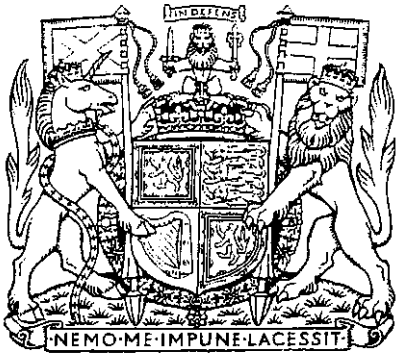

SCOTTISH LAW COMMISSION

MEMORANDUM NO . 50

FOURTH MEMORANDUM ON DILIGENCE :
DEBT ARRANGEMENT SCHEMES

October 1980

This Memorandum is published for comment and criticism, and does not represent the final views of the Scottish Law Commission.

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SCOTTISH LAW COMMISSION

MEMORANDUM NO. 50

FOURTH MEMORANDUM ON DILIGENCE: DEBT ARRANGEMENT SCHEMES

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SCOTTISH LAW COMMISSION

Memorandum No. 50

Fourth Memorandum on Diligence: Debt Arrangement Schemes

PART I: THE NEED FOR DEBT ARRANGEMENT SCHEMES

A. The problem of wage-earners' insolvency

1.1 In this Memorandum, we seek views on proposals for the introduction in Scots law of new procedures, called debt arrangement schemes, designed to assist a wage earner with multiple debts to make orderly and regular payments of the debts to his several creditors.[1] Every year in Scotland, many ordinary wage or salary earners become insolvent, that is to say, unable to pay their debts as and when they fall due. There are no directly relevant statistics, but the numbers are likely to be measured in thousands. The research into debtors' circumstances initiated on our behalf by the Central Research Unit of the Scottish Office throws much light on the causes of debt of ordinary wage-earners.[2] This research suggests that in most cases of consumer insolvency or multiple debt, several of the manifold causes of default debt are often intermingled, and frequently the default is a manifestation of a wider deprivation and misfortune. It also suggests that in most of those cases, the debtor has been unfortunate or unwise, but in no sense fraudulent or dishonest. Moreover, the debtor will often be quite unable to handle the financial crisis by himself.

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[1] This Memorandum is the fourth of five Memoranda (Nos. 47 to 51) on diligence issued on the same date. The scope and thrust of these Memoranda and future Memoranda on diligence are described in our First Memorandum on Diligence, Memorandum No. 47.

[2] See especially Adler and Wozniak, "The Origins and Consequences of Default - An Examination of the Impact of Diligence", Research Report for the Scottish Law Commission No. 5. Central Research Unit Papers (1980).

1.2 We consider that there is a gap in the provision made by the law of Scotland for helping ordinary wage-earners in multiple debt situations to arrange for the payment of their debts in the interests both of the debtor and his several creditors. Most insolvent wage-earners in Scotland have insufficient assets to make sequestration under the Bankruptcy (Scotland) Act 1913 of benefit to creditors and, accordingly, it seems desirable to introduce a procedure which would allow the wage-earner to pay multiple debts out of his income over a period during which diligence and sequestration would be precluded.

B. A possible solution: debt arrangement schemes

1.3 In this Memorandum, therefore, we advance for comment and criticism detailed proposals for the introduction in Scots law of a system of debt arrangement schemes. In framing these proposals, we have had regard to the solutions adopted or proposed in other countries. Those systems which we have examined broadly speaking exemplify two models. The first model is represented by the "administration order" system available in the county courts in England and Wales,[1] and the "instalment order" system of the magistrates' courts in New Zealand.[2] The other model is represented by the "wage-earner plans" available under the federal law of the United States of America[3]; by proposals for legislation in the federal law of Canada[4]; and by the recent proposals of the Law Reform

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[1] See especially County Courts Act 1959, ss.148-156; Administration of Justice Act 1965, s.20; Attachment of Earnings Act 1971, ss.4 and 5; Insolvency Act 1976, ss.11-13; County Court Rules 1936, Order 22 (inserted by S.I. 1977/2194); see also Report of the Departmental Committee on the Enforcement of Judgment Debts (1969) Cmnd. 3909, ('the Payne Report') paras. 737-854.

[2] Insolvency Act 1967, (New Zealand) Part XVI.

[3] Chapter XIII of the U.S. Bankruptcy Act introduced by the Chandler Act 1938; Report of the Bankruptcy Commission of the United States (1973).

[4] Report of the Study Committee on Bankruptcy and Insolvency Legislation in Canada (1970), Part III, Chapter 1, which forms the basis of provisions in two Bills in the Dominion Parliament: Bill C-60 introduced in May 1975 and withdrawn for redrafting and Bill S-11 introduced in March 1978.

Commission of Australia for introducing in the federal law of that country "regular payment plans" for non-business insolvent debtors.[1]

1.4 From an examination of these systems, we have provisionally concluded that it would be desirable to introduce in Scotland a relatively simple and inexpensive process whereby an employed person, faced with a plurality of debts which he cannot pay, would normally be able to apply for a court order confirming a scheme (called a "debt arrangement scheme") under which the debtor would enter into officially supervised and legally regulated arrangements, short of sequestration, for making orderly and regular payments of his debts out of his future earnings or other income. (Proposition 1).

1.5 The advantages of debt arrangement schemes may best be appreciated if we describe briefly their main features[2]:-

(1) A debt arrangement scheme, (which would come into operation only after it had been confirmed by the sheriff), would allow the debtor an extension of time to pay his debts in reasonable instalments over a period of (say) three years.

(2) Under such a scheme, an administrator appointed by the sheriff would collect the payments due by the debtor[3] and disburse them to creditors. He would also have important functions in preparing a scheme and keeping it under review once it is in operation.

