SCOTTISH LAW COMMISSION

INSOLVENCY, BANKRUPTCY AND LIQUIDATION

CONSULTATION PAPER ON GIBSON v HUNTER HOME DESIGNS LTD

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A. INTRODUCTION

1. The Commission in the course of their examination of the law of bankruptcy have considered whether the law of Scotland operates fairly in the circumstances that arose in Gibson v. Hunter Home Designs Ltd[1]. The facts are straightforward. Missives were conclude for the sale of a house by a limited company to Mr Gibson, who took entry and paid the whole price without receiving in exchange the title deed, a feu disposition. In exchange for the price Mr Gibson received from the seller's solicitors a letter of obligation whereby they undertook to deliver the feu disposition within a period of one month. An order for the winding-up of the company was, however, granted before delivery could be made, and the liquidator refused to deliver the feu disposition to the purchaser. In these circumstances a special case was presented for the opinion and judgement of the Court of Session, the question at issue being whether (as Mr Gibson contended) the house had become his property at the date

[1] 1976 S.L.T. 94.

of commencement of the winding-up or whether (as the company and its liquidator represented) it remained in the ownership of the company at that date. The Court unanimously held that no right of property had passed to the purchaser and that the liquidator was not obliged to deliver the feu disposition to the purchaser.

2. The dispute in Gibson arose in a liquidation, but it can be confidently said that if a similar question arose in a sequestration the result would be the same. The first proposition put forward by the purchaser in Gibson was that the house had become his property at the commencement of the winding-up by virtue of the missives, payment of the price and actual entry to the house. The Court had no difficulty in rejecting the proposition, the Lord President stating that under the law of Scotland no right of property could pass to a purchaser of heritable property before delivery to him of a disposition. Until the moment of delivery he had no more than a right to demand performance of the contractual obligations. Lord Cameron agreed, and in his opinion he discussed the effect of section 327(1)(b) of the Companies Act 1948, which puts the liquidator in the position of an adjudger of the company's heritable property.[1] The relevant paragraph from Lord Cameron's opinion is as follows:-

[1]Section 327(1)(b) of the 1948 Act provides that "the winding up shall, as at the date [of commencement thereof], be equivalent to a decree of adjudication of the heritable estates of the company for payment of the whole debts of the company, principal and interest, accumulated at the said date ..."

> "The effect of the winding up order was clear. It brought into play s.327(1)(b) of the Companies Act 1948 which provides that it shall be the equivalent of a decree of adjudication of the heritable estates of the company being wound up for payment of the whole debts of the company subject to the preferable heritable rights and securities. A decree of adjudication has the legal operation and effect of a conveyance, in ordinary form, of the lands adjudged which thus enables the adjudger to complete a feudal title thereto, but an adjudger takes the subject tantum et tale as it is vested in the person of the debtor and subject to all the conditions and qualifications attaching to it. But this equivalent only applies to real conditions affecting the subjects itself and not to any personal obligation under which the debtor has come with regard to it. Thus, if the debtor is the beneficial owner, his personal obligation to convey the subjects to a third party even for onerous causes will not affect an adjudger. Even if the obligation has been so far implemented as by delivery of a conveyance or disposition an adjudger infeft before the disponee will be preferred. (See Graham Stewart on Diligence, pp.620, 621.)"[1]

The foregoing passage demonstrates that a liquidator - or a trustee in sequestration[2] - is, in a question with competitors for the heritable property of the debtor, not to be equated with a personal representative such as an executor or attorney - who would, of course, be bound by the contractual obligations of his constituent. The liquidator or trustee in sequestration is in the very different position of being an adjudger, and therefore subject only to the real burdens and conditions affecting the heritable property itself.

3. The purchaser's alternative submission was that even if the house still belonged formally to the company at the commencement

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[1] Gibson supra at p.97.

[2] Section 103 of the Bankruptcy (Scotland) Act 1913 likewise provides that "the sequestration shall, as at the date thereof, be equivalent to a decree of adjudication of the heritable estate of the bankrupt for payment of the whole debts of the bankrupt, principal and interest, accumulated at the said date ..."

