditors

12. At common law, and apart from the statutory remedy of sequestration with which the Report is concerned, a debtor may arrange with his creditors to execute a trust deed for their behoof. While the effect of this procedure is regulated in each case by the terms of the particular deed, within the frame-work of the general law of trusts, the statutory rules as to preferences of creditors and distribution of the debtor's assets are normally imported conventionally into the deed. We propose later on (in paras. 37 to 45) that this procedure should be discontinued, and that a system of voluntary bankruptcy be introduced in its place.

PART III GENERAL CRITICISMS, AND PROPOSALS FOR CHANGING STRUCTURE of, EXISTING LAW of BANKRUPTCY

13. We received many criticisms of the present law of bankruptcy. Some of these were of a general character relating to the scope and structure of the existing legislation while others were concerned with detailed amendments of the machinery of bankruptcy procedures. It is those in the first category with which we now deal. We are satisfied that the 1913 Act, which has operated for more than half a century without substantial amendment, has provided, by means of sequestration, a method, fair and equitable both to creditors and debtors, of realising the objectives which the code was intended to attain. The procedures enjoy, in principle, the confidence of the mercantile and professional classes; our suggestions are intended to simplify and improve the familiar code, not to supersede it. For example, our new proposals for creditors' bankruptcy are, as will be seen, intended as a streamlining of the old process rather than the substitution of an entirely new system. We have borne in mind one major consideration. In the business world of today it may be a fortuitous matter whether an enterprise is carried on by an individual or partnership on the one hand or by a limited liability company on the other. We think, therefore, that the arrangements for dissolving a business for the satisfaction of creditors should proceed, so far as possible, on the same principles in either situation, i.e., in bankruptcy or in liquidation.

14. The results of our consultations leave us in no doubt that it would be of advantage if the law relating to insolvency and bankruptcy were comprehended in a single modern statute regulating the rights and obligations of the debtor and his creditors and providing machinery which could operate in all cases of insolvency. In other words, the whole enactments relating to bankruptcy should be re-stated in a single statute consolidating and

amending the present law, and repealing all existing bankruptcy statutes. This is especially necessary for the old Scots Acts of the seventeenth century relating to gratuitous alienations and fraudulent preferences; these Acts are couched in archaic language and the remedies they were designed to provide require stating with greater precision. We consider, however, that the Judicial Sale Acts of 1681 (c. 17), 1690 (c. 20) and 1695 (c. 6) have long since fallen into desuetude and accordingly recommend that they should be repealed in toto as being no longer necessary. There is much room for simplification of language and style in the 1913 Act itself; if proposals for reform in detail were to be accepted, it would in our view be quite wrong to give effect to them by an amending Act, unless as a preliminary to consolidation.

Insolvency and Notour Bankruptcy

15. We consider that new definitions of insolvency should be contained in any new legislation in order that no doubts may exist as to the meaning of the term. There are two types of insolvency. The first type is "practical insolvency", which consists in a present inability to meet obligations immediately exigible. In a question with the debtor himself it is this kind of insolvency that is considered; when the term is used in the bankruptcy statutes it is usually this type of insolvency which is meant. The second type is "absolute insolvency", which consists in a person's debts exceeding his assets on a comprehensive estimate of his estate at a particular time. In questions between creditors, when, for example, creditors wish to set aside deeds on the ground of fraud, the insolvency must be absolute. Absolute insolvency is a significant situation since, from the time when the debtor becomes aware of the fact, he comes into a fiduciary relationship with his creditors. He may continue his business, trade or profession, but in that event everything must be done in the ordinary course of business, that is to say, the debtor must

carry on his business in the ordinary way. Any transactions which do not conform to the debtor's ordinary course of business are liable to be challenged by the trustee if sequestration proceedings are subsequently instituted and may be set aside either as gratuitous alienations or fraudulent preferences. Goudy on the Law of Bankruptcy (4th Ed. p. 83) quotes from the dictum in the case of Taylor v Farrie 1855 17 D. 639 at p. 649, which was concurred in by the whole Court:-

> "We think that by that statute (i.e., the Act of 1696, c.5) 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 prestable."

It was suggested to us by the Institute of Chartered Accountants of Scotland (later referred to as "the Institute of Chartered Accountants") that any new legislation should include a clear statement of the doctrine, referred to (at para. 10 above) by Lord Dunedin, that an insolvent person holds his assets as trustee for his creditors. We regard this phrase more as a broad statement of principle than as an accurate statement of a juridical relationship. It would require too much explanation and qualification to make it of serious utility, and for this reason we think the doctrine is unsuitable for legislative expression.

16. The Sale of Goods Act 1893 s. 62(3) defines, for the purposes of that Act, an insolvent person as one "who either has ceased to pay his debts in the ordinary course of business, or cannot pay his debts as they become due, whether he has committed an act of bankruptcy or not, and whether he has become a notour bankrupt or not." We consider that this statutory precedent could be adapted to define practical insolvency, for the purposes of the Bankruptcy Act, on the following lines:- "a state of practical insolvency exists when a debtor either has ceased to pay his debts

in the ordinary course of business[1] or cannot pay his debts as they become due".

17. A definition of absolute insolvency will also be required and we suggest the following:- "a state of absolute insolvency exists when the debtor's total liabilities exceed the debtor's total assets".

18. The term "notour bankruptcy" has been criticised, we think justly, on the ground of the ambiguity, to which we allude in para. 6 above, of the word "bankruptcy". We suggest that the word "bankruptcy" ought to be reserved for the formal act by which a debtor divests himself of his assets for the behoof of his creditors. What is now known as "notour bankruptcy" is in truth no more than a consequence of insolvency, and we suggest that the term "public insolvency" be substituted for it. This is the term used by Goudy on the Law of Bankruptcy (4th Ed. p. 15).

19. The circumstances necessary to constitute notour bankruptcy are set out in section 5 of the Bankruptcy (Scotland) Act 1913. We consider that the circumstances there set out do not require alteration, but we consider that in addition public insolvency should be constituted by the debtor calling a meeting of all the creditors known to him and submitting to them a statement of affairs showing either practical or absolute insolvency.

20. Section 222 of the Companies Act 1948 specifies circumstances in which a company may be wound up by the court, one of which (para. (e)) is its inability to pay its debts. Section 223 specifies circumstances deemed to amount to such inability. We have given careful consideration to the suggestion that a similar rule,

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[1] This would equiparate the contumacious with the impecunious non-payer - See Scottish Milk Marketing Board v Wood 1936 S.C. 604.

with certain qualifications, might be introduced into bankruptcy law as another method of constituting public insolvency in the case of an individual. The qualifications which have been suggested are that public insolvency should only be constituted where the debtor did not dispute the debt; that the demand for payment should be served personally on the debtor by a sheriff officer; and that a period of six weeks from the date of service of the demand should elapse before bankruptcy proceedings could be instituted. Those who support this suggestion maintain that the necessity to raise a court action may involve delay which, in certain circumstances, can be prejudicial to the creditor, and that this could be avoided if a procedure on the lines of sections 222 and 223 of the 1948 Act were available in cases of bankruptcy. Another view is that a creditor should be required to raise an action in a court of law in order to recover his debt, and that a procedure on the lines indicated above is open to serious abuse. We entertain grave doubts about the advisability of introducing into bankruptcy a procedure whereby a person may be made publicly insolvent without the intervention of the courts. We therefore suggest that this proposal should not be adopted without further consultation.

Gratuitous Alienations

21. Gratuitous alienations, that is any alienation by an insolvent person without receiving valuable consideration therefor, are reducible both at common law and also by virtue of the Bankruptcy Act 1621 (c. 18).

22. An anomaly would appear to exist, however, in the present law relating to voluntary alienations by a bankrupt which may be challenged. At common law every form of transference, whether by direct conveyance, or by some indirect operation, and whether embodied in writing or consisting of a simple delivery of goods or money, may be challenged. It is at least doubtful, however,

whether the 1621 Act (c. 18) applies to mere transfer of property unaccompanied by writing, such as the delivery of goods or the payment of money. We therefore recommend that in new legislation the application of the law should be made clear by including therein an express definition as to what constitutes an "alienation". Such a definition could, we suggest, be on the lines of the common law.

23. The rules of the common law and those developed under the Bankruptcy Act 1621 are concerned with basically the same problem and are similar in approach. The differences on such matters as the title of creditors to challenge are, however, a source of confusion and we consider that any restatement of the law should rationalise and harmonise both sets of rules. Under the statute gratuitous alienations can only be challenged if they are made to conjunct or confident persons, whereas alienations at common law can be challenged regardless of the person to whom they are made. The penalties provided in the Bankruptcy Act 1621, namely, declaration of infamy and incapability of holding any public trust or office or of passing on any inquest or assize, are in desuetude.

24. We consider that the provisions relating to gratuitous alienations should be brought more into line with those relating to fraudulent preferences (see paragraph 25 below) and we recommend that:-

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

(b) Any alienation made by a debtor during the year preceding his public insolvency 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;

(d) Such alienations should be reducible at the instance of the debtor's trustee in bankruptcy or of any creditor who was an onerous creditor at the date of the alienation; and

(e) It should be an offence for a debtor who knows he is insolvent to make such alienations, such offence being punishable by fine or imprisonment.

