SCOTTISH LAW COMMISSION

INSOLVENCY, BANKRUPTCY AND LIQUIDATION IN SCOTLAND

CONSULTATION PAPER

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1. On 27 November 1971 the Commission issued Memorandum No 16 containing the Report by the Working Party appointed to examine the law relating to insolvency, bankruptcy and liquidation in Scotland. The Commission invited comments upon the proposals of the Working Party before submitting their own Report. The comments received on the Working Party's Report have raised important questions of principle, the implications of which were not fully examined in the Report and upon which, in consequence, the Commission wish to obtain further views.

Introduction of Official Trustee

2. Having considered the case for the introduction into Scotland of a service analogous to that of the Official Receiver in England, the Working Party suggested that the advantages of the English system could be obtained more economically by instituting a register of practising accountants and solicitors who would be prepared to act as trustee, the costs and remuneration of the trustee being met from a state fund in cases where the assets of the bankrupt's estate were insufficient.*

3. The comments which we have received indicate that there is general support for the provision of a system which would secure the appointment of a trustee in all sequestrations. While most commentators favoured the Working Party's proposal to institute a register of accountants and solicitors, a few, including the Registrar of Friendly Societies and the Insolvency Service of the Department of Trade and Industry, strongly

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* Memorandum No 16, paragraphs 30-36

advocated the introduction of Official Receivers. In this way a trustee would be available in all sequestrations with some incentive to carry them through to a conclusion.

4. We have thought it right, therefore, to consider at least in outline, what might be the duties, in the Scottish system of bankruptcy, of an Official Receiver (whom we propose, in accordance with earlier usage in Scotland, to describe as an "Official Trustee") and to consider the advantages and disadvantages of a system of Official Trustees as compared with the institution of a register of professional persons prepared to act.

5. If a system of Official Trustees were introduced we consider that, in the case of petitions on the part of the debtor, the Court, if the necessary conditions for sequestration obtain, should automatically appoint as trustee in the sequestration, the Official Trustee, or in the remoter areas, an ad hoc deputy trustee taken from a list prepared by the Official Trustee. In the case of a creditor's petition the Court would appoint the Official Trustee or a deputy as interim trustee leaving it to the creditors, at their first meeting, to apply to the Court either to confirm the interim trustee in office or to appoint another named person as trustee It is envisaged that, once appointed as interim trustee, the Official Trustee would have powers and duties similar to those of a judicial factor appointed for the interim preservation of the estate. Emphasis, however, would be placed upon his interviewing the bankrupt, receiving the bankrupt's own statement of affairs, preparing an interim statement of affairs for production at the first meeting of creditors, and investigating the conduct of the debtor with a view to advising the Lord Advocate or Procurator Fiscal when he has reason to believe that the debtor in the conduct of his business committed offences under common law or statute. When appointed (permanent) trustee, the duties of an Official

Trustee would be similar to those of a private trustee in a sequestration. It is thought that, even in cases where the Official Trustee is superseded by another trustee appointed by the creditors, the investigatory role of the Official Trustee in relation to frauds should continue. It seems desirable that the investigation should proceed.

6. Quite apart from the desirability of harmonising bankruptcy procedures in the United Kingdom there are a number of practical arguments in favour of the introduction of a system of Official Trustees. These, it might be suggested, include the following:-

(a) Investigation of fraudulent conduct on the part of bankrupts could be undertaken more effectively by a trustee occupying an official position and belonging to a service which would accumulate specialised knowledge. They could act in close liaison with the police. This would facilitate, in appropriate cases, the prosecution of fraud.

(b) If a system of criminal bankruptcy on the lines of that introduced in England by the Criminal Justice Act 1972 ss. 7-10 is extended to Scotland, the existence of an Official Trustee would facilitate its operation.

(c) Since in many cases the costs of the trusteeship would be borne entirely or preponderantly by the state, it seems right to employ public officers appointed directly by the state.