of winding up, the whole beneficial interest in the property had passed to the purchaser when he completed payment of the price at the date of entry, and that the company thereafter held the property as a mere trustee for the purchaser. That submission, if successful, would have defeated the liquidator's claim to the property because there was unassailable authority that property held by a bankrupt on an ex facie absolute title but truly in trust for another person did not pass to the trustee in sequestration.[1] The same result would, it was accepted, follow in a liquidation. But the second submission was also rejected, the Lord President stating that the personal obligation undertaken by the sellers "clearly did not make nor did it purport to make the sellers at any time before completion of the contract a trustee of the subjects for the purchaser, or confer upon the purchaser the character or the rights of a trust beneficiary".[2] He added that there was "no evidence whatever of the constitution of a trust" and that it was "impossible to entertain the suggestion that mere entry to the subjects and payment of the price, both unequivocally referable only to the terms of the missives, in some way instructed the existence of a trust pending delivery of the disposition." Lord Cameron's opinion was to the same effect. The opinions contain a reference to the leading case of Heritable Reversionary Co. Ltd v. Millar,[3] where the bankrupt, although the owner on record of certain heritable property, had executed an unrecorded declaration that he held the property in trust for the company. The Court

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[1] Heritable Reversionary Co. Ltd. v. Millar (1892) 19 R. (H.L.) 43. It is irrelevant to the question at issue whether the trust is patent or latent.

[2] Gibson supra at p.97.

[3] Supra.

held that the property did not form part of the property of the bankrupt and so did not pass to his trustee. In the course of his opinion Lord Watson said:-

> "Were the subjects in dispute the property of [the bankrupt] within the meaning of that enactment, at the date of his sequestration? Upon the language of the statute, that appears to me to be a very simple question, admitting only of a negative answer. An apparent title to land or personal estate, carrying no real right of property with it, does not, in the ordinary or in any true legal sense, make such land or personal estate the property of the person who holds the title. That which, in legal as well as in conventional language, is described as a man's property is estate, whether heritable or moveable, in which he has a beneficial interest which the law allows him to dispose of. It does not include estate in which he has no beneficial interest, and which he cannot dispose of without committing a fraud."[1]

Lord Watson was careful to distinguish the case from that where the competitors with the trustee in sequestration or adjudger had (as in Gibson) "prior but merely personal rights to demand a conveyance from [the bankrupt]."

B. COMPARISON OF SCOTS AND ENGLISH LAW

4. A sequestration has the effect of an arrestment and furthcoming and a completed poinding of the funds and effects of the bankrupt[2] and (as has been noted) an adjudication of his heritable property.[3] A consequence of this is that the trustee in sequestration becomes, immediately on his appointment, the beneficiary of a universal diligence, and therefore able either to defeat at once or to compete with any other rights or titles in or to the bankrupt's

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[1] Heritable Reversionary Co. Ltd. v. Millar supra at p.49.

[2] Bankruptcy (Scotland) Act 1913, s.104.

[3] ib, s.103.

property that have not been completed or made real by the date of sequestration. The approach of English law is somewhat different. It expressly excludes from vesting in a trustee in bankruptcy property held by the bankrupt in trust for any other person[1] but, that apart,

> "The general rule is that the trustee in bankruptcy takes no better title to property than the bankrupt himself had. The bankrupt's property passes to the trustee in the same plight and condition in which it was in the bankrupt's hands, and is subject to all the equities and liabilities which affected it in the bankrupt's hands, to all dispositions which have been validly made by the bankrupt, and to all rights which have been validly acquired by third persons at the commencement of the bankruptcy."[2]

The reference to the bankrupt's property passing to the trustee "subject to all the equities" which affected it is of significance in relation to any contract by the bankrupt for the sale of his real property. This must be explained by reference to the system of law - equity - that was developed by the Court of Chancery to provide remedies where there was none or no adequate remedy at common law.[3] The only remedy under common law for breach of contract was an award of damages, but from early times equity assumed jurisdiction to compel a defaulting party to perform his contract where a mere award of damages would have been inadequate. The making of a contract for the sale of land gives the purchaser an "equitable" right in the land, and the law assumes that damages would not adequately compensate him for breach of contract and will,

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[1] Bankruptcy Act 1914, s.38(1).

[2] Halsbury's Laws of England (4th Edn.) Vol. 3 at p.328.

[3] The Supreme Court of Judicature Acts 1873 and 1875 (largely replaced by the Supreme Court of Judicature (Consolidation) Act 1925) provided for the fusion of law and equity.

if necessary, order specific performance against the vendor.[1] None of this is different in effect from Scots law - where specific implement will, of course, be ordered against a seller of land who is unwilling to proceed with the contract[2] - but English and Scots law take very different roads in the event of the bankruptcy or liquidation of the seller before the contract has been carried to its conclusion. The result under Scots law has already been noted,[3] whereas under English law the result of the vendor's bankruptcy is that "the legal estate in the property agreed to be sold vests, as a rule, in his trustee in bankruptcy, subject, nevertheless, to the equitable title of the purchaser to have the estate conveyed to him on payment of the purchase price".[4] It will

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[1] Chitty, Contracts (24th edn.),p.1635. In Oughtred v. Inland Revenue Commissioners [1960] A.C. 206 it was stated (at p.240) that "[the purchaser] is treated in equity as entitled by virtue of the contract to the property which the vendor is bound under the contract to convey to him."