Fraudulent (Illegal) Preferences

25. At common law every voluntary preference granted by an insolvent debtor to a creditor is open to challenge except (i) payments in cash of debts actually due; (ii) transactions in the ordinary course of trade and (iii) nova debita (i.e., obligations forming the counterpart of others in onerous contracts). A challenge at common law is difficult to prove and the Bankruptcy Act 1696 (c. 5) made it easier for a challenger to prove that a preference had been fraudulent.

26. It has been suggested to us that the law should be simplified in its language and application, that the common law ground of challenge is of little practical value and should be abolished, that the machinery for dealing with fraudulent preferences and gratuitous alienations should be as similar as possible and that the penalties in the Bankruptcy Act 1696 are in desuetude.

27. We consider that these criticisms are justified, and we therefore recommend that the law on fraudulent preferences should be stated as follows:-

(a) "Fraudulent preferences" should be known as "illegal preferences".

(b) Illegal preferences should not be reducible at common law.

(c) Every voluntary transaction whereby, directly or indirectly, a preference is conferred by a debtor upon his creditor, in satisfaction or part security of a debt, should be reducible where the preference is given during the year preceding the debtor's public insolvency.

(d) The term "voluntary transaction" should not apply to payments of debts actually due, either in cash or its equivalents, to transactions in the ordinary course of trade, or to nova debita as these terms are now understood.

(e) Such voluntary transactions should be reducible at the instance of the debtor's trustee in bankruptcy or of any creditor who was an onerous creditor at the date of the voluntary transaction.

(f) It should be an offence for a debtor who knows he is insolvent to enter upon such voluntary transactions, such offence being punishable by fine or imprisonment.

Central Register of Bankruptcies

28. We have been informed that despite the provisions of the Bankruptcy (Scotland) Act 1913 many undischarged bankrupts obtain credit to the extent of £10 or more without informing the creditor that they are undischarged bankrupts. We believe that if a central register of undischarged bankrupts were provided then this unlawful practice would become more difficult. At present, by the Bankruptcy (Scotland) Act 1913 (s. 156), the Accountant of Court has to keep a register of sequestrations awarded in Scotland. We consider that this register should be expanded so that all sequestrations, whether they be voluntary or at the instance of creditors, should appear in this register. In the absence, at present, of any compulsory registration of insolvencies, estates which are wound up by the voluntary method of trust deed for behoof of creditors are not registered in the register of sequestrations. Thus it is not possible to ascertain the number of trust deeds executed in any one year nor is

any information regarding such estates currently available from a public register. Persons trading with an insolvent person may therefore do so in ignorance of his real financial position. We consider that information regarding undischarged bankrupts should be available in a public register for the protection of persons who might otherwise enter into transactions with them.

29. We have been advised that the Scottish Banks would like to see bankruptcies registered at the point of public insolvency, rather than actual voluntary or creditors' bankruptcy. On consideration, however, we feel that if this proposal were adopted the number of bankruptcies to be registered would be so numerous that it would be quite impracticable to maintain such a list. We recommend that registration should take place, in the case of a creditors' bankruptcy at the point when a petition for bankruptcy is presented, or in the case of a voluntary bankruptcy when the insolvent party executes the declaration of insolvency. (see para. 39 below). Registration could not take place at an earlier stage since the debtor might pay the debt sued for either outright or by instalments. We consider that arrangements should be made to provide that, in the event of a voluntary bankruptcy not proceeding, the debtor should be enabled to have his name removed from the register. We therefore recommend that the debtor should be entitled to make application to the Accountant of Court (with the consent of the trustee in bankruptcy where one has been appointed) for the removal of his name from the register. We propose that on the application of the debtor, with the approval of the trustee (where there is a trustee), the debtor should be entitled, after the lapse of a period of three months from the date of registration of the declaration of insolvency in the register of bankruptcies, to have his name removed from the register of bankruptcies. We also consider that it is important

that when a debtor's name is removed from the register of bankruptcies by the Accountant of Court the reason for its removal therefrom should be shown in the register.

Provision of System for Appointment of a Trustee in all Sequestrations

30. From evidence submitted to us it appears that out of 347 sequestrations during the years 1966, 1967 and 1968 there were 133 cases where no further procedure took place after the first meeting of creditors. This would seem to indicate that in these 133 cases the debtor enjoyed the privileges and benefits of the bankruptcy law, but did not undergo the supervision of the administrative procedure which that law provides, including, inter alia, public examination before the Sheriff. In many of these cases assets were insufficient to meet a private trustee's fees and disbursements. The relative frequency of this type of case suggests to us that it is desirable to introduce a system whereby a trustee is always appointed, regardless of whether the assets of the debtor are sufficient to provide for his adequate remuneration. Another aspect of this same problem is that there are cases, the number of which cannot by their very nature be ascertained, where frustrated creditors fail even to petition for sequestration because they know that it would be impossible to obtain, under the present law, the services of a trustee. In some instances where a debtor has had all his apparent goods poinded there are preferential claims for rates outstanding; the consequence is that no person is willing to undertake the office of trustee and no action is taken under the bankruptcy law although this is the very type of case where its sanctions and procedures are most needed.

31. In England, upon the hearing of a petition for bankruptcy by the debtor himself or by any creditor, the court may make a receiving order whereby an official receiver is constituted receiver of the debtor's property. Thereafter creditors have

no remedy against the property or person of the debtor. Official receivers are officers of the court to which they are attached, although they are appointed by and act under the authority and directions of the Department of Trade and Industry. We understand that the post of official receiver is to some extent an unattractive one; inadequate salary scales have led to serious staffing difficulties in England. The office does, however, fulfil a useful function in that the property of the bankrupt vests in the official receiver immediately the order of the court is granted, and the situation referred to in the preceding paragraph, whereby the debtor obtains the privileges of bankruptcy without investigation, is avoided. Creditors are enabled to initiate bankruptcy proceedings although they could not have engaged the services of a private trustee.

32. An associated problem arises where, while there is no difficulty in getting a trustee appointed, the debtor's estate can suffer damage through delay in effecting the appointment. The most obvious example is where the assets include stocks for sale and contracts for completion; the first two or three weeks of the sequestration constitute the critical period. In England the court is compelled to vest the estate in the official receiver in the first instance and the appointment of the trustee has to be postponed until the first meeting of the creditors. We consider however, that it is desirable that the estate should be vested at the earliest possible stage in the proceedings in the person who is to act in the continuing capacity of trustee and not merely as interim receiver of the property.

33. We have considered the possibility of introducing the office of official receiver into Scotland and have decided against its introduction. Our reasons are as follows:-

(a) the cost of setting up a wide network of civil servants

to staff the service would be significant; and

(b) in any event there might be the same staffing difficulties as those encountered in England.

34. We suggest that the advantages of the English system could be obtained without the foregoing disadvantages if the system outlined in the next paragraph were adopted for Scotland.

35. We suggest that each sheriff-clerk should maintain a register of persons who would be prepared to act as a trustee. The persons entitled to be included in this register should be either members of a recognised body of accountants which, in the opinion of the Accountant of Court, requires of its members suitable training in the law and practice of bankruptcy in Scotland, or solicitors holding a current Practising Certificate. Each of the persons whose name appears on this register would be prepared to act as interim trustee, and as trustee where no trustee was appointed, or the nominated trustee was not accepted by the court, or the nominated person did not accept office. These interim trustees would have the full powers given to trustees under the system of voluntary bankruptcy and creditors' bankruptcy. In most cases the costs and remuneration of the trustee would be provided for out of the bankrupt's estate, but where the assets were not sufficient to meet these, then we recommend that such costs and remuneration should be met out of a fund set up by the state. The cost to the state of such a scheme would, we consider, be much less than the cost of setting up a system of official receivers. On the basis of figures presently available we estimate that the cost of such a scheme would not exceed £5,000 per annum.

36. It has been suggested to us that, in both the voluntary and the creditors' bankruptcy process, the interim trustee should take into his custody or under his control all the bankrupt's assets, and that he should have power inter alia to carry on the business of the bankrupt so far as may be necessary for the beneficial

winding-up of his estate. We agree with this suggestion and recommend that the interim trustee should have all the powers of a permanent trustee. In short, we consider that there should be immediate vesting of the estate in the interim trustee, (in the case of the creditors' bankruptcy procedure whenever he finds caution), with full powers of administration. If he is superseded, the permanent trustee should relieve him of all obligations undertaken; the interim trustee would require to disclose (preferably at the first meeting of creditors) any obligations undertaken by him for which he was personally liable. Since, under the new voluntary bankruptcy procedure which we propose in paragraphs 39-45, the interim trustee nominated either by the bankrupt or by the sheriff-clerk requires to register the declaration of insolvency in the register of bankruptcies within seven days of its execution by the bankrupt and such registration vests the bankrupt's estate in the interim trustee, the interim trustee will thereafter be able to take whatever immediate measures are necessary for the preservation of the bankrupt's estate. Under the creditors' bankruptcy process we propose that the petitioner should move the court to appoint a named person as interim trustee and that the interim trustee so appointed should assume control immediately the decree of bankruptcy is awarded by the court.