(3) Creditors would be prevented from enforcing their debts by diligence and by sequestration while the debt arrangement scheme is in operation, and diligence would be sisted pending disposal of the application.[4]

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[1] Report No. 6 on Insolvency: the Regular Payment of Debts (1977).

[2] A short description of the proposed procedure is set out in the Table overleaf.

[3] In this connection, the administrator would be entitled to intercept the debtor's earnings by obtaining an earnings transfer order such as we propose in Memorandum No. 49.

[4] An application for a scheme would be refused if a majority in number and value of the creditors whose claims are admitted object, or if the sheriff, in his discretion, upholds an objection by such a creditor.

TABLE 1

MAIN STAGES IN DEBT ARRANGEMENT SCHEME PROCEDURE

1. Debtor lodges application (containing statement of affairs) for debt arrangement scheme in sheriff court.*

2. Court checks whether application prima facie competent.

3. Sheriff grants interim order appointing administrator to prepare draft scheme and making conditional sist of diligence.

4. Administrator interviews debtor and ascertains whether statement of affairs prima facie substantially correct.

5. Administrator (a) intimates order to creditors and arrestees listed in the statement of affairs and diligence sisted;

   (b) at same time invites listed creditors to lodge claims:

   (c) thereafter adjudicates on and admits or rejects creditors' claims; and

   (d) prepares draft debt arrangement scheme, and circulates it to those creditors whose claims have been admitted.

6. Unless a majority in number and value of creditors object to the scheme, application would be made to sheriff for confirmation of scheme in form submitted to creditors or with amendments.

7. Sheriff, after hearing any objections by any creditor whose claim admitted, makes an order confirming the scheme (which may be secured by an earnings transfer order) or refuses to confirm it, or continues the case to allow time for agreement to be reached.

8. If an order is made, the administrator receives payments of instalments and disburses them in dividends to the creditors periodically.

9. After final dividends distributed, application for discharge made to sheriff with report by administrator certifying that debtor has complied with the scheme. Creditors may object to application.

10. Sheriff makes order discharging debtor from debts comprised in the scheme.

*In a creditor's application the procedure at paras. 1 to 4 would be replaced by a modified procedure involving an interim order appointing an administrator and a sist of diligence conditional on the debtor's consent to the application; an interview between the administrator and the debtor; the debtor's consent to the application; and the preparation of a statement of affairs by the administrator. Thereafter the procedure would continue as if the application had been made by the debtor.

(4) The scheme would provide either for payment in full of the debts included in the scheme or, in appropriate cases, for a composition of those debts. The debtor would be entitled to a discharge of debts if, in accordance with the debt arrangement scheme, he pays the whole amount of them or, as the case may be, a composition.

1.6 The main difference between a debt arrangement scheme and sequestration under the Bankruptcy (Scotland) Act 1913 is that a scheme would operate as a sequestration only of the debtor's income, and the debtor would not be divested of his assets.[1]

1.7 A debt arrangement scheme such as we propose would have considerable advantages for an insolvent wage-earner. He would normally retain all or part of his assets; he would avoid the stigma associated with the sequestration of a bankrupt; he would be assured of compliance on the part of unco-operative or non-acceding creditors; he would obtain the privilege of an extension of time to pay his debts free from the threat of poinding, arrestment or other diligence; and in appropriate cases he would also obtain a discharge on payment of a composition (viz. a rateable diminution) of his debts. Debt arrangement schemes might have other advantages for debtors. In many actions for debt, the creditor and debtor are agreed that the debt is due, and the creditor raises the action simply because he has no alternative method of obtaining a warrant for diligence. A debt arrangement scheme could be made available where no decree has yet been obtained for the debt, for example if the debt is one for which the creditor could rank in sequestration. In this way, court actions as well as diligence (for the expenses of which the debtor would be liable) might be avoided.

[1] The debtor, however, might be required to sell assets in order to make payments under the scheme, depending on the level of the instalments due by him fixed by the scheme: see paras. 2.75-79 below.

1.8 Advantages would also accrue to creditors. Debt arrangement schemes would be especially appropriate in cases where an insolvent debtor has no assets or only "nominal" assets, that is to say, insufficient assets to cover the expenses of a summary or ordinary sequestration. Moreover, in a proportion of other "small asset" cases, creditors would normally expect to receive from a successful, or partially successful, scheme more than they would receive in a sequestration.

1.9 The success of the proposals, however, will depend not only on careful formulation of the details of the legislation, but on the provision of information to debtors and to creditors, on their attitudes, and on the attitudes of debt counsellors and others and the judges and the officials concerned with the initiation and operation of such schemes. Our proposals, moreover, will present certain difficulties. Safeguards must be built into the proposals to prevent abuse of the system by debtors who apply for a debt arrangement scheme without any real intention of making payment of their debts in compliance with the scheme. From the standpoint of debtors, it must be recognised that a debt arrangement scheme would not protect from diligence those insolvent debtors who are unemployed and often most in need of assistance. In their case, however, reforms proposed in other memoranda would provide some measure of protection.

C. Advantages of debt arrangement schemes over existing procedures and arrangements

1.10 Faced with a multiple debt situation, an insolvent wage-earner may respond in a number of ways which may be conveniently discussed under the following heads:-

(a) Debtor's inaction: detrimental effect of multiple diligence against insolvent wage-earner.

(b) Court procedures
    (i) summary cause instalment decrees; and
    (ii) summary sequestrations.
(c) Extra-judicial legal procedures
    (i) composition contracts;
    (ii) trust deeds for creditors; and
    (iii) contracts with debt-adjusters; and
(d) Informal voluntary payment arrangement schemes: debt counselling.

We are not concerned in this Memorandum to suggest improvements in the procedures or arrangements to which we refer but are concerned rather to demonstrate how, in our view, debt arrangement schemes would differ from, and, in the context of the problems of the insolvent wage-earner, have advantages over these procedures and arrangements.