[2] The seller will not be permitted the option of payment of damages and the Court will, if necessary, authorise the clerk of court to subscribe in place of the seller the disposition of the subjects of sale - see Mackay v. Campbell 1966 S.L.T. 329; 1967 S.L.T. 337.

[3] See paragraphs 1 to 3 above.

[4] Halsbury's Laws of England (4th Edn.) Vol. 3 at p.377. See Ex Parte Holthausen (1874) 9 Ch.App. 722,where the question was whether an equitable mortgage was binding on a trustee in bankruptcy James L.J. stated (at p.726) "that the law of England is, that, with certain exceptions, the trustee in bankruptcy is bound by all the equities which affect a bankrupt or a liquidating debtor; that is to say, if a bankrupt or a liquidating debtor, under circumstances which are not impeachable under any particular provision connected with his bankruptcy or insolvency, enters into a contract with respect to his real estate for a valuable consideration, that contract binds his trustee in bankruptcy as much as it binds himself." But the purchaser can demand a conveyance only if, after the adjudication of bankruptcy, he pays the purchase price or the outstanding balance to the trustee and not to the bankrupt, it being immaterial in this connection whether the purchaser had notice of the adjudication or otherwise (Ex parte Rabbidge [1878] 8 Ch.D.367).

be apparent therefore that a contract for the sale of the bankrupt's real property is binding upon the trustee because of the equitable right which the making of the contract has conferred upon the purchaser, and that it is immaterial whether he has paid the price or any part thereof to the vendor before his bankruptcy.[1] The binding effect upon a trustee in bankruptcy of a contract for the sale of the bankrupt's real property is simply one manifestation of the general rule that equitable rights which are pleadable against the bankrupt are likewise pleadable against his trustee.

5. If the rule of English law were rigidly enforced against a trustee in bankruptcy it might sometimes result in actual loss or injury to the bankrupt's estate. Indeed, it is easy to figure cases where the available resources would be insufficient for the carrying through of the contract. The rule is therefore qualified by the provisions of section 54 of the Bankruptcy Act 1914, which entitles a trustee in bankruptcy to "disclaim" onerous or unprofitable contracts or property of the bankrupt. The leading provisions of section 54 (which is a long and somewhat involved section) are to the following effect:-

(1) A trustee in bankruptcy is entitled to disclaim any real or personal property or any contract of the bankrupt

[1] A constructive trust in favour of the purchaser arises when a contract for the sale of land is concluded (Oughtred v. Inland Revenue Commissioners [1960] A.C. 206 per Lord Jenkins at p.240) but the trusteeship of the vendor is qualified by his own beneficial interest in the property until the price is paid (see eg Rayner v. Preston [1881] 19 Ch.D. 1, C.A., at p.13 per James L.J.; Ex parte Rabbidge supra per Cotton L.J. at p.371).

where retention of the property or the carrying out of the contract would be burdensome or unprofitable.[1] Disclaimer must normally be made within the period of twelve months after appointment of the trustee. (subsection (1)).

(2) The effect of disclaimer is to terminate "the rights, interests, and liabilities of the bankrupt and his property in or in respect of the property disclaimed" and to discharge the trustee from personal liability in respect of the disclaimed property. Except in so far as is necessary for the foregoing, disclaimer does not affect the rights or liabilities of any other person. (subsection (2)).

(3) Disclaimer of a lease will normally require the leave of the court. (subsection (3)).

(4) A person interested in any property of the bankrupt may seek an accelerated decision from the trustee as to whether he will disclaim the property or otherwise. (subsection (4)).

(5) The court may, on the application of any person interested in any disclaimed property, make such order as seems just for the vesting of the property in or its delivery to any person entitled thereto or to whom it may seem just that it should be delivered as compensation. (subsection (6)).

(6) Any person injured by the operation of a disclaimer may prove the injury as a debt under the bankruptcy. (subsection(8)

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[1] A contract is not to be regarded as "unprofitable" simply because the estate could derive greater benefit if the contract were not carried out. There must be release from some burden (Re Bastable [1901] 2 K.B. 518). Accordingly, a trustee in bankruptcy cannot disclaim a contract of the bankrupt for the sale of a lease unless he also disclaims the lease itself.