The Existing System of Voluntary Trust Deeds

37. In the absence of compulsory registration of insolvencies it is not possible at present to ascertain the number of trust deeds executed in any one year, but a large percentage of insolvent estates are at present wound up by this voluntary method. The trust deed for creditors is normally granted by the debtor in favour of a solicitor or chartered accountant. There is no statutory code for the conduct of bankruptcy administration under a trust deed apart from section 185 of the 1913 Act which deals

with the audit of the trustee's account. A creditor not acceding to the trust deed may refuse to give effect to certain conditions of the deed while nevertheless claiming a dividend. While his right to sequestrate the debtor is not lost, he cannot effectively do separate diligence after the trustee's title has been completed. A voluntary trust deed granted by a party insolvent, but not notour bankrupt, for behoof of all his creditors, and containing no extraordinary clauses, will be irrevocable by the granter, and will be effective in relation to non-acceding as well as acceding creditors, if the estate is reduced into possession by the trustee, and the debtor is not rendered notour bankrupt within six months. The trustee in such a case does not represent the debtor. He represents the creditors in their just proportions and all preferences by arrestment are excluded. This process offers a simple and largely informal method of winding-up insolvent estates and it has proved generally satisfactory. This system has, however, a number of disadvantages one of which is that in many instances in practice the creditors refuse to give the debtor a discharge. Other disadvantages of the trust deed system are the absence of public information about such insolvencies since they are not entered in the register of sequestrations and the lack of any effective means of disciplining either the debtor or the trustee.

38. We consider that it is desirable to retain a simple process whereby an insolvent debtor can effect the objects of a trust deed but that this process should be contained within a statutory framework which provides adequate safeguards for the interests both of the creditors and of the debtor. We therefore recommend that the existing method of voluntary trust deeds by private arrangement should be replaced by a system of voluntary bankruptcy initiated at the instance of the insolvent party. The details of this procedure are given in the following paragraphs.

Proposed Procedure of Voluntary Bankruptcy

39. The procedure should be commenced by the insolvent party (hereinafter called "the bankrupt") voluntarily executing an attested document to be called the "declaration of insolvency", the form of which should be prescribed by statute and a supply of which should be kept by sheriff-clerks, solicitors and accountants. The form would declare that the bankrupt was insolvent; annexed to it there would be a brief inventory of the assets and liabilities of the bankrupt as declared by him, with the name of an interim trustee who was duly authorised and was prepared so to act. The bankrupt would then immediately submit the declaration of insolvency to the sheriff-clerk. In the event of the bankrupt not having nominated an interim trustee, the sheriff-clerk would nominate one from the register maintained by him of persons willing to act as such. Within seven days of the execution of the declaration the interim trustee would require to register it in the register of bankruptcies and in the register of inhibitions and adjudications. The principal declaration of insolvency which is sent to the Accountant of Court by the trustee for registration would be accompanied by a certified copy thereof which copy would be retained by the Accountant, the principal declaration being returned to the trustee. Registration in the register of bankruptcies would vest the whole estate of the bankrupt in the interim trustee and an acknowledgment of registration in this register, which might take the form of an extract from the register, would be equivalent to an act and warrant under the existing law. In order to limit the period of searches in the register of inhibitions and adjudications we consider that provision should be made for renewal of the registration of the declaration in the register of inhibitions and adjudications every five years.

40. The interim trustee would summon the first meeting of creditors to be held within twenty-eight days of the registration of the declaration of insolvency. Seven days notice of this

meeting would require to be given and the notice should be published in the Edinburgh Gazette and in a newspaper circulating in the district where the bankrupt carried on business or resided. Postal notice should also be sent to all known creditors. Creditors would be required to submit their claims both for ranking and voting at or prior to the meeting of creditors and only those creditors who submit their claims at or prior to the first meeting of creditors would be able to vote at that meeting. We consider that the present statutory requirement for a sworn affidavit and claim should be removed by an appropriate section in a new Bankruptcy Act. The new statutory form of claim which we propose should replace the present affidavit and claim would be in the form suggested by the Law Society of Scotland. It would take the form of a certificate as to the veracity of the debt claimed by the creditor and would not require to be signed on oath.[1] The new statute should also provide that the making of a false statement in a claim would be a punishable offence. In view of our recommendation for the abolition of the oath, sections 21 and 22 of the 1913 Act will become superfluous and should be repealed. We also recommend that section 24 should be amended by substituting references to the certificate as to the veracity of the debt claimed by the creditor or to the certificate for references to an oath of verity or to an oath contained in that section.

41. We suggest that at the first meeting of creditors the interim trustee would act as chairman and would submit such details of the assets and liabilities as he had then been able to ascertain. The creditors assembled would either accept as trustee in bankruptcy the interim trustee nominated either by the bankrupt or by the sheriff-clerk or appoint their own nominee as trustee. In the event of the creditors appointing their own nominee as trustee

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[1] The Commission think it may be helpful to readers of the Working Party's Report to see the new form of claim which has therefore been attached to the Memorandum as Appendix F.

the person so appointed would immediately take over from the interim trustee as chairman of the meeting. If the interim trustee nominated by the bankrupt or by the sheriff-clerk were not to be appointed, his fee and outlays should be the first charge upon the estate. An abbreviate of bankruptcy stating the name and address of the trustee confirmed at the first meeting of creditors and giving the date of execution and of registration of the prior declaration of insolvency would require to be registered by the trustee in the register of bankruptcies within seven days of this meeting and such registration would confirm the vesting of the whole estate in the trustee named in the abbreviate with effect from the date of registration of the declaration. The abbreviate of bankruptcy would also be registered simultaneously in the register of inhibitions and adjudications. Provision would also be made for publication of the appointment of the trustee in the Edinburgh Gazette within seven days of registration of the abbreviate of bankruptcy.

42. We propose that at the first meeting of creditors, commissioners to a number not exceeding five should be appointed to assist and advise the trustee. The trustee should be required within seven days of the meeting to intimate to the Accountant of Court for insertion in the register of bankruptcies the names and addresses of these commissioners. The creditors should also have power to appoint other commissioners at a later date where it has been impracticable to obtain the services of sufficient commissioners at the first meeting. We consider that the existing provisions of sections 72 and 73 of the 1913 Act forfilling any vacancies caused by death, resignation or removal from office of a commissioner should be re-enacted and also apply to voluntary bankruptcies.

43. We propose that in a voluntary bankruptcy the trustee should be empowered to arrange for the bankrupt, his wife and employees to attend on the trustee for examination without applying to the court for a warrant. The examination, if required, should take place within four months after the date of registration of the declaration

of insolvency. The trustee would be required to advertise the date (being not less than seven days from the date of the advertisement in the Gazette) and also the place of the examination in the Edinburgh Gazette and in a newspaper circulating in the district where the bankrupt carried on business or resided and written notice would also be sent to every creditor. At this examination the bankrupt would be required to make a declaration before the trustee, which declaration should be given the force of a statutory declaration made under the Statutory Declarations Act 1835. In the event of the bankrupt, his wife or employees failing to attend on the trustee for examination as required by the trustee, we propose that the trustee should be able to obtain a warrant from the Sheriff on summary petition to compel them to do so. In such a case the date of the examination would be not less than 14 nor more than 28 days from the date of the petition. It should also be in the option of the trustee if he considers it necessary, to insist upon this examination taking place upon oath before the Sheriff.

44. The trustee would proceed to ingather the assets, call for claims and adjudicate thereon. Claims would require to be lodged within six months of the date of registration of the declaration of insolvency, without prejudice to the obligation of the trustee to admit to a ranking any valid claim lodged up to one month before the date of distribution. If necessary a claim could be intimated to the trustee without being quantified but even if not quantified exactly a formal claim in the prescribed form should nevertheless be submitted, the amount of the claim being estimated until actually known. The trustee would be required to call a second meeting of creditors in accordance with the same procedure as we have recommended in the case of the first meeting, and to issue a written report on the progress of the bankruptcy, and to produce accounts within two months following the expiry of twelve months after the registration of the declaration of insolvency. Thereafter, unless the commissioners considered it unnecessary, the trustee would convene further meetings at six monthly intervals

or at such longer or shorter periods as might be fixed by the commissioners. The distribution of dividends would be made on dates decided by the commissioners.

Creditors' Bankruptcy Procedure to apply mutatis mutandis to new Voluntary Declaration of Insolvency procedure

45. We also recommend that the procedure in a creditors' bankruptcy (amended as after suggested) in relation to such matters as the meetings of creditors, payment of dividends, discharge of the bankrupt et cetera should mutatis mutandis apply also to the new voluntary declaration of insolvency procedure so that the two procedures may be equiparated so far as possible. In addition, the rules regarding the ranking of preferable claims applicable in formal sequestrations would also apply in the case of a voluntary bankruptcy.

Proposed Procedure of Creditors' Bankruptcy

46. As we pointed out earlier (para. 13), our proposals for reforming the procedures for creditors' bankruptcy, though at first sight extensive, are intended to have a streamlining rather than a superseding effect. We have therefore been in some doubt whether, logically, they should not appear in Part IV among the recommendations for detailed changes. On the whole, however, since our proposals are a consequence of widespread criticisms of the cumbersome and inelastic nature of present procedures, we have decided to present them as going to principle, rather than detail, at least in so far as concerns the earlier stages, to which most of our recommendations are directed. We believe that this will make the Report easier to grasp as a whole. We propose that the details of the new system of creditors' bankruptcy should be as described in the following paragraphs.