(a) Debtor's inaction: detrimental effect of multiple diligences against insolvent wage-earner

1.11 As we indicated in previous Memoranda, diligence or a particular step in diligence (the service of a charge, the poinding of goods, the intimation of a warrant of sale authorising advertisement and sale of poinded goods, the advertisement of the sale, the laying of an arrestment against earnings or a bank account) normally operates as the catalyst for an arrangement for payment of the debt, usually by instalments out of income.

1.12 In a multiple debt situation, however, the insolvent wage-earner may find it difficult to enter into payment arrangements with all his creditors. Often he may rob Peter to pay Paul. He may worsen his insolvency by recourse to desperation borrowing. Frequently, for any of a variety of possible reasons, he will not respond to invitations by his creditors to make an instalment settlement. If he simply does nothing, then his total indebtedness may be increased considerably since his several creditors may initiate separate court actions, and instruct separate diligences, for the expenses of which the debtor will be liable.

1.13 Moreover, multiple debt can be unfair to creditors since it can lead to an unco-ordinated race of diligences in which the practical rule of priority among competing creditors is "first come, first served". The considerate creditor, who wishes to allow the debtor time to pay, risks being shut out by the prior diligences of competing creditors.

(b) Court procedures

1.14 There are no court procedures in Scots law which cater adequately for the small insolvent debtor in a multiple debt situation.

1.15 Summary cause instalment decrees: the summary cause instalment decree procedure enables a debtor to obtain an extension of time to pay his debt by instalments, but, otherwise, it falls far short of the type of procedure which is needed. Although the sheriff has power to attach conditions to an instalment decree,[1] it is generally accepted that he has no power to conjoin two or more creditors in one consolidated instalment decree. Nor, in our opinion, would it be appropriate to engraft such a power on to the summary cause procedure which ought not to be made more complicated than is strictly necessary. The sheriff's summary cause court is not an appropriate forum in which to enable a multiple debtor to make arrangements with his several creditors for the regular payment of his debts.

1.16 Summary and ordinary sequestration: one solution for the small multiple debtor with earnings but little or no capital is to petition for his own sequestration. Due perhaps to ignorance about the remedy, or to apathy, or to a healthy dislike of the stigma of bankruptcy and sequestration, together with an understandable misapprehension and fear of the consequences of sequestration, few insolvent wage-earners apply for that remedy as a way out of their financial difficulties. The existing Scots procedure of summary sequestration, however, provides a very effective method of defeating the claims of

[1] Sheriff Courts (Scotland) Act 1971, s.36(4).

creditors. A debtor's petition for summary sequestration does not require the concurrence of creditors. As the Law Society of Scotland have observed:-

> "Such a petition for [summary] sequestration [by a debtor with income but few or no assets] is normally presented in order to prevent a series of arrestments of wages. The petitioning debtor may apply for legal aid. In such cases although the initial procedure is carried through, creditors rarely think it worthwhile to appear at the first meeting and, in the absence of any assets to provide a fee, there is little inducement for 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 [Bankruptcy (Scotland) Act 1913]."

In the context of our review of the law of bankruptcy, we propose to repeal the provisions of the Bankruptcy (Scotland) Act 1913 relating to summary sequestration.

1.17 But however its procedures are reformed, sequestration is an inherently expensive and complicated process which is not appropriate for a small wage-earner's insolvency.[1] From the standpoint of the insolvent wage-earner, sequestration is a drastic remedy. If he owns his own house, he is likely to be deprived of it. He may also be deprived, subject to certain restrictions, of his household goods and effects which have become part of his daily life and which may be sold at a fraction of their use-value to him. He may also be exposed to public examination and be subjected to certain disabilities.

[1] Any system of sequestration necessarily involves elaborate and complex procedures. Sequestration interferes with the property and other rights of the debtor, the creditors and contingently of third parties. It provides for meetings of the creditors; the appointment of a trustee and commissioners; the vesting in the trustee of the debtor's estate; measures for the interim protection of that estate; the recovery of the debtor's property in the hands of third parties, including wrongfully alienated property; the investigation of the bankrupt's conduct; the examination and ranking of the claims of the creditors, including their claims to a preferential status; the payment from time to time of dividends to the creditors; a final accounting to the creditors; and a procedure for the bankrupt's discharge.

Equally from the standpoint of creditors, especially unsecured creditors who enjoy no preferences, sequestration is often a futile remedy. It is designed essentially for cases where the debtor, while possibly having considerable debts, has assets whose proceeds on sale may be divided among the creditors. But in Scotland, where most people do not own their homes, there must be many insolvent wage-earners who have income but no assets of any consequence available for distribution. Moreover, the lengthy procedures of sequestration are liable to diminish significantly the fund available to creditors.

1.18 In short a debt arrangement scheme would have considerable advantages over sequestration in the case of insolvent wage-earners. It would avoid the disproportion, evident in sequestrations, between the considerable and necessary complexity and expense of the procedure and the low value of the insolvent wage-earner's assets.

(c) Extra-judicial legal procedures

1.19 At least in theory, Scots law permits an insolvent person (including a wage-earner) in a multiple debt situation, (i) to enter into a composition contract with his creditors; (ii) to grant a trust deed for his creditors; and (iii) to enter into a contract with a debt-adjuster (whereby the latter takes over liability for the debts). None of these extra-judicial arrangements are satisfactory in the case of an insolvent wage-earner with few assets faced with multiple debts.

1.20 Composition contracts: under a composition contract between a debtor and his creditors, the creditors agree to forego further diligence and to discharge their debts in consideration of the debtor paying-off, usually by instalments, a proportion of those debts. If the debtor is in business, he will usually agree to a measure of supervision of his business activities. The debtor is not divested of his whole estate (though sometimes certain assets may be conveyed in trust to a person for the benefit of the creditors).