(d) The Official Trustee would be immediately available in any sequestration. It would be unnecessary to compile and maintain registers of professional trustees for each sheriff court and possible delay in securing the services of a professional trustee would be avoided.

(e) The Official Trustee would prepare reports of sequestrations on a uniform system and would provide better statistical information.

(f) The introduction of an Official Trustee, except in the case of a petition by the bankrupt himself, would not restrict the freedom of creditors to appoint a professional trustee of their choice.

7. The principal reason for the Working Party's preference for establishing registers of professional practitioners who would undertake the duties of trustee was an economic one. They estimated that setting up a system of Official Trustees would be much more costly. They further envisaged that there might be difficulties in recruiting staff, with adequate knowledge and experience, in sufficient numbers.

8. In our view the principal objection to the introduction of an Official Trustee service into Scotland would be its cost both to the creditors and to the public at large. This cost is not easy to quantify, because costs will clearly depend upon the administrative structure of the service, the extent to which it is utilised, and the financial criteria for the admissibility of sequestration. The Insolvency Service of the Department of Trade and Industry suggest that, since the average number of ordinary and summary sequestrations in Scotland during the period 1967-1971 was less than 120 per annum, the staff required in Scotland should correspond with that required in one of the 35 local Official Receivers' Offices in England. The office at Nottingham was suggested for the purposes of comparison. On a similar case-load, the staff consisted of one Official Receiver, one Assistant Official Receiver, six examiners, and supporting staff. It was suggested that Scotland might be served from a single office situated in Glasgow, possibly with interviewing rooms at Aberdeen and Inverness. It must be

borne in mind, however, that the provision of a state system might result in an increase in the number of sequestrations. The Official Trustee would be appointed in cases where today no appointment is made because the assets are insufficient to provide for the adequate remuneration of a private trustee. If, moreover, the legislation which we propose in paragraph 16 hereof were introduced providing for the compulsory registration of voluntary trust deeds, this would have the effect of increasing the number of formal sequestrations and reducing the number of trust deeds. This trend is likely to be marked in remote areas. The attached Schedule gives some indication of the expenses which might be involved respectively in establishing an Official Trustee service and in utilising the services of practitioners. An Official Trustee service would appear to be considerably more costly whether or not the number of sequestrations increases.

9. Apart from the cost of the service, consideration must be given to the possibility of attracting staff of the appropriate calibre to the work and the practicability of offering them appropriate training and opportunities of advancement. Having regard to the wide differences between the laws of England and Scotland in so many areas relevant to their work, not only in the law of bankruptcy, but in the law of obligations, prescription, heritable and moveable property, diligence and the criminal law, we do not believe that it would be practicable, even if it were otherwise desirable as affording to its members a better career structure, to have a system of interchangeability with members of the Insolvency Service of the Department of Trade and Industry. Our tentative view, on which we desire comments, is that the staff should be recruited initially at least from persons who have acquired some knowledge of Scots law, for example, from members of the accountancy or the legal

professions or from members of the Department of Registers of Scotland or the Sheriff Clerk's Service. For junior staff, training would be necessary in the relevant aspects of Scots law.

10. A further consideration relevant to the possible introduction of an Official Trustee service is the convenience of creditors and their advisers and of the bankrupt himself. We have explained that the Insolvency Service of the Department of Trade and Industry have suggested that the whole territory of Scotland might be served by a single office situated in Glasgow. The staff, where necessary, would travel to the court of the sequestration and it is envisaged that interviewing rooms might be located at Aberdeen and Inverness. It is arguable, nevertheless, that the centralisation of the administration of bankruptcy in Glasgow would impose considerable inconvenience upon those concerned with bankruptcy in places at any considerable distance from Glasgow. Some Sheriff Courts are so remote from Glasgow that even a brief visit may involve more than one day's absence. This inconvenience could be mitigated if the Official Trustee were authorised to nominate local deputies who could be appointed to deal with cases in the remoter parts of Scotland. This, however, would amount to a partial acceptance of the alternative system proposed by the Working Party. It is clear, whatever the administrative structure envisaged for the system of Official Trustees, that it will not be easy to reconcile the need to reduce administrative expense with the need to consult the convenience of those in the remoter parts of Scotland.