47. This procedure would be initiated by petition either to the Court of Session or to the Sheriff in summary form, in respect of

any person alive or dead who is publicly insolvent, at the instance of any creditor or group of creditors having together claims amounting to not less than £50. We recommend that it should be sufficient for a petitioning or concurring creditor to produce with the petition a certificate as to the veracity of the debt claimed by him and to specify any security which he holds over the bankrupt's estate and state whether any other persons besides the bankrupt are liable for the debt; he should not require to produce an oath. A new section 20 amended to this effect should therefore be included in the proposed new legislation. At present a petition for sequestration must be made within four months of the constitution of public insolvency; we propose that in order to avoid having a multiplicity of different periods this period should be amended to three months. The application would be by way of a petition in the standard form, presenting the evidence of public insolvency and the creditor's claim. The petition would be presented in any sheriffdom where the bankrupt had resided or carried on business at any time during the twelve months preceding the presentation of the petition.

48. We propose that where the insolvent debtor, instead of using the new voluntary bankruptcy procedure, prefers for some reason to use the more formal procedure, he should be entitled to present a petition, with concurrence of one or more creditors having claims totalling £50, moving the court for his sequestration. In addition to the procedure being initiated by the insolvent, it might also be initiated by his representatives or his or their mandatory presenting a petition with the like concurrence.

49. We propose that the petition should move the court to declare the debtor to be bankrupt and to appoint a named person to act as interim trustee. The petition should also ask that in the event of the named person declining to act as trustee then a further person who should also be named and who should be on the register of persons prepared to act, be appointed. It is understood that it is now the general practice to insert a crave in all petitions for sequestration that the court shall in terms of section 25 of

the 1913 Act if desired grant diligence to recover evidence of the notour bankruptcy or other facts necessary to be established and that the court normally appoints a commissioner. In nearly all cases this is an unnecessary expense and we recommend that the appointment of a commissioner as a matter of course should be discontinued. We believe that this could be safely done if it is provided that evidence of the facts establishing public insolvency should be lodged with the petition.

50. We suggest that the petition should be served upon the debtor on a seven days induciae if in Scotland or fourteen days if abroad with a warrant to appear at a fixed diet. Details of the petition would be registered in the register of bankruptcies and in the register of inhibitions and adjudications within four days of the granting of the warrant for service. We consider that the provision in section 27 of the 1913 Act that intimation be made in the Edinburgh Gazette of the warrant and of the diet of appearance should be retained. If the citation were returned, the petitioner would lodge an affidavit that the debtor could not be found, and this would be followed by edictal citation and appointment of a further fixed diet. If no appearance were made at the stated diet by or on behalf of the bankrupt, a decree of bankruptcy would then be granted forthwith. If the debtor appeared or was represented he would be required to show cause why the bankruptcy should not be awarded or instantly to pay the debt in respect of which his bankruptcy is sought or produce written evidence of the same being paid and satisfied or otherwise would require to satisfy the terms of section 29 of the 1913 Act.

51. The decree of bankruptcy awarded by the court would be registered in the register of bankruptcies and in the register of inhibitions and adjudications within four days of granting and an extract from the register of bankruptcies would have the same effect as an act and warrant of confirmation according to the present practice.

52. We do not, however, consider that it is right that the court

should appoint a permanent trustee on a petition by one creditor or group of creditors without giving the other creditors a chance to have a say in the appointment. Section 239 of the Companies Act 1948 provides that in England the official receiver, who acts as provisional liquidator, is required to summon a meeting of creditors for the purpose of determining whether an application is to be made to the court for appointing a liquidator in place of the official receiver. We believe that the person named in the petition should be appointed an interim trustee and that he should be required to call a meeting of creditors to determine whether his appointment should be confirmed or whether application should be made to the court to appoint some other person as trustee. The interim trustee would take over immediately the decree of bankruptcy was awarded by the court but before obtaining the authority of the court to act as such and intromit with the bankrupt's estate he would require to lodge a bond of caution with the court. A fresh bond of caution would also require to be lodged with the application for the appointment of a permanent trustee following the first meeting of the creditors.

53. In the event of the debtor meeting the debt upon which the petition was based or of the matter being otherwise settled the petitioning creditor would require to record a notice clearing the register of bankruptcies and the register of inhibitions and adjudications. Once approved by the court the appointment of the permanent trustee would take effect from the date of the presentation of the petition. Special provision would be made to provide for the case where the permanent trustee is a person other than the interim trustee named in the petition in order to ensure that the fee and outlays of the interim trustee would be the first charge on the bankrupt's estate.

54. All petitions for bankruptcy would be competent in the Court of Session and also in the Sheriff Court as at present, irrespective of the amount of the estate. Once the decree of bankruptcy

had been granted the interim trustee would publish a notice in the Edinburgh Gazette and in a daily newspaper circulating in the appropriate area. He would call a meeting of creditors within twenty-eight days in the same manner as is contemplated in respect of the voluntary bankruptcy process, this meeting being convened to appoint a permanet trustee. As in the case of the voluntary bankruptcy process, the interim trustee would act as chairman at this meeting and would submit to the meeting such details of the assets and liabilities of the bankrupt as he had then been able to ascertain. In the event of the creditors assembled appointing as permanent trustee someone other than the person named in the petition to act as interim trustee, the person so appointed would immediately take over from the interim trustee as chairman of the meeting. At this meeting we propose that, as in the case of the voluntary bankruptcy procedure, commissioners of any number up to five should be appointed to assist the trustee and that the sheriff-clerk should be required within seven days of the election of the trustee being confirmed by the court to intimate the names and addresses both of the permanent trustee and of these commissioners to the Accountant of Court for insertion in the register of bankruptcies. When commissioners are appointed subsequently the trustee should inform the court within 7 days of their election and the sheriff-clerk should, within 7 days of their election being confirmed by the Sheriff, intimate to the Accountant of Court their names and addresses for insertion in the register of bankruptcies.

55. As in the case of the voluntary bankruptcy procedure, the trustee would proceed to ingather the assets, call for claims and adjudicate thereon. Claims would require to be lodged within six months of the date of the award of bankruptcy, but the trustee would be obliged to admit to a ranking any valid claim received thereafter which is lodged at least one month before the date of

payment of the dividend. Again, as in the case of the voluntary bankruptcy procedure, claims would be made in the new statutory form of claim to be prescribed by the proposed new legislation and would not require to be signed on oath. We also propose that the trustee should be required to convene a second meeting of creditors to be held in accordance with the same procedure as we recommend in the case of the first meeting, and to issue a written report on the progress of the bankruptcy and to produce accounts within two months following the expiry of twelve months after the first deliverance in the petition for bankruptcy. Thereafter, unless the commissioners considered it unnecessary, the trustee would convene further meetings to be held at six monthly intervals or at such longer or shorter periods as might be fixed by the commissioners. The distribution of dividends would be made on dates decided by the commissioners.

Bonds of Caution

56. We have given careful consideration to the question whether it is essential for the trustee in bankruptcy to obtain a bond of caution before intromitting with the bankrupt's estate or whether such a requirement is merely an administrative nuisance and an unnecessary waste of money. We were informed that if caution were retained no real delay would take place since a bond of caution can normally be obtained on the same day as that on which application for it is made. The Law Society of Scotland (later referred to as "the Law Society") are of the opinion that a bond of caution should be required both in the case of a voluntary and of a creditors' bankruptcy. On consideration, however, we have come to the conclusion that the requirement of a bond of caution should be retained in the case of the creditors' bankruptcy procedure only, on the ground that traditionally, the court always insists on caution being found where someone is appointed by the court to administer funds belonging to someone else. We are fortified in our decision that caution should not be required in the case of voluntary bankruptcy by reason of the fact that one of our objectives is to equate voluntary bankruptcy to voluntary liquidation as much as possible

and, since a voluntary liquidator does not require to find caution, we do not consider that the trustee in a voluntary bankruptcy should be required to do so. Moreover, at present,a trustee acting under a private trust deed for behoof of creditors does not require to find caution.

Summary Sequestration

57. The history of the process of summary sequestration is that it was created by the 1913 Act, superseding the older process of cessio bonorum, and applied to sequestrations where the estimated value of the debtor's assets did not exceed £300. After the election of the trustee the whole proceedings are summary in their nature, there being no statutory periods as in an ordinary sequestration and dividends being notified and paid as funds permit.

58. In their representations the Law Society propose the complete abolition of the summary sequestration procedure. They point out that one of the abuses of the present bankruptcy law is that cases are known of debtors possessed of an income but with little or no capital who, in an attempt to defeat their creditors, petition for their own sequestration and that this is sometimes done by summary procedure which requires no concurrence of creditors. Such a petition for sequestration is normally presented in order to prevent a series of arrestments of wages. In such cases, where there are substantially no assets, creditors are naturally reluctant to incur expenses in the sequestration and therefore rarely think it worth while to appear at the first meeting. Furthermore, in the absence of any assets to provide a fee, there is little inducement to a trustee to accept office. Although the proceedings (or lack thereof) at the meeting may be reported to the court in accordance with the statute, the process is virtually dead. The debtor, however, remains a bankrupt and all future arrestments or poindings are ineffective under section 104 of the 1913 Act. As the Report of the McKechnie Committee on Diligence (1958 Cmnd. 456 para. 304) puts it, "The effect is

that in about 2 out of 5 cases of summary sequestration the debtor, although subject to the various statutory disabilities and disqualifications imposed by the Bankruptcy Act, has not been penalised thereby and yet has been immune from arrestment of wages and other forms of diligence by creditors". To restore the process of sequestration and have a trustee elected, a creditor requires to lodge a note in the original process of sequestration applying to the Sheriff to appoint a special meeting of creditors for the purpose of electing a trustee (see Act of Sederunt of 25 May 1937). In some cases, also, where some essential part of the procedure has not been carried out and the statutory machinery has consequently broken down, the situation can only be remedied by presenting a petition to the Court of Session ex nobile officio. An example of this is the case where, no trustee having been elected, there is therefore no report on the bankrupt's conduct; the bankrupt is thus deprived of his statutory right to apply to the Sheriff in the normal way for his discharge, but must apply to the Court of Session in the exercise of its nobile officium to grant his discharge.