1.21 In some limited respects, composition contracts are an ideal solution to the problems of the small multiple debtor since they embody the main principles of extension (of time to pay), composition (ie rateable diminution of the debts by agreed amounts), and the debtor's ultimate discharge and rehabilitation. Their great disadvantages, however, are that (even if the vast majority of creditors enter into a reasonable composition contract) no creditor can be compelled to accede to the contract, and a non-acceding creditor can continue to have diligence executed notwithstanding the contract. Recourse to composition contracts is relatively infrequent in Scotland nowadays[1] and, while we think such contracts should remain an option, their voluntary basis and unstable qualities seem to make them a quite inadequate solution to the problems of most insolvent wage-earners.

1.22 Trust deed for creditors: voluntary trust deeds for creditors differ from composition contracts insofar as a trust deed involves a formal conveyance by the debtor to a trustee of his property - usually the whole of it - for the benefit of the creditors.[2] While trust deeds are popular, flexible and useful instruments when the debtor has substantial assets, they are arguably even less appropriate than composition contracts to the case of the insolvent wage-earner with few assets. As in the case of composition contracts, non-acceding

[1] This may be partly because it does not bind non-acceding creditors. It is understood that, in practice, the larger companies and nationalised industries tend to stand aloof from composition contracts.

[2] Usually the purposes of the trust are simply the realisation of the debtor's estate and its proportional division among the creditors. The trust is established by a private contract between the debtor and his creditors and, for this reasons, it does not bind non-acceding creditors.

creditors may frustrate the objects of the trust deed by executing diligence. As in the case of sequestrations, a trust deed normally involves the formal sale of the wage-earner's few assets to his serious detriment without corresponding advantage to his creditors.

1.23 Contracts with debt adjusters: we do not know whether "debt adjustment agencies" operate in Scotland to any significant extent[1] but they certainly do not provide a widespread "private enterprise" service for insolvent consumers or wage-earners and there is no reason to suppose that they ever will.

(d) Debt counselling and voluntary arrangements

1.24 Instead of relying on one of the foregoing legal processes, an insolvent wage-earner may turn for help to a debt counselling agency. Debt counselling can play an important role in assisting the insolvent wage-earner to overcome his difficulties and in selecting the most appropriate course of action available to him. But arrangements for payment made as a result of debt counselling are voluntary. They presuppose the existence both of a willing debtor and willing creditors. A creditor has no assurance that the debtor will continue to pay the instalments which he has agreed to pay and refrain in the meantime from incurring further indebtedness. Further, by giving the debtor an extension of time, the creditor may find that another creditor secures payment in full by diligence. Likewise, the debtor has no assurance that one of his creditors will not terminate the informal arrangements and proceed to do diligence against his income or assets. In our view arrangements of a mandatory character are needed and this gap should be filled by a system of debt arrangement schemes.

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[1] Debt adjustment (or "pro-rating") occurs inter alia where a debt adjuster takes over liability for an individual's debts in return for payments from him and can be attractive to the multiple debtor since his liabilities are converted into a single debt due to the debt adjuster: see the Crowther Report on Consumer Credit (1971; Cmnd. 4596) para. 6.12.14. Such agencies must be licensed under the Consumer Credit Act 1974.

D. Potential scale of use of debt arrangement schemes

1.25 The potential scale of use of debt arrangement schemes is not easy to assess. In England and Wales in 1978, only 1,958 applications were made for administration orders and only 1,619 orders were made.[1] We understand that the orders are not evenly spread over all county courts; many of the orders are made by just a few county courts. On a comparative population basis, this suggests that there might be under 200 applications for debt arrangement schemes in Scotland, and if so, this would not make a very significant impact on the estimated 20,000 poindings and 10,000 arrestments executed every year, though it might have an impact on the relatively small number of sequestrations under the Bankruptcy (Scotland) Act 1913.[2] Much would depend, however, on local practices and attitudes to the process of the sheriff courts and local branches of debt counselling organisations who would require to have confidence in the legislation.

1.26 It is likely that debt arrangement schemes will not be used much unless they are given publicity to ensure that insolvent wage-earners learn about the schemes. Even referral systems would not suffice since debt counselling agencies have an incomplete coverage of Scotland and since many debtors who are taken to court do not seek formal assistance for their debt problems.[3]

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[1] Judicial Statistics for England and Wales, Annual Report 1978 (Cmnd. 7627) Table F.1(c)

[2] In 1977, 132 awards of sequestration were made: Civil Judicial Statistics for Scotland for 1978, Cmnd. 7762, Table 17. It is not known how many of these related to "consumer" bankruptcies.

[3] The O.P.C.S. Defenders Survey disclosed that a substantial proportion, about three quarters, of persons who have court action taken against them for recovery of debt do not seek assistance from debt counselling agencies or professional advisers such as solicitors.

1.27 Most multiple debtors are insolvent because of a single crisis (eg sickness) precipitating the insolvency or because of a recurrent lack of financial resources often aggravated by poor money management. A scheme might enable an insolvent multiple debtor to surmount a single crisis. Even low wage-earners with recurrent debt problems might have recourse to schemes since they would only have to pay a composition (or rateable reduction) of the debts, but in their case advice on money management might well be needed to prevent default in the future.

PART II: SPECIFIC PROPOSALS

2.1 In this Part, we set out our detailed proposals for the introduction of debt arrangement schemes in Scots law. Much of the detail concerns matters which will not happen very often but which will nevertheless require regulation when they do occur. We would expect that, in most cases, the procedures will be relatively simple to operate.

A. Outline of procedure in applications for debt arrangement schemes

2.2 We suggest that the main steps in the procedure for obtaining a debt arrangement scheme should be as follows:-

(1) In a debtor's application, the debtor would initiate the procedure by lodging in the appropriate sheriff court an application in a prescribed form for a debt arrangement scheme. The form of application, which would incorporate a statement of the debtor's affairs, would be completed and signed by him (see para. 2.23 below).