11. An additional question is whether it would be desirable to establish another agency (in addition to the Crown Office and the Police) having powers of investigation into alleged fraudulent conduct with a view to prosecution. If that question is answered affirmatively there would

require to be legislative provision for the appropriate powers, the necessary liaison between the bodies concerned and appropriate safeguards.

It is at present uncertain whether any system of criminal bankruptcy is likely to be introduced in Scotland. Such a system would, in any event, lie outside the mainstream of bankruptcy law and in Scotland somewhat different procedures might be proposed than those which have been evolved in England. One possible expedient might in appropriate cases be to make provision for appointment of a judicial factor on the assets of the criminal and other property found in his possession.

12. The Commission would welcome views as to the validity and weight of the various arguments for and against the introduction of an Official Trustee service into Scotland.

Voluntary Trust Deeds

13. The Working Party in its Report (paras. 37-38) recommended that the existing methods of administering the affairs of insolvent persons by voluntary trust deeds should be replaced by a system of voluntary bankruptcy initiated by the insolvent person himself. The main reasons advanced by the Working Party for superseding voluntary trust deeds were the absence of public information about the debtor's state of insolvency, the lack of any effective means of disciplining either the debtor or the trustee, the fact that a creditor not acceding may claim a dividend while refusing to accede to certain conditions of the deed, the fact that he may set at naught the procedure by applying, if qualified, for sequestration, and the fact that there are no effective means for compelling the creditors to grant the debtor a discharge.

14. The Commission appreciate that voluntary trust deeds are subject to these disadvantages but find difficulty in justifying prohibiting their use. If the system merely had disadvantages, it might have been expected to have fallen largely into disuse. We have no accurate figures relating to the number of such trust deeds but, in 1910, the Cullen Committee[1] estimated that three or four estates were wound up under trust deed for every estate wound up under sequestration. Not all trust deeds are advertised but the Accountant of Court has noted the advertisement of 416 private trust deeds over the period 1967-1971, during which there were 368 ordinary and 204 summary sequestrations. The method, therefore, remains a popular one despite its apparent disadvantages. The reasons are to be found in the greater discretion afforded to the trustee to adapt the winding up to the circumstances of the debtor, his freedom from precise compliance with the rigid procedural requirements of a sequestration, and, from the debtor's standpoint, the relative privacy of the procedure. It seems likely that, even if voluntary trust deeds were formally banned, there would still be occasional resort to them. To impose such a ban, in any event, would constitute in our view an unreasonable interference with freedom of contract.

15. The effective choice, therefore, lies between retaining the voluntary trust deed procedure in its present form and modifying it by legislation to remove some at least of its associated disadvantages. The Cullen Committee considered the same problem and concluded that it would be inadvisable to regulate private trust deeds: "To enact that all windings up under trust deed must in future lose their voluntary character by being subject to a variety of statutory regulations providing inter alia for the coercion of a minority by a majority, appears to us to be inexpedient. The assumption of the witnesses who support such proposals is that,

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[1] Cd. 5201 (1910)

notwithstanding the making of so radical a change in their character, trust deeds would maintain their present popularity, while acquiring an enhanced effectiveness. We feel unable to accept this assumption". [Cd. 5201 (1910), p.11]. The Commission's tentative opinion is that this conclusion is unsatisfactory. It was not shared by most witnesses who gave evidence to the Committee and was subsequently criticised by experienced practitioners, including John Burns ["Bankruptcy Reform", 29 S.L.R. (1913) p.153]. In our view, some regulation of voluntary trust deeds would be desirable not only in the public interest, but in that of the parties to the deeds. The difficulty is really one of determining precisely what degree of regulation is desirable, if it is considered proper to retain the system of voluntary trust deeds as a viable option to sequestration, particularly for country districts.