59. The unsatisfactory nature of the procedure is well illustrated by the fact that during the years 1967, 1968 and 1969 respectively no trustee was elected in (a) 42 out of 47 awards (b) 36 out of 43 awards and (c) 32 out of 44 awards. Other unsatisfactory features of the procedure are:-

(1) That the trustee when appointed does not, as in the case of an ordinary sequestration, require to call a meeting of creditors immediately after his appointment . Indeed the second statutory meeting is not normally called until the end of the sequestration.

(2) The bankrupt is entitled to apply for his discharge "where the Sheriff has dispensed with further procedure". It is open to the Sheriff to dispense with further procedure at any time

in cases where there are no funds for division among the creditors (see section 176(8)(2) of the 1913 Act), and immediately this has been done it is competent for the bankrupt to apply for his discharge without the consent of the creditors (see section 176(17) of the said Act). The bankrupt must, however, observe the conditions laid down in the 1913 Act relative to discharge, e.g., produce a report by the trustee and normally have paid at least 25p per £1, (see Fyfe's Bankruptcy Code page 151) but it is thought that at least in some Sheriff Courts this procedure is not always carried out.

60. As can be seen from para. 39 hereof we are making recommendations for a voluntary declaration of insolvency and suggesting that a scheme should be provided for registration thereof. In addition we are recommending that provision should be made for a creditors' petition for compulsory bankruptcy of a debtor and also for a debtor's petition for bankruptcy with concurrence of a qualified creditor and there therefore seems to be no sufficient need to retain the process of summary sequestration. In view of this, and of the unsatisfactory nature of the process to which we have referred above, we recommend the abolition of the summary sequestration procedure.

Power to Remedy Defects in Procedure

61. One of the defects in the procedure prescribed by the 1913 Act is in the provision of varying and strict time-limits with the expensive penalty upon failure to observe them of the trustee requiring to present a petition to the Inner House of the Court of Session. We accordingly propose that the new Bankruptcy Act should provide that in the event of any failure, by error or neglect, to comply with any statutory provision, it should be competent for the trustee, in the case of a Sheriff Court sequestration, to make application to the Sheriff for authority at his discretion to remedy the same. In the case of a Court of Session sequestra-

tion we recommend that the trustee should be similarly empowered to make application to the Outer House or, after the cause has been remitted to the Sheriff Court, to the Sheriff.

Preferential Claims

62. Preferential claims are dealt with by section 118 of the 1913 Act (the English equivalent is section 33 of the 1914 Act). Section 118 provides that certain classes of debts shall rank equally among themselves and shall be paid in full unless the assets are insufficient to meet them in which case they shall abate in equal proportions. It is possible to discern that these classes of debt have something in common, that is to say, that the creditor may be said to have given credit involuntarily, at least to the extent to which he was not in a position to select his debtor. This appears to be the justification for the special position in which creditors for these classes of debt are placed in competition with secured or unsecured creditors.

(a) Local Rates

63. The first class includes local rates due by the bankrupt having become due and payable within the twelve months next before the award of sequestration or the date of death of a deceased debtor or the date of the concourse of diligence for distribution of the estate of a party being notour bankrupt. We shall call this "the relevant date". There are also included in this class taxes assessed on the bankrupt up to the 5 April next before the relevant date and not exceeding the whole of any one year's assessment. We have received no reasoned recommendations to the effect that the law be altered in so far as it refers to rates and we do not think that such an alteration is called for. A local authority carries out its statutory duties and expends public money on behalf of good and bad debtors alike on the faith of being able to reimburse itself by levying a rate annually. This seems to be a strong case for a preferential claim for one year.

(b) Taxes[1]

64. "Taxes" includes all taxes levied by assessment, and certain other taxes in respect of which special provision has been made by the statute in virtue of which the tax is imposed. Examples are short-term capital gains tax, arrears of purchase tax, P.A.Y.E. deductions, Selective Employment Tax, Redundancy Fund contributions and Betterment Levy. The case for treating such debts as preferential is not so clear as that in regard to rates and we have received representations that the law should be reviewed. Furthermore, we ought to point out that historically the position of Crown debts is not precisely the same in Scotland as in England, although we do not suggest that there is now in this respect any difference in the fiscal or bankruptcy laws as between the two countries.

Historical Background to Crown Preference

65. In the case of In re Pratt - Inland Revenue v Phillips [1951] Ch. 225, where the corresponding section of the 1914 (English) Act was under construction, it was pointed out that such a provision, which can be traced back to 1649, so far from conferring a privilege upon the Crown, is in fact an abridgement of the Royal Prerogative at common law. "I take it", said Macdonald CB in Rex v Wells [1807] 16 East 278, "to be an uncontrovertible rule of law that where the King's and the subject's title concur the King's shall be preferred". This doctrine was held by the Privy Council in New South Wales Taxation Commissioners v Palmer [1907] A.C.179 to be conclusive in determining that, in a colony where no special statutory provision relating to arrears of taxes had been made, "in the administration of a bankrupt's estate under the New South Wales Bankruptcy Act 1898 the Crown is entitled to

[1] This part of the Report was prepared and agreed before the 1971 Budget Statement. Since, in consequence, the taxes will be in a somewhat unsettled condition for the next year or two, it was decided to leave the passages referring to them as they stood.

preferential payment over all other creditors". It was for this reason that in In re Pratt it was held that section 33 of the Bankruptcy Act 1914 is, in dubio, to be construed in favour of the Crown, being an abridgement of prerogative, not against the Crown in accordance with the ordinary rule for construing a taxing provision.

Crown Privilege in Scotland

66. However, the Royal Prerogative is one of the areas of law in which English precedents have to be looked at narrowly in Scotland. There is some tendency among English lawyers to assume the transfer to the British Sovereign of all the prerogatives enjoyed by the English Sovereign before 1707. Such an assumption cannot be made in the present field. "The Crown", says Goudy on the Law of Bankruptcy in Scotland at page 514, "has by statute, though not by common law, a special preference in bankruptcy or insolvency of its debtors for all imperial taxes ...". The matter was expressly provided for as far as heritage is concerned in the Exchequer Court (Scotland) Act 1709, 6 Anne c. 53, whereby "no debt ... to the crown in Scotland shall affect ... any real estate in Scotland, ... further or otherwise ... than such real estate may ... be subject ... thereto by the laws of Scotland and that the laws of Scotland shall in all such cases ... hold place". Bell in Volume I of his Commentaries (7th Edition) at page 782 quotes the case of Creditors of Burnet v Murray (1754) Mor. 7873. as follows:

"The receiver-general of the customs adjudged for the King the land estate (sic) of Burnet, on account of duties on tobacco. The other creditors followed with adjudications within year and day of the King, and claimed pari passu preference, as if the King's adjudication had been for a common debt. The Court found: that before the Union, the King, by the laws of Scotland, was entitled to no preference for revenue debts upon the real land estates of his subjects, but only according to his diligence, and that by the

Act 6 Anne the laws of Scotland are saved and declared to hold place and be observed; and therefore that His Majesty is preferable only pari passu with the adjudgers within year and day of his adjudication". This decision was affirmed in the House of Lords - see Mor. 7875.

67. The purpose of the foregoing is to point out that a curtailment of the Crown privilege in this matter would not, in Scotland, constitute a further derogation from the Royal Prerogative, as apparently it would in England. The Board of Inland Revenue, in their Memorandum to us, place considerable stress on the historical argument, which may not be of equal validity in this country. Nor is it so easy, against the Scottish background, to be satisfied with the according of the present extensive Crown privilege on the ground that debts owed to the community ought to have precedence over debts owed to an individual. This is, in any case, by no means a self-evident proposition of universal validity. We do, however, agree with the Board that it would not be practicable to give the Crown different preferential rights in England and Scotland. This suggests that any abridgement of Crown preference, such as we recommend, should be on a United Kingdom basis.