(2) The court would scrutinise the application to ensure that it was properly completed and prima facie complied with certain rules as to competence. (para. 2.25) The sheriff would then normally pronounce an interim order remitting the case to a person (whom we call an administrator) to prepare a draft debt arrangement scheme. (para. 2.26)

(3) The administrator would interview the debtor and would ascertain whether prima facie the statement of affairs was correct: if necessary, he would amend the statement of affairs . (para. 2.26). The administrator would then send a copy of the debtor's statement of affairs to the creditors listed in the statement inviting each creditor within a prescribed period to return a form of claim, or to make objections, if so advised, to the inclusion of other creditors or to the competence of the application. (para. 2.29).

(4) The interim order would be intimated at the same time to creditors and arrestees listed in the debtor's statement of affairs (para. 2.29). The order would operate to interrupt pending diligences as from the time of intimation (para. 2.30). Pending actions in which the debt was admitted would be sisted but not actions in which liability, or the amount of the debt, was disputed (para. 2.31). The creditors would, however, retain the right to petition for sequestration (paras. 2.18-2.20).

(5) In a creditor's application, the sheriff would make an interim order appointing an administrator and imposing a sist of diligence and legal proceedings conditional on the debtor's consent to the application. The administrator would if possible interview the debtor, and ascertain whether he consented to the application. If the debtor gave his consent, the administrator would prepare a statement of affairs (which the debtor would sign) and would intimate the order sisting diligence to the creditors and arrestees listed in the statement of affairs. Thereafter the procedure would continue as if the application had been made by the debtor. (paras. 2.14-2.17).

(6) The administrator would then adjudicate on and admit or reject the creditors' claims. A creditor whose claim was rejected would be entitled to appeal to the sheriff (paras. 2.37-2.39). The administrator would also ascertain the debtor's proposals for payment (paras. 2.27 and 2.72).

(7) Thereafter the administrator would prepare a draft debt arrangement scheme setting out the debtor's financial position, the proposals for payment, and details of the expected in-payments by or on behalf of the debtor and of disbursements to the creditors whose claims are admitted and who are thus to be included in the scheme (para. 2.80).

(8) The administrator would send the draft scheme to the creditors to be included in the scheme inviting them to give or withhold consent to the draft, or to make representations for its amendment, within a prescribed period. If a majority in number and value of the creditors objected to the scheme, it would not be confirmed by the sheriff. Otherwise application would be made to the sheriff for confirmation of the scheme either in the form submitted to the creditors or with amendments made by the administrator with the debtor's consent in the light of any creditor's representations (para. 2.81).

(9) The sheriff, after hearing representations by any objecting creditors and applying certain statutory criteria, would confirm the scheme with or without modifications, or refuse to confirm the scheme, or continue the case to allow time for agreement to be reached (para. 2.84). An order confirming the scheme might be secured by an earnings transfer order (paras. 2.93 and 2.95).

(10) If the application for confirmation of the scheme was refused, creditors' rights of action and of enforcement by diligence would revive (para. 2.84). If the scheme was confirmed, the sisted diligences and actions would be terminated and it would not be competent for a creditor to apply for the debtor's sequestration while the debt arrangement scheme was in force (para. 2.86).

Comments are invited on the procedure set out in this paragraph. (Proposition 2).

B. Competence of applications and relationship to sequestration

(1) Preliminary

2.3 A primary purpose of a debt arrangement scheme is to allow an honest consumer debtor in financial difficulties an extension of time to pay his debts in whole or in part in reasonable instalments over a prescribed period. To protect the interests

of creditors, to avoid abuses of the procedure and to ensure that a scheme is not made available in cases where sequestration in bankruptcy would be more appropriate, limits have to be set on the availability of such schemes.[1]

2.4 We suggest that an application for a debt arrangement scheme should be competent only if the following conditions are satisfied, viz:-

(1) that the debtor is "domiciled" in Scotland as the term "domicile" may be defined for the purpose of theEuropean Judgments Convention and is either domiciled in that sense or habitually resident within the district of the sheriff court to which the application has been made;[2]

(2) that the debtor is in practical insolvency;[3]

(3) that an earlier application for a debt arrangement scheme in respect of which an interim order has been granted has not been refused on the merits or abandoned within a prescribed period (say, six months) before the making of the current application; or that a subsisting scheme has not been revoked within that period;[4]

(4) that the debtor's whole indebtedness (excluding heritably secured debts) does not exceed a prescribed sum (of, say, £3,000);[5]

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[1] At this stage, we are concerned with defining one set of limitations, namely the conditions which have to be satisfied before an application for a debt arrangement scheme can be competently made. These conditions of competence are not however the only limits on the making of schemes since at a later stage or stages of the procedure, rules will have to be applied providing that the debtor's proposals for payment may be refused by the court or by a majority (as defined) of the creditors acting in a prescribed manner. Since lax criteria of competence may be offset by strict grounds of refusal and vice versa, reference is made to the description of the possible grounds of refusal at para. 2.84 below.

[2] See para. 2.5.

[3] See para. 2.6.

[4] See para. 2.7.

[5] See paras. 2.8-2.13.

(5) possibly, that his debts do not consist of or include debts incurred in the course of a profession trade or business;[1] and

(6) that the debtor is not an undischarged bankrupt whose estate either has been recently sequestrated or is subject to a "live" sequestration.[2]

We now examine each of these conditions.

(2) Jurisdiction, appeals etc.