16. The Commission, therefore, suggests that in relation to voluntary trust deeds legislation might provide for some at least of the following matters -

(1) a definition of trust deeds to which the legislation applies;

(2) a requirement of approval by the debtor and by a majority in number and a majority in declared value of the creditors present at a meeting specially convened for the purpose;

(3) the granting by the trustee of caution or security for his intromissions;

(4) the registration of the trust deed in the Central Register of Bankruptcies;

(5) the registration of the trust deed to constitute an act of notour bankruptcy;

(6) the limitation of the right of a creditor to sequestrate to a period of one month after the registration of the trust deed;

(7) the reduction of gratuitous alienations and fraudulent preferences, the equalisation of diligence, and the application of bankruptcy rules relating to the valuation of securities and ranking of claims;

(8) the submission of accounts by the debtor, and his public examination if required by the trustee;

(9) power to the trustee and to the Accountant of Court to apply for the debtor's sequestration;

(10) the powers of sale of the trustee;

(11) the duty of the trustee to submit accounts to the debtor, the creditors and the Accountant of Court;

(12) the trustee's fee and expenses to be a prior claim in any subsequent sequestration;

(13) the discharge of the trustee and the debtor; and

(14) invalidation of an unregistered trust deed coming within the class of deeds to which the legislation applies.

The Commission appreciate that the effect of these proposals, if implemented, might be to reduce the number of trust deeds, since they would lose some of their present advantages in the eyes of creditors and of the bankrupt himself. The proposals are designed, however, to improve the effectiveness of the procedure where it is adopted.

17. The Commission invite views upon these suggestions and also upon any other improvements in the voluntary trust deed procedure which might be desirable.

Voluntary Bankruptcy

18. The Working Party in its Report (paragraphs 38 to 44) proposed the introduction of a new procedure of voluntary bankruptcy designed to supersede the procedure by way of voluntary trust deed for creditors. If voluntary trust deeds are to remain available, the need to introduce the proposed procedure of voluntary bankruptcy requires reconsideration. The suggestions in this Paper in relation to voluntary trust deeds incorporate many of the features of the Working Party's proposals in relation to voluntary bankruptcy, and the introduction of a system of voluntary bankruptcy in addition to modifying voluntary trust deeds and the procedure of judicial sequestration may be thought to be unnecessary.

19. Many of those who commented upon Memorandum No 16 expressed approval of the proposed voluntary bankruptcy procedure, but the Commission now invite views as to whether its introduction would be necessary if effect were given to the suggested changes in the procedure relating to voluntary trust deeds.

20. This paper is designed to promote discussion of the tentative proposals it contains. It does not represent the final views of the Scottish Law Commission. The Commission would be glad to have comments which should be addressed, preferably before 31 August 1974, to Mr J B S Lewis, Scottish Law Commission, Old College, South Bridge, Edinburgh EH8 9BD.

SCHEDULE

POSSIBLE COSTS OF OPERATING IN SCOTLAND

(a) AN OFFICIAL TRUSTEE SERVICE

(b) A PRIVATE PRACTITIONER SERVICE

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1. It will be appreciated that the estimates of costs in this Schedule are necessarily tentative and are dependent upon various assumptions.

2. The principal assumptions are:-

(a) That the introduction of provision for a trustee, whether the Official Trustee or a practitioner trustee, in all sequestrations would increase the total number of sequestrations.

(b) That the suggested legislation relating to voluntary trust deeds would probably reduce the number of such deeds but would increase the number of formal sequestrations, and that thi trend would probably be particularly obvious in the case of the remote areas.

(c) That the expense of an Official Trustee service in Scotland would be greater than in the case of a district office, such as the Nottingham Office, in England handling an equivalent number of sequestrations because, as in the case of the Department of Trade and Industry headquarters in London, a structure of senior officials would be required to carry out the necessary investigations for the purpose of reporting upon possible prosecutions in the High Court.