Criticism of Crown Preference for Assessed Taxes

68. The common criticism of the preference accorded to assessed taxes is stated in Williams on Bankruptcy, 18th Ed. p. 329 as follows: "Whereas rates enjoy priority only in respect of sums due and payable within twelve months before the receiving order, the priority accorded to taxes extends to a maximum of one year's assessment out of all the assessments which have become due and payable and are unpaid, thereby entitling the Crown to select for preferential payment its "best year", which may well not be the concluding year, and which in the case of Excess Profits Tax would not, except by chance, conclude on April 5th. The Crown

may also select different preferential years for different taxes, e.g., in respect of Income Tax, Excess Profits Tax and Profits Tax. Thus the Crown, by putting forward a large unpaid tax claim several years old may deprive the ordinary creditors of any dividend. Where this occurs, the ordinary creditors tend to lose interest in the administration from which they cannot benefit, and the Crown's privilege is sometimes regarded as unfair, in that the bankrupt has been permitted to enjoy, to the prejudice of other traders, "false credit" in respect of his arrears of tax ". The Blagden Committee on Bankruptcy Law Amendment also records criticism levelled at Revenue preferences. After reporting that "many of the witnesses have been in favour of the total abolition of priority for rates and taxes, the Committee recommend that the Crown should have preference for taxes "assessed on the bankrupt in respect of either of the two fiscal years immediately preceding the date of the (Court) order, at the option of the crown".[1]

The Involuntary Creditor Rule

69. In our view the answer to this question is to be found in an application of the "involuntary creditor" rule which, in para. 62 above, we suggest as the rational foundation for all preferential claims. We would apply it in this way, that a creditor who is not in a position freely to choose his debtor ought to have a preference sufficient to extend to those debts which he could not reasonably have been expected to have recovered, or to have constituted by legal action before "the relevant date". In support of our general proposition, that the justification for a preference is the doctrine of the "involuntary creditor", and that preferences ought to be restricted to debts which could not reasonably have been collected by the relevant date, we submit the high authority of the following passage from Bell's Commentaries[2]:-

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[1] 1957 Cmnd. 221 p. 31

[2] 7th Edition ii. 41

> "It might be a consideration worthy of some attention from the Legislature, whether it does not savour of injustice, that arrears, which the officers of the revenue ought to have recovered, instead of allowing them to accumulate, should continue a preferable burden against all the creditors? whether it is not to bestow a privilege upon the officer and his sureties, rather than upon the public? whether, at all events, it is not throwing oppressively on a few, what would otherwise fall lightly on the general mass of the people? The duties which are current, or which have fallen due, without having been improperly left to accumulate, ought indeed to form a preferable burden: for no property can be considered by creditors as free from such burden; and so they are not deceived into a false credit. But duties may accumulate to an enormous and incalculable amount, and sweep away by preference the bulk of the fund."

The consequences of the application of the "involuntary creditor" rule, so far as taxation is concerned, would be as follows.

Income Tax

70. Income tax, although based on a previous year's profits, is the legal liability of the fiscal year assessed. Income tax is payable in January of the year of assessment and in July following the year of assessment and thus at the worst possible time from the Inland Revenue point of view there should be outstanding not more than tax for 9 months (assuming a bankruptcy at 31 December). In fact, since the taxpayer may withhold payment without collection proceedings until about the end of February, tax for 11 months could be involved. By June, the potential outstanding sum is an instalment of one half of the preceding full year plus 3 months of the next year. Again through late payment, this could stretch to August when the potential outstanding sum is half of the preceding year plus 5 months of the year in which bankruptcy occurs -

again the equivalent of 11 months tax. It seems to follow therefore that the preferential right should extend to income tax appropriate to the 12 months preceding "the relevant date" less any sum paid thereon. As Short Term Capital Gains are charged to income tax, the same provisions should apply to them.

Long Term Capital Gains Tax

71. The Inland Revenue can assess to tax capital gains immediately after the end of the year concerned. For example, a realisation taking place in April 1970 would be included in the tax return for 1970, lodged in April 1971. The tax could not normally be determined before, say, August 1971, or finally negotiated until about the end of the year. Working, accordingly, on the principle that the preference should not extend beyond the period reasonably necessary for assessment, we would suggest that two years would be appropriate.

Surtax

72. For the same reason, and on the same principle, we suggest a period of two years.

Corporation Tax

73. In the case of corporation tax, the liability is a legal liability of each accounting period, although the amount cannot be determined until the coming into effect of a Finance Act some time after the end of such period. For example, the liability for the year to 30 June, 1970 cannot be determined until the passing of the Finance Act of 1972 - (the Finance Act of 1970 fixed the rate for the year to 30 March, 1969). Thus the Inland Revenue have no power to collect the debt at the time when it becomes a legal liability. In the case of limited companies who were in business prior to 6 April 1965, corporation tax is payable on the 1st of January in the fiscal year following the end of the chargeable year. In the case of limited companies who commenced business after April 1965 and those for whom the balance date was altered since

April 1965, corporation tax is due on a date 9 months after the end of the chargeable period. Thus the payment date may be from 9 months to 21 months after the end of the period involved. The acceptance of the principle which we have proposed would lead to the Inland Revenue getting preferential ranking for corporation tax for the last 24 months before "the relevant date". The extension of such right in the case of corporation tax should not be injurious to ordinary creditors (subject to the right of appeal which we propose in paragraph 80 below), as in the normal case a bankrupt concern can be shown to have made losses, not profits.

P.A.Y.E. and S.E.T.

74. It has been suggested that a much wider preference should be accorded to taxes which have been collected by the debtor from his employees, on behalf of the Revenue, and not paid over. This would apply to P.A.Y.E. and also to S.E.T., which is collected along with the National Insurance Contribution. This suggestion is made, for example, by the Accountant of Court, who, on the other hand, would reject the claim to preferential treatment in respect of the assessed taxes. The argument is that, after the gross wages have suffered deduction, the employer holds for the Revenue in something of a fiduciary capacity, and that special consideration should be given to that fact. On the other hand the general rule is that claims for trust funds which have been immixed in the debtor's own funds - as these would have been - enjoy no preferential ranking. Again, the argument would not avail in the case of a self-employed debtor, in relation to his insurance contributions. Furthermore, if the Revenue, as a matter of policy, choose to turn employers into collectors of these imposts, we do not see why the position should, for the Revenue, be different from that of any other principal whose insolvent agent has failed to account to him in whole or in part.

75. Once more, however, we would apply the "involuntary creditor" rule, and recommend a preference sufficient to cover the period between the debt falling due and the date when the creditor is reasonably in a position to enforce payment. P.A.Y.E. is collectable on the 19th day of the month and is for the period to the 5th day of that month. We think that if 12 months were allowed for identifying the non-payment and effecting collection, we would be recommending a period which was on the long side, but which would be conveniently in line with that relating to the other taxes.

National Insurance Contribution

76. National Insurance Stamps (the price of which includes S.E.T.) are due to be affixed to cards weekly. The cards run for 12 months and failure to stamp the card timeously can result in criminal proceedings. The Department of Health and Social Security employ inspectors who periodically call on employers to check cards against wage records. Although a card covers 12 months, the cards held by an employer are in 4 groups, closing on different quarter dates. Accordingly at any given date there should be outstanding a quarter with 12 months stamps affixed: a quarter with 9 months; a quarter with 6 months and a quarter with 3 months (maximum). These considerations suggest that the preferential ranking should be in respect of 12 months unpaid stamps.

Arrears of Purchase Tax

77. While normally purchase tax returns are made quarterly, the Commissioners of Customs and Excise have the power to, and sometimes do, ask for returns monthly or even weekly. In these circumstances we do not see a case for preference for arrears over more than a year.

Power of Trustee to Challenge Assessments

78. Independently, however, of the foregoing recommendations as

to claims for tax, and even in the event of the present law remaining unchanged, we are of opinion that some power to challenge assessments made upon bankrupt estates should be conferred on trustees.

79. In many and possibly in the majority of cases, the bankrupt has either failed to keep proper books and records or at least has failed to prepare proper Profit and Loss Accounts for production to the Inland Revenue. For one or more years prior to bankruptcy the Inspector of Taxes accordingly raises estimated assessments. The first of such is usually based on an 'expected' profit; subsequent assessments are generally on increasing sums and often no personal allowances are given. The object of the Inspector is to force the taxpayer into producing proper accounts and returns. The assessments are made primarily in terrorem, and cannot be genuine estimates of the amount of tax due. Once bankruptcy occurs, the Inland Revenue rank preferentially for the largest assessment and ordinarily for the others and the trustee or liquidator has no power to have the assessments appealed.

80. Accordingly we recommend that on the bankruptcy of an individual or firm or liquidation of a company the trustee or liquidator should be empowered to appeal against the outstanding assessments although the time limit for appeal under section 31 of the Taxes Management Act 1970 is 30 days from the date of issue of the assessment. The appropriate period in which a trustee/liquidator could appeal is suggested as being 3 months from the date of his appointment.

81. It may be objected that this would be to confer upon the trustee a right which the debtor himself, as at his sequestration, had not enjoyed. This is true. On the other hand, the debtor, knowing of his impending insolvency, will have had no inclination or interest to challenge assessments which, even if they had been

amended to reflect his true tax liability, he could not have met. We think that justice requires that the trustee should have power, in the interests of creditors who have no competence in that behalf, to challenge assessments which have been laid on, not as fair estimates, but in order to force the production of facts on which fair estimates could have been based.

82. It is probable that such an alteration in the law would be more appropriately made by amending the Taxes Management Act 1970 than by making provision in a Bankruptcy Act and amending Companies Act, but this question we leave for consideration by the Scottish Law Commission.

(c) Preference for Wages and Salary

83. The next class of preferential payments relates to sums due to employees by the bankrupt. Some degree of preference is in general called for here, since employees must find employment where they can, and are not normally paid in advance; furthermore, the sums payable to them by their employers represent, in many cases, personal subsistence for them and their families. Employees are divided into two sub-classes, (a) clerks and servants, and (b) labourers and workmen, but the distinction is not of importance today. The preference is identical for each sub-class, that is to say, it covers a sum not exceeding two hundred pounds and a period of four months before "the relevant date". By the Bankruptcy (Amendment) Act 1926, it is declared "for the removal of doubts" that in the case of clerks or servants the preference applies to wages or salary "whether or not earned wholly or in part by way of commission". By a strange anomaly this Act does not apply to Scotland. Since, however, the relevant words of section 118 of the 1913 Act and section 33 of the 1914 Act are identical, it must surely follow that if the doubts were removed in respect of one Act, they can no longer be said to bedevil the other.