2.5 Insolvency proceedings are specifically excluded from the European Judgments Convention[3] and it might be thought that applications for debt arrangement schemes, like administration orders, would be excluded from the Convention. It is understood however, that it is intended that this exclusion should relate only to procedures which fall within the scope of the Bankruptcy Convention.[4] If this is so, the European Judgments Convention would be applicable. For a number of reasons, that Convention is not, however, well adapted to insolvency proceedings and its applicability is not free from doubt In this situation, we think that a specific rule regulating jurisdiction should be enacted. Debt arrangement schemes appear appropriate for the sheriff court rather than the Court of Session. To elicit views, we propose that (1) the sheriff court **should have** jurisdiction in an application for a debt arrangement scheme if the debtor is "domiciled" in Scotland as the term "domicile" may be defined for the purpose of the European Judgments Convention and is either domiciled in that sense or habitually resident within the territorial jurisdiction of

[1] Idem.

[2] See paras. 2.14-2.18.

[3] See Article 1(2)(2) which provides that the Convention should not apply to "bankruptcy, proceedings relating to the winding-up of insolvent companies or other legal persons, judicial arrangements, composition and analogous procedures".

[4] Official Journal, c.59 of 3 March 1979, pp. 89 and 90.

of the court. (2) The Court of Session should not have original jurisdiction but an appeal from a sheriff's decision should lie to the Court of Session, or to the sheriff principal and thereafter to the Court of Session, on a question of law only. (Proposition 3).

(3) Other limits on competence of applications

2.6 Insolvency: clearly it should be a requirement of a debtor's application for a debt arrangement scheme that the debtor is insolvent in the sense that he cannot pay his debts as they fall due. It would, however, be inappropriate to require that he be notour bankrupt, since a debtor whose wages or bank accounts have been arrested would not satisfy the requirement. It would, moreover, be undesirable to make an unimplemented extract decree for debt a pre-condition of an application for a debt arrangement scheme, since, if the debtor admits the debt, it would be pointless to require also that he must await decree in an action for payment, with its concomitant expenses for which he would be liable, before making the application. It should be enough that he cannot pay his debts as they fall due.[1]

2.7 Earlier proceedings: some safeguard must be conceded to creditors against the repeated use or abuse of applications for debt arrangement schemes for the improper purpose of delaying creditors without intention of reaching a settlement. One such safeguard is that the administrator could apply for the dismissal of the application in certain circumstances[2] but we suggest that an additional safeguard is needed on the lines suggested at head (2) of para. 2.4. A safeguard on these lines is found in certain other systems.

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[1] We revert at para. 2.24 below to the question whether an application for a debt arrangement scheme should render the debtor notour bankrupt.

[2] See para. 2.36 below.

2.8 Upper limit on indebtedness: exclusion of business debts or business debtors: in formulating other limits on the competence of applications, we suggest that a primary aim should be to ensure that the schemes are made available to consumer debtors in financial difficulties. This aim presents problems of definition, and it may moreover be argued that the schemes should be available also to business debtors, or to wage or salary earners whose debts consist of or include debts incurred as a self-employed person in the course of a previous profession, trade or business. The main limits found in other systems are limits on the total amount of indebtedness and limits expressly excluding business debts or business debtors.

2.9 Comparative survey: in England and Wales, the main limitation on the competence of an application for an administration order (apart from the requirement that the debtor cannot pay a specific judgment debt forthwith) is that his whole indebtedness does not exceed a prescribed sum, which is currently £2,000.[1] The limit applies to secured, as well as unsecured, debts; this inclusion of inter alia house mortgages must prevent a large number of debtors who are owner-occupiers from applying for administration orders. In New Zealand, by contrast, an instalment order is available where the debtor's total unsecured debts are not more than 2,000 New Zealand dollars.[2] In the USA, wage-earner plans under Chapter XIII of the Federal Bankruptcy Act are available to certain wage-earners and the ceiling on income imposed by the constituent legislation in 1938 was removed in 1950. The Law Reform Commission of Australia recommended in 1976 that eligibility for the "regular payment plans" which they proposed should be set inter alia by reference to total indebtedness, the upper limit being 15,000 Australian dollars, excluding debts secured on real estate used for domestic purposes where the security was taken in respect of the purchase of, or making of improvements to, the property in question.[3]

2.10 Fairly low limits on indebtedness have the effect of excluding many business debtors, and this seems to be one of the main purposes of the limits. In England and Wales and in New Zealand, business debtors are not specifically excluded but it is generally accepted that the orders are designed primarily for wage or salary earners and mainly used by them. In the

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[1] County Courts Act 1959, s.148 as amended by the County Courts (Administration Order Jurisdiction) Order 1977. The order is not invalid by reason only that the limit of indebtedness is exceeded but in that event, the court may set aside the order: s.148(3).

[2] Insolvency Act 1967 (N.Z.) s.146(1) as amended.

[3] ALRC Report, para. 47.

USA, the restriction to cases where the debtor's principal income derives from a salary, wage or commissions necessarily excludes most business debtors. The Federal Bankruptcy Commission, however, observed that some limitation was needed since a wage-earner's plan "can work well only if the debtor has a regular income out of which a predetermined periodical payment can be made and applied regularly to the reduction of the creditors' debts", and accordingly recommended that it should "be made available to any debtor who can propose and expect reasonably to comply with an undertaking to pay a prescribed amount periodically out of an anticipated regular income".[1] In Australia the Federal Law Reform Commission received submissions from the business community that small traders might find credit restricted from credit sources such as wholesalers because of the possibility that the traders might become subject to regular payment plans in which the business creditors would be outvoted by other creditors. In response to these submissions the Commission reluctantly excluded businessmen and business debts from their proposals, while not conceding that the proposed regular payment plans would have constituted the threat which the business community feared.[2] The Canadian legislative proposals include all individual debtors whether in business or not.[3]

2.11 Our proposals: in most systems, there is a rule limiting the duration of a payment scheme to a prescribed period, normally three years, which we suggest below should be the period applicable to debt arrangement schemes in Scotland. This limitation on the time allowed for payment, however, would not necessarily restrict debt arrangement schemes to cases where the total indebtedness is relatively small, since we propose that the debtor might be required to pay only a proportion of his debts by way of composition.