(d) That the expense of an Official Trustee service in Scotland would be increased since there would be greater travelling distances involved than in the case of a local district office in England.

(A) Estimated Costs of Official Trustee Service

3. The General Annual Report of the Department of Trade and Industry 1972 relating to Bankruptcy discloses that the total number of receiving orders and administration orders issued in England and Wales in 1972 was 3884 (Table 1) but over the years 1970-1972 the average annual number exceeded 4,000. In relation to population it might have been anticipated that in Scotland the number of bankrupt estates would have been about 400 per annum. In fact the Accountant of Court's records show that the number of sequestrations in Scotland is slightly in excess of 100 yearly. The principal reason for the difference appears to be the existence of the Official Receiver service in England Out of a total of 3,048 bankrupt estates administered by Official Receivers 1,855 (61% of the total) had assets of a value of £100 or less (Table 5). In Scotland, where there is no public bankruptcy service, it seems probable that a large proportion of cases where the assets do not exceed £100 do not result in sequestration proceedings. If it is assumed that on the introduction of a public bankruptcy service in Scotland, the number of bankruptcies would increase upon the English pattern, the total number might reach 400 of which 300 might be small value cases.

4. In relation to a maximum caseload of 300 per annum (the remaining 100 larger value cases being administered mainly by professional trustees), we have estimated the number of staff which might be required. We have also taken advice as to the Civil Service gradings

which would be appropriate for the various members of staff who might be required in order to operate an Official Trustee service in Scotland. Based on the experience of staff requirements in England, with some slight upward adjustment for Scotland to allow for the effect of the assumptions (c) and (d) in paragraph 2 of this Schedule, the staff of different grades required for an Official Trustee service in Scotland might be:-

Cases	Director	Official Trustee	Assistant Trustee	Examiner	Office Manager	Totals
100	1	2	1	8	1	13
300	1	4	2	12	1	20

In addition there would be supporting typing and junior staff. On this basis, and on the basis of costs experience in England, the net cost of operating the service in Scotland might be of the order of £80,000 to £100,000 if the number of cases continued at around 100 per annum (which may be regarded as minimal) and £120,000 to £140,000 if the number of cases increased to 300 per annum (which may be regarded as the maximum). From these sums there would require to be deducted the fees or commissions recoverable from assets which might reduce the nett cost of the service to £75,000 to £80,000 on the basis of 100 cases and to £105,000 to £125,000 on the basis of 300 cases. It might, however, be possible to reduce these costs further if the work of the Official Trustee service could be associated with that of an existing department in Scotland. Consideration might also be given to the possibility of the Official Trustee being empowered to nominate deputes from lists of qualified chartered accountants or of solicitors for the purpose of providing a service at an economic cost in areas outwith the central belt of Scotland.

(B) Estimated Costs of Private Practitioner Service.

5. The majority in number of estate s wound up by the Official Receiver in England were of a value of less than £100. It would be reasonable to assume that a similar pattern would emerge in Scotland: any form of state financed service would tend to deal mainly with the cases where assets were insufficient to meet the fees of a professional trustee. It further appears from the Report (Table 6) that on average estates of which the total value was less than £100 which were wound up by non-official trustees involved greater expense in winding up than the available assets. If cases where the assets were less than £100 may be taken as typical it appears from Table 6 that on average the costs of winding-up 52 estates by non-official trustees were approximately 200% of the value of the estate. If the proportion of estates of small value was 75% and the total number of sequestrations is 100 per annum there would be about 75 cases where the nett costs of winding-up would exceed the value of the estate. On the basis that the average nett cost in each case after allowing for the value of the assets is from £100 to £150 the cost of the service annually would not exceed £10,000. If the total number of sequestrations increased to 400 (300 low value cases) the total cost might be of the order of £30,000 to £40,000.