(d) Assimilation of Preferences in Bankruptcy and Liquidation

84. Before turning to the details of employees' preferential

claims, there is one general recommendation with which we should like to deal. The Law Society suggested inter alia that the preferential claims in bankruptcy should be brought into line with the provisions of section 319 of the Companies Act 1948. We agree with this suggestion. There does not appear to be any reason why, in the several proceedings, preferential claims, which are almost identical in scope, should be stated otherwise than in identical language. The only substantial alteration in the law which this would entail, would be the importation into bankruptcy procedure of the provisions of section 319(4) of the Companies Act, whereby monies advanced for the purpose of paying salaries and wages enjoy the same privileges as do arrears. We have given careful consideration to this proposal, since it would result, in the aggregate, of a large increase in the bulk of preferential claims. Nevertheless we recommend without hesitation that no distinction should be drawn in this matter between bankruptcies and liquidations. The legal category into which an employer may fall- company, partnership, or individual - should make no difference to the policy of encouraging, in the national interest, the advancing of money for wages, which may make all the difference between the employer pulling through a financial embarrassment and his being forced out of business. We do not see any reason why abuses may be more probable in the field of bankruptcy than in that of liquidation.

85. The Institute of Chartered Accountants are also in favour of assimilating the rules as to preferential claims in bankruptcy to those obtaining in liquidation. They further suggest that the number of preferences be reduced, but apart from our suggestion relating to taxation, we are not able to recommend any action in this direction. It was also suggested by the Institute that eight weeks rather than four months should be the period allowed for wages and salary preferences. We deal with this matter later on. On the other hand we have received recommendations that the number

of preferences should be increased, and it is to these recommendations that we now turn.

(e) Commission due to Commission Agents

86. The Scottish Association of Manufacturers' Agents point out that a commercial business may adopt one of two methods of promoting its sales. It may employ its own sales representatives, the arrears of whose wages and commission would rank preferentially on the employers' sequestration. On the other hand, it may sell through independent commission agents, who will be self-employed and may in fact act for a number of manufacturers. The Association maintains that it is anomalous that commission due to the second class should not rank preferentially. The anomaly is easily appreciated. Nevertheless we do not see our way to recommend an extension of the preferential class to include debts due to a creditor who is in an independent business of his own.

(f) Payments in Lieu of Minimum Period of Notice

87. The Department of Employment and Productivity make three recommendations: First, they urge that the payment in lieu of the minimum period of notice to which an employee is entitled, under the Contracts of Employment Act 1963, should rank equally with remuneration for services actually rendered and accrued holiday remuneration, as preferential claims. On one view, since this claim is for a money payment, arising out of a contract of employment, due to an employee, there is no reason for differentiating between it and wages or salary. The latter is the payment made in respect of the time he is working for his employer, the former is the payment which Parliament has directed that that employer must make in order to tide the employee over the time he is looking for another job. On the other hand, a majority of us are of opinion that a payment in lieu of notice should only be a preferential debt provided that the statutory limit for a preferential claim for arrears of wages, or for the amount advanced for wages, has not

been reached, and to the extent of the surplus so remaining. To allow both, on this view, would be to give the employee a preferential claim for a payment in respect of a time when he may well be working in another job; any such payment should be an unsecured debt. We are, accordingly, only able to support the Department's recommendation to this limited extent.

(g) Claims for Compensation under Part II of the National Service Act 1948

88. Secondly, the Department would like to see the same preference accorded to claims for compensation under Part II of the National Service Act 1948 as to those under the Reinstatement in Civil Employment Act 1944, that is, a limit of two hundred pounds applicable in cases of company liquidation as well as bankruptcy. The Department of Trade and Industry agrees with this recommendation and we support it; it is not likely that many cases will arise but it has been pointed out that the Army Reserve Act 1969 has kept the question alive. We would, however, make the limit adjustable by the Department of Trade and Industry in the way we recommend in para. 92.

(h) Payments under the Redundancy Payments Act 1965

89. Thirdly, the Department consider that they should be able, as a preferential secured creditor, to claim an insolvent employer's share of the payment made from the Redundancy Fund to a redundant employee of an insolvent employer under the Redundancy Payments Act 1965. Since the payment to the employee is made direct from the Redundancy Fund, to which all employers contribute, the money in the Fund is thus collected by the Department on behalf of employers as a whole. When the Department makes a payment to an employee they seek recovery from his employer of that part of the payment which was the latter's net responsibility. If the employer is insolvent, of course, this recovery cannot take place except by the Department

ranking as an ordinary creditor. In our view, the present system does not lead to unfairness. The loss arising to the Redundancy Fund is borne by the broad backs of employers in general; we do not see any reason why they should be relieved at the expense of creditors in individual cases.

(i) Preference for Wages and Salary

90. The amount of wages and salary in respect of which a preferential claim can be made, that is to say, not more than two hundred pounds and over not more than four months, has remained the same since the passing of the Companies Act 1947. On general principles, therefore, it would seem that the amount should long ago have been reviewed. We have, however, had very great difficulty, in spite of the most able assistance from officials of the Department of Trade and Industry, in discovering what are the principles in accordance with which the scope of the preference was originally fixed and has from time to time been altered. On the one hand, two hundred pounds earned over four months discloses a wage of about £11.50p a week, which is much less than the present average figure. On the other hand, certainly as far as wages are concerned, it would be a very extraordinary circumstance if they were to remain unpaid for anything like four months. We think we can, accordingly, confine our attention to advances for wages in liquidations and - if our proposal were to be accepted - in bankruptcy also.

91. The obvious practical consequence of the obsolete monetary limit is that it stultifies the time limit. No lender is going to advance 4 months wages (which will be running perhaps at an average of £20-£30 a week) if his maximum preferential claim in respect of each employee is £200. We have been informed that in practice a bank will now advance not more than 10 weeks wages, if they have nothing but the preferential nature of their claim in a liquidation to rely on by way of security. This demonstrates

that some alteration in the present rule is necessary, if only to restore to some extent the situation as it was in 1947. We have to balance two public considerations. On the one hand, it is unfair to trade creditors if a dying concern is kept on its feet by injections of credit, which enjoy a preference over their own claims, and of the existence of which they are unaware. On the other, it is in the public interest that banks should be encouraged in the exercise of their important function of supplying short-term credit to concerns or individuals who have present difficulties but a bright future. Giving the matter the best consideration we can we would suggest that the time limit be fixed at 3 months and the monetary limit at £300. We also consider that in addition all money disbursed by an employee arising out of his employment should be included in the employee's preferential entitlement.

92. It is likely, however, that, supposing we have fixed upon the correct time limit, the financial limit will again tend towards obsolescence. We therefore recommend that the Secretary of State be given power to alter it, from time to time, by Statutory Instrument.

(j) Date from which period for preferential debts should be calculated

93. The Department of Health and Social Security point out that under section 118(1)(f) of the 1913 Act they are entitled to rank as preferential creditors on the estates of debtors who have been sequestrated in respect of unpaid National Insurance contributions relating to the twelve months preceding the date of the award of sequestration. Section 41 of the 1913 Act lays down that "the sequestration shall be held to commence and take effect on and from the date of the first deliverance on any petition for sequestration, which shall be held to be the date of the sequestration, although the sequestration be not actually awarded until a later date". Section 118 provides that the date from which the preferential

period is to be calculated is "the date of the award of sequestration". The Department say that where the date of the first deliverance and the date of the award are not the same the Department's practice has been to proceed on the basis of the latter date even though this can result in a reduction in the sum ranking as preferential. The Department advise us that on several occasions trustees have challenged the Department's interpretation of the date to be taken as governing the twelve-month period for preferential ranking and that in practice there is a considerable difference of opinion as to whether the twelve months' preferential period should be calculated from the date of the first deliverance or from the later date of the award of sequestration. We have given careful consideration to this question and, in view of the fact that there are obviously diverging views as to the correct interpretation of the existing statutory provisions, we have decided to recommend the inclusion in a new Bankruptcy Act of a provision for the avoidance of doubt. We therefore recommend that the new statute should provide that the twelve months' period for preferential ranking should be calculated from the date of commencement of sequestration, that is, the date of the first deliverance on any petition for sequestration or, in the case of a voluntary bankruptcy, from the date of registration of the declaration of insolvency in the register of bankruptcies.

Discharge without Composition

94. We received recommendations on this topic from the Law Society, the Bankruptcy Committee of the Institute of Chartered Accountants and the Accountant of Court. We also refer to the Report of the Blagden Committee on Bankruptcy Law Amendment[1] (paras. 53-78) and the Report of the Working Party on the Blagden Report (paras. 53-78).

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[1] 1957 Cmnd. 221

95. The major recommendations of the Law Society and the Chartered Accountants' Institute were for simplification of the statutory provisions and the adoption of a timetable specifying periods within which in varying circumstances the bankrupt could obtain his discharge. The main theme of the Blagden Committee was that the discharge of a bankrupt should be automatic and not dependent upon the action of the bankrupt in making application to the court. In our opinion both of these objectives are desirable.