2.12 If "small" business debtors are included, the rules might be more complicated: for example, employees would presumably be ranked as priority creditors. It is also the case that the

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[1] Report, supra, pp.164-5.

[2] ALCR Report, para. 47.

[3] Bill S-11, (supra) section 2(1) defines a "consumer debtor" to mean inter alia an individual whose debts do not exceed 20,000 Canadian dollars.

insolvency of business debtors may often be more appropriately dealt with in sequestrations where there is scope for a deeper examination of the bankrupt's affairs. Business debtors are often less in need of assistance in financial matters than consumer debtors, and there may also be a risk that the business community in Scotland will restrict credit to small businessmen if debt arrangement schemes become available.

2.13 To elicit views, we suggest that an application by a debtor for a debt arrangement scheme should be competent only if the following conditions are satisfied:-

(a) that the debtor is in practical insolvency (but not necessarily absolute insolvency) ie that he cannot pay his debts as they fall due;

(b) that an earlier application for a debt arrangement scheme has not been refused on the merits or abandoned within a prescribed period (say, six months) before the making of the current application, or that a subsisting scheme has not been revoked within that period;

(c) that his whole indebtedness (excluding heritably secured debts) does not exceed a prescribed sum (of, say, £3,000); and

(d) possibly, that his debts do not consist of or include debts incurred in the course of a profession, trade or business.

(Proposition 4).

(4) Creditor's title to apply and debtor's consent to application

2.14 It is for consideration whether a creditor should have a title to apply to the court for the preparation and confirmation of a debt arrangement scheme. In our view, such a scheme would require the full co-operation of the debtor both in preparing

the scheme and in operating it when it is in force. The debtor must make a full disclosure of his means, and since the source of the payments to creditors will be the debtor's earnings he must be willing to "work for his creditors" over an extended period. The question which arises therefore is whether, or to what extent, the debtor can be coerced into giving this co-operation. If he can, then there is a case for allowing creditors to apply for a debt arrangement scheme and the court to confirm such a scheme without the debtor's consent or, indeed, over his protests. In other legal systems, approaches to this question vary.

2.15 Comparative survey: in England and Wales, the Payne Report,[1] suggested that a judgment creditor should be entitled to apply for an administration order apparently upon the ground that such an order can be of very real benefit to creditors. The Report observed that a "judgment creditor may, in practice, apply for such an order more rarely than others, but he may wish to bring in non-judgment creditors, to defer future creditors or to bring the debtor under stricter control."[2] This recommendation has not been implemented. In New Zealand, the debtor "or any creditor", may apply for an instalment order. In the American system of wage earner plans the initiative lies only with the debtor. In considering whether the court should be empowered to substitute a wage-earner plan in place of bankruptcy, or a discharge from bankruptcy, the US Federal Bankruptcy Commission observed that "forced participation by a debtor in a plan requiring contribution out of future income has so little prospect of success that it should not be adopted as a feature of the bankruptcy system."[3] The Commission accepted evidence that a wage-earner's plan "requires not merely a debtor's consent but a positive determination by him and his family to live within the constraints imposed by the plan during its entire term and a will to persevere with a plan to the end."[4] Imposition of a plan on the debtor would merely encourage him to change his job or leave the area where he resides. The Australian and Canadian proposals envisage that arrangements or plans would be proposed only by the debtor and should not be imposed compulsorily on him at the creditor's instance.

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[1] Para. 781.

[2] Ibid.

[3] Report (1973) pp. 158-9.

[4] Ibid.

2.16 On balance, we do not consider that a debtor should be compelled against his will to submit to the constraints of a debt arrangement scheme. On the other hand, there may be cases where the debtor would comply with such a scheme but is, for one reason or another, unwilling himself to make an application. He may have been badly advised or be so inadequate or distraught as to be unlikely to apply for a scheme even if it would be of benefit to him. But if the creditor could initiate proceedings, and if the administrator appointed by the interim order of the court could interview the debtor, explain the benefits of submitting to a scheme, and elicit the information on which a scheme could be framed, then the debtor might be willing to comply. On this view, a creditor might be entitled to apply for a scheme without the debtor's consent, and the debtor invited to appear and be interviewed and questioned by the administrator as to his means and as to his willingness to submit to a debt arrangement scheme. We do not, however, consider that the debtor should be required under the threat of fines or imprisonment to attend the court, and if he declined to appear for interview the proceedings should be dismissed leaving the creditor to his alternative remedies of diligence or sequestration.

2.17 We therefore propose that (1) a creditor should be entitled to apply for a debt arrangement scheme without the concurrence of the debtor. (2) It is for consideration whether the creditor must have constituted his debt by decree. (3) The sheriff would make an interim order appointing an administrator and, if the debtor consented to the application, sisting diligence against him. (4) The administrator would, if possible, interview the debtor and, if the administrator thought fit and the debtor consented to the application, the administrator would elicit information on the debtor's financial position and frame a statement of affairs which the debtor would sign. The administrator would intimate the interim order sisting diligence to the creditors and any arrestees listed in the statement of affairs and invite the listed creditors to lodge claims. (5) Thereafter, the procedure would continue as if the application had been made by the debtor. (Proposition 5).