Accordingly the principal effects of section 54 are (a) to enable a trustee in bankruptcy to prevent the vesting in him of any property of the bankrupt to which some burdensome obligation attaches, and (b) to permit any person prejudiced by the disclaimer to establish (where appropriate) his right to the property and prove for any loss in the bankruptcy.

6. The rules in the liquidation of a company registered in England are similar to those above described. It seems therefore that had a case similar to Gibson arisen in England, the liquidator could have been required to deliver the conveyance to the purchaser if that was the only outstanding obligation upon the company. But an English trustee or liquidator could, it seems, disclaim as onerous a contract for the sale of property where (say) part of the purchase price had been paid to the bankrupt or insolvent company (and was beyond the reach of the trustee or liquidator), and the balance of the price was less than the amount of a mortgage that the seller had undertaken to discharge. The disclaimer would entitle the purchaser to obtain an order vesting the property in him but he would, of course, require to pay more than the balance of the price in order to satisfy the outstanding charge. Nevertheless, he would probably be better placed than a Scottish purchaser in similar circumstances, who could neither compel the trustee or liquidator to implement the contract nor claim the burdened property. The relevant distinction between English/law and Scots law is therefore that under English law a person who has contracted to buy (say) a house has an equitable right in the property that bankruptcy cannot destroy, whereas under the Scottish rules he would have no more than a right under a contract that a trustee in sequestration is not obliged to adopt.

C. WHAT CHANGES SHOULD BE MADE IN THE LAW

7. Any approach to this problem must take account of the implications for other creditors of protecting any special class of creditors. To protect purchasers in all sales of property, specific or unspecific, would favour creditor-purchasers as a class at the expense of creditor-sellers, and would derogate from the fundamental principles of Scots law governing the vesting in the trustee of the bankrupt's estate. There would also be an increased risk of fraud. The restriction of any remedy to sales of specific property, or to specific property of any particular class, would be open to similar objections, though the practical effect of the derogation from the principles of vesting would diminish as the excepted class of transactions was narrowed. The question, therefore is whether there are any particular cases where the hardship to the individual is so evident or flagrant that an exception to the general principles of vesting is desirable.

8. One such case, in our view, clearly calls for consideration, namely where the bankrupt before sequestration has delivered to the purchaser a title which he may complete without any further action on the part of the bankrupt or his trustee. If the purchaser has in fact failed to complete title before the sequestration or the appointment of the trustee it would seem that under existing law the trustee may acquire or complete a title to the property

in his own name, and so defeat the right of the purchaser.[1] In our view this result is unjust: whatever the nature of the property, most people would regard it as

> "estate in which the bankrupt has no beneficial interest and which he cannot dispose of without committing a fraud",

the criterion for exclusion from vesting in the trustee enunciated by Lord Watson.[2] On that view of the matter, there seems to be no justification for permitting the trustee to compete with the purchaser.[3] In our view, therefore, where a purchaser for value holds an uncompleted title granted by the bankrupt to property of any kind, the trustee should not be entitled, by completing a title before the purchaser, whether by recording or otherwise, to defeat the latter's right.

9. The protection which we propose should be afforded to the purchaser with an uncompleted title would be limited. The trustee's duty would be purely one of non-interference and so he could not be required to secure the discharge of a heritable security. The purchaser's right quoad the bankrupt in this respect would be

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[1] See e.g. Mitchells v. Ferguson 1781, M.10296; Melville v. Paterson (1842) 4 D.1311 per Lord Ivory at p.1315; Smith v. Frier (1857) 19 D.384; Heritable Reversionary Co. Ltd. v. Millar, supra; see also Tod's Trustees v. Wilson (1869) 7 M.1100 (but cf. Watson v. Duncan (1879) 6 R.1247 per Lord Deas at p.1252). In relation to heritable property the trustee's entitlement follows from the fact that he is placed not in the position of a universal successor such as an executor but in that of an adjudger (see Mitchells v. Ferguson and paragraphs 2 and 3 above).

[2] See Heritable Reversionary Co. Ltd. v. Millar supra at p.49.

[3] See footnote (c) at page 251 of Goudy, Bankruptcy (4th Edn.), where he states that Lord Watson's definition "would seem to exclude property sold by the bankrupt upon a delivered conveyance which has remained unrecorded" but notes that this runs counter to authority. The Encyclopaedia of theLaws of Scotland (Vol.13 at p.404) asserts, but without any citation of authority, that in such a case the property does not pass to the trustee.

converted into a claim for damages in the sequestration.[1] The Commission invites comments on these proposals.