96. The first matter of principle is to determine when the bankrupt should, without any requirement as to dividend or concurrence of creditors, be entitled to a discharge. The Law Society suggested 3 years from registration of the decree of bankruptcy; the Chartered Accountants' Institute and the Blagden Committee suggest 2 years from the date of the conclusion of the public examination of the bankrupt. The Working Party on the Blagden Report, however, suggested 4 years. We recommend a 3 year period after conclusion of the examination. Of course there would be a discretion in the court to defer discharge beyond that period in appropriate circumstances.

97. The next matter is to adjust the periods when earlier discharge would be competent. At the outset it is suggested that this would only operate where the bankrupt made application - only the 3 years discharge would be automatic. We recommend that the relevant periods should be:-

With concurrence of all creditors	Any time
With concurrence of majority in number and value of creditors and dividend of 50p per £1	12 months
With concurrence of majority in number and value of creditors and dividend of 25p per £1	24 months

and that the periods specified should be computed from the date

when the examination of the bankrupt was concluded. These views are arrived at after considering the advice given to us by the Law Society and the Institute; they appear to fit with the period of 3 years proposed in para. 96 supra. It is also suggested that the conditions for the two latter periods (12 months and 24 months) should include, not only the concurrence of a majority in number and value of the creditors, but also the consent of the trustee and the commissioners or of the Accountant of Court if there are no commissioners.

98. On the above basis the scheme of the legislation might be:-

(1) Every bankrupt who shall not already have obtained his discharge shall be automatically discharged three years after the date when the examination of the bankrupt has been concluded, provided that no bankrupt shall be discharged from a later bankruptcy while he is undischarged from an earlier bankruptcy.

(2) At any time within the foregoing period of three years the trustee may lodge in court a caveat against the bankrupt's discharge and the automatic discharge shall not apply when a caveat has been lodged.

(3) A bankrupt may apply to the court for a discharge at any time after his examination has been concluded.

(4) The court shall order service of the application upon the trustee and shall order intimation of the application in the Edinburgh Gazette and a newspaper circulating in the district where the bankrupt carried on business or resided.

(5) The trustee shall within 28 days after the service of the notice lodge in court a report upon the position of the bankrupt's affairs and the conduct of the bankrupt. The report shall contain particulars of the matters specified in the Schedule hereto.

Note. The Schedule will require:-

(a) a list of all the creditors and the amounts of their respective claims (in an appendix),

(b) the total amount of the bankrupt's unsecured liabilities,

(c) the amount which the property of the bankrupt has realised or is likely to realise (in an appendix),

(d) whether the trustee and the commissioners (or, if there are no commissioners, the Accountant of Court) and all the creditors or a majority in number and value of the creditors, concur in the application for discharge,

(e) whether, in the case of a debtor who was in business on his own account or as a partner, proper profit and loss accounts were prepared to a date within 18 months before the date of sequestration,

(f) whether income tax assessments on the bankrupt for the 6 years prior to the date of sequestration were based upon proper accounts and computations or upon estimates,

(g) whether, if proper balance sheets were prepared, the bankrupt's capital account in the last balance sheet prior to the date of sequestration was in debit, and

(h) any other particulars which the trustee may deem relevant to disposal of the application for discharge.

The report shall be engrossed in the sederunt book of the estate.

(6) Upon the hearing of the application the court shall take into account the trustee's report and shall hear any creditor who objects to the granting of the discharge. The trustee, on being notified of the date of the hearing, shall give notice of it to the creditors.

(7) (a) Subject to sub-paragraph (b) hereof the court may (i) refuse the discharge, (ii) defer the discharge for such period as it thinks proper or (iii) grant the discharge absolutely or subject to such conditions as it may consider reasonable.

(b) A discharge may be granted by the court

(i) at any time after the date when the examination of the bankrupt has been concluded provided that all creditors who have claimed in the sequestration concur in the application for discharge, or

(ii) not earlier than 12 months after said date provided that the trustee and the commissioners (or, if there are no commissioners, the Accountant of Court) and a majority in number and value of all such creditors concur in the application and the amount realised or likely to be realised from the property of the bankrupt is equal to at least one half of the amount of his unsecured liabilities, or

(iii) not earlier than 24 months after said date with the like concurrence as in (ii) above provided that the amount realised or likely to be realised from the property of the bankrupt is equal to at least one fourth of the amount of his unsecured liabilities.

(8) For the purposes of these provisions the report of the trustee shall be prima facie evidence of the amount which the property of the bankrupt has realised or is likely to realise and of the amount of his unsecured liabilities.

(9) A discharged bankrupt shall, notwithstanding his discharge, give such assistance as the trustee may reasonably require in the realisation of such of his property as is vested in the trustee and in the adjustment of claims by creditors. If he fails to do so the court may revoke his discharge but without prejudice to any transaction entered into subsequent to the discharge but before its revocation.

(10) A deliverance of discharge, whether automatic or otherwise, shall be signed by the court and an abbreviate of it shall be registered in the Register of Bankruptcies and the Register of Inhibitions and Adjudications and shall be published in the Edinburgh Gazette.

(11) The bankrupt shall have a right of appeal against the

refusal or deferment of a discharge or the conditions on which a discharge is granted.

99. In order to ensure that the Register of Bankruptcies will contain a complete record of the proceedings in a bankruptcy we propose that in all cases the trustee should, within 28 days of the date of conclusion of the bankrupt's examination, notify the Accountant of Court of that date and that the Accountant should then enter that date in the Register of Bankruptcies. We also recommend that the trustee should in every case be required to prepare a report on the bankrupt's conduct and to send a certified copy thereof to the Accountant of Court for inclusion in the Register within 3 years from the date of conclusion of the examination of the bankrupt.

100. We observe from the case of Henry Black - Petitioner 1964 S.L.T. 308 that there are certain cases where, owing to a breakdown in the statutory procedure, the bankrupt can only obtain his discharge by presenting a petition to the Court of Session in the exercise of its nobile officium. The Accountant of Court suggests that where the trustee in bankruptcy has been discharged and no report has been made by him on the bankrupt's conduct, or where no trustee has been appointed, provision might be made to enable the bankrupt to apply to the Sheriff for his discharge thus obviating the need for application to be made to the nobile officium of the Court of Session. We support this proposal of the Accountant's and accordingly recommend that in order to cover all possible cases a general provision should be included in the new Bankruptcy Act which would enable a bankrupt who has done all that is required of him to apply to the Sheriff for his discharge in any case where either no trustee has been elected, or where, owing to the failure of the trustee to comply with the procedure laid down in the Bankruptcy Act the statutory machinery whereby the bankrupt can obtain his discharge has broken down, or where, for some other reason for which the bankrupt is not responsible,

he is precluded from obtaining his discharge in the normal way and can thus only do so by presenting a petition to the Court of Session ex nobile officio. The only condition which we would attach to the bankrupt obtaining his discharge in this way is the provision that he must either have paid 25p in the £1 or have shown cause why he should obtain his discharge.

101. Before proceeding with our comments on various sections of the 1913 Act which comprise Part IV hereof, there are two proposals of a general nature with which we would like to deal.

Proposals as to the liability of the trustee on contracts

102. The Law Society point out that a trustee who takes up an executory contract into which the bankrupt has entered can at present incur personal liability. They suggest that where there are such contracts, provided the trustee has the approval of the commissioners, or where there are no commissioners an application for authority has been made by Note to the Sheriff and granted, the trustee should not be subjected to personal liability if he carries out the contract. On the other hand the Law Society consider that where the trustee himself embarks upon a new contract of any description he should incur personal liability for performance but should have a right of recourse against the bankrupt's estate, and we agree with this latter proposal.

103. We have given full consideration to the proposal to remove from a trustee in bankruptcy the personal liability which presently exists in respect of a contract entered into by the bankrupt and continued by the trustee. While we agree that it is illogical to require a trustee employed for a fee to become personally liable for what could well amount to a large sum in relation to that fee, and while we appreciate that the removal of the personal liability would be most welcome by all trustees, we are of the opinion that

the contracting party should not be obliged to risk the continuation of the contract by someone who may not have the knowledge, experience, labour and capital, limited as it would be to the funds in the estate, to carry out the contract to a satisfactory conclusion without some form of undertaking.

104. We have considered the possibility of providing that, on bankruptcy, all contracts which are not automatically terminated in terms of the particular contract be terminated. We consider, however, that such a change, while eliminating the requirement for a personal responsibility, would be inadvisable since it would give rise to many cases where the benefit of a contract, substantially completed by the bankrupt, could be lost to the estate. We recommend, therefore, that the proposal to relieve the trustee of personal liability on contracts should not be accepted and that the present situation should remain unchanged.

Disclaimer of onerous property by trustee or liquidator

105. We have given careful consideration to the question whether a statutory provision such as that existing in England empowering a trustee in sequestration or a liquidator of an incorporated company to disclaim onerous property of the bankrupt or of the company as the case may be could with advantage be introduced into the law of Scotland. We have come to the conclusion that, in the absence of public demand for such a provision and in view also of the impending changes in the law relating to feudal tenure, such a change in the law is not required. In order, however, that persons who may be consulted by the Scottish Law Commission may have a summary of the present law before them, we consider that it may be helpful to publish the Paper on this subject prepared by Professor J M Halliday, our Vice-Chairman, and accordingly include it in our Report as Appendix D.