10. The situation, however, in Gibson differed from that discussed in paragraphs 8 and 9 in that the purchaser held not a disposition but merely a letter of obligation for delivery of a disposition. Thus the two cases differ in respect that in the case discussed in paragraphs 8 and 9 the purchaser can complete his title without any assistance from the trustee, whereas in the circumstances of Gibson he cannot do so without an act on the trustee's part. It seems more difficult to concede that in the latter situation the purchaser should have a higher right to demand performance than creditors in other obligations. The purchaser's problems may have arisen by reason of a departure from normal practice in the buying and selling of property. For example, it might be open to a purchaser to protect himself by obtaining from the seller a declaration that he holds the property in trust for the purchaser during the interval between payment of the price and the delivery of the conveyance. This would entail that the estate purchased would not vest in the trustee and, in consequence, that the purchaser would be protected to that extent. There might, of course, be other hazards, such as a defect in the seller's title or heritable securities whose discharge would be prevented by the sequestration.

11. We have asked ourselves, indeed, whether irrespective of the execution of a deed of trust, a bankrupt seller who has received

[1] The purchaser might, of course, be protected by a letter of obligation granted by the bankrupt seller's solicitor.

payment of the price might, following Stevenson v. Wilson,[1] be held to stand in a fiduciary relationship to the purchaser. We doubt, however, whether the ratio in that case can be so far extended.[2] It would obviously assist purchasers in situations analogous to those in Gibson if the law were to impute the existence of a trust relationship between the seller and the purchaser. But it would be anomalous to apply such a rule to cases where the purchaser's title to property has not been completed by reason of the seller's failure to deliver the title and not to cases where the purchaser's misfortune has been occasioned by the seller's failure to deliver the property itself, as in a sale of goods where (say) payment is made before delivery but the passing of ownership is deferred till the latter event. To extend, however, protection to purchasers of goods would be grossly subversive of the equality of creditor-purchasers and creditor-sellers in a sequestration situation. We conclude, therefore, that the use of the device of an implied trust to protect purchasers in the situation in Gibson would be unjustified. We would welcome, however, comments on this conclusion.

12. Another option, of course, would be to empower any purchaser of property to require the trustee to complete the bargain where the purchaser has paid or offers to pay the price or any outstanding balance. The trustee, for his part, would have a choice between (a) fulfilling the contract, and (b) disclaiming the property in

[1] 1907 S.C. 445.

[2] In Stevenson the seller had executed and delivered a transfer of shares to the purchaser, and the circumstances were unusual.

accordance with a scheme based on section 54 of the Bankruptcy Act 1914. The second alternative might be achieved more simply by permitting the trustee to convey the property in its existing condition (subject to any defects in the title and existing securities etc) to the purchaser without consideration but entirely at the latter's expense. Once again, however, this proposal is open to the objection that it favours creditor-purchasers as against creditor-sellers. The facility could no doubt be restricted to purchasers of certain types of property, in particular heritable property, and possibly to specified classes of purchasers, for example, the purchasers of dwelling-houses for personal occupation, who may suffer exceptional hardship in the kind of situation that arose in Gibson. The creation, however, of preferences in favour of all or some purchasers may be thought to introduce indefensible anomalies into the law. We would welcome, nevertheless, comments on this conclusion and suggestions for alternative devices to protect purchasers in the circumstances discussed in this paper.

13. The Commission would be grateful for comments upon the proposals in paragraphs 8 and 9 of this paper and upon the questions in paragraphs 11 and 12. Comments should be addressed to Mr A J Sim, Scottish Law Commission, 140 Causewayside, Edinburgh EH9 1PR. It would be helpful if comments could be submitted by 31 July 1979.

Scottish Law Commission
140 Causewayside
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May 1979

NOTE/

NOTE OF PROPOSALS OR QUESTIONS ON WHICH OBSERVATIONS ARE INVITED

1. The Commission propose that where a purchaser for value holds an uncompleted title to any property granted by a bankrupt before the date of sequestration, the trustee in sequestration should not be entitled, by completing a title before the purchaser, whether by recording or otherwise, to defeat the latter's right. (paragraphs 8 and 9).

2. Should a seller who has received payment of the price of any property be deemed to hold the property thereafter as trustee for the purchaser? (paragraph 11).

3. Alternatively, where a bankrupt has contracted to sell any property, should the purchaser be entitled to insist upon completion of the contract by the trustee in sequestration, the trustee having the option of doing so or of "disclaiming" the property? Should any such entitlement apply only to (a) specified types of property, or (b) specified classes of purchasers? (paragraph 12).