(5) Relationship between debt arrangement schemes and sequestrations

2.18 Careful provision would be needed to regulate the relationship between debt arrangement schemes and sequestrations, including the related questions of whether or when the existence of one type of proceeding should bar commencement of the other; how to preclude or otherwise deal with cases of concurrent debt arrangement scheme and bankruptcy proceedings in different courts (and even different countries); and the conditions under which one type of proceedings may be superseded by the other. In cases where the debtor has no assets, or only nominal assets, (viz insufficient to pay the expenses of a sequestration), a debt arrangement scheme, if successful, is to be preferred from the standpoint of both debtor and creditors. Where there are substantial assets, the balance of advantage for the creditors may often lie in sequestrations. Under the present law on sequestrations, the creditors have a near absolute right to compel the realisation of these assets since they will normally give the creditors a more certain and secure return than would payments out of future income.[1] Moreover, the court may require the bankrupt to pay creditors out of income arising during the sequestration,[2] and, where he has a regular income, may refuse discharge unless he undertakes to pay reasonable sums to his creditors for a reasonable period.[3] There are no time limits on these payments such as we envisage in this Memorandum.[4] In sequestrations, more effective measures for securing the debtor's assets may be available than in debt arrangement schemes.

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[1] See e.g. Fraser's Sequestration (1931) 51 Sh.Ct.Reps. 225, where the court refused to approve a deed of arrangement providing for payment out of future business income and for the retention by the bankrupt of his assets where a dissenting minority of creditors preferred realisation of the bankrupt's assets.

[2] Bankruptcy (Scotland) Act 1913, s.98(1); Caldwell v. Hamilton 1919 S.C. (H.L.)100.

[3] Down's Sequestration (1927) 43 Sh.Ct.Reps. 282.

[4] In our forthcoming Report on Bankruptcy, however, we propose to recommend that, unless the court has already granted or deferred discharge, a bankrupt whose estate has been sequestrated should (with certain minor qualifications) be held to be discharged of his whole debts and obligations on the expiry of the period of five years from the date of the sequestration.

2.19 We think that the general policy of the law should be to foster and encourage the use of debt arrangement schemes at least in small asset cases. Accordingly, just as an undischarged bankrupt may be sequestrated a second time, so he should be entitled to apply for a debt arrangement scheme provided that no "live" sequestration is in operation.[1] Where concurrent proceedings for debt arrangement schemes and sequestration proceedings occur, preference should not depend on the test of priority of time but on the merits of the case. Since the emphasis in debt arrangement schemes is on the voluntary co-operation of the debtor, the court should not have power to refuse a debtor's petition for sequestration on the ground that a debt arrangement scheme would be more appropriate unless the debtor concurs.[2]

2.20 In the light of these remarks we invite views on the following propositions: (1) unless and until the law of bankruptcy is reformed to ensure that in the normal case a bankrupt will receive a discharge within a reasonable time on surrendering his assets, the fact that the debtor is an undischarged bankrupt should not by itself bar him from making an application for a debt arrangement scheme. It should, however, be a condition rendering an application by an undischarged bankrupt incompetent that an award of sequestration has been made and either (a) that a trustee has been appointed on the bankrupt's estate; or (b) where no trustee has been appointed, that the award of sequestration was made within the period of (say) six months preceding the application. (2) A debtor applying for a debt arrangement scheme, or a creditor to whom such an application is notified, should be required to furnish the administrator with such particulars within his knowledge as may be prescribed relating to any petition for or award of sequestration of the debtor's estate, and any other prescribed

[1] In our forthcoming Report on Bankruptcy, we shall advance proposals designed to ensure that a trustee is appointed in all sequestrations.

[2] But provision might be made to ensure that a debtor petitioning for sequestration has at least considered the alternative option of applying for a debt arrangement scheme.

particulars of which he has knowledge relating to any sequestration or analogous insolvency proceedings whether within or furth of Scotland. (3) An application for a debt arrangement scheme should not bar a creditor's petition for the debtor's sequestration. Such a petition should be competent following the application, notwithstanding that the debtor is not notour bankrupt, at any time until a debt arrangement scheme is confirmed by the court. An application for a debt arrangement scheme should be sisted if a petition for the debtor's sequestration is proceeding concurrently. If the application and the petition are in different courts, the court dealing with the petition should (after such intimation, hearings and inquiry as it thinks fit) determine which proceedings should continue. (4) The court should not have power either to refuse a debtor's petition for sequestration, or to recall an award of sequestration, on the ground that a debt arrangement scheme would be more appropriate unless the debtor concurs. (Proposition 6).

(6) Debt arrangement schemes and notour bankruptcy

2.21 Though proceedings for a debt arrangement scheme amount to a public acknowledgment by the debtor of his own practical insolvency, such proceedings should not be treated as the constitution of notour bankruptcy, since in our view the rules of equalisation of diligence on notour bankruptcy[1] or on the reduction of illegal preferences should not apply. In a relatively simple procedure such as we envisage, it would be inappropriate to impose on the administrator of a debt arrangement scheme a duty to trace and recover the proceeds of prior furthcomings and sales of poinded goods, or a duty to reduce illegal preferences, for the benefit of the listed creditors. On the other hand, as already indicated, a creditor should be entitled to petition for the debtor's sequestration notwithstanding proceedings for a debt arrangement scheme.

[1] Bankruptcy (Scotland) Act 1913, s.10.

2.22 To elicit views, we suggest that provided creditors are allowed to petition for sequestration in appropriate circumstances notwithstanding proceedings for a debt arrangement scheme,[1] such proceedings should not be treated as the constitution of the debtor's notour bankruptcy.[2] If, however, a debt arrangement scheme is superseded by sequestration of the debtor's estate the debtor should be deemed to have been rendered notour bankrupt at the date of his application for a debt arrangement scheme for the purposes of the equalisation or cutting down of prior diligences under sections 10,103 and 104 of the Bankruptcy (Scotland) Act 1913 and the challenge of illegal preferences at common law or by statute. (Proposition 7).

C. Commencement of proceedings; interim order appointing administrator and its effect

(1) Lodging of application and statement of affairs

2.23 We envisage that the procedure would normally be initiated by the debtor lodging in the appropriate sheriff court an application in the prescribed form. The application should incorporate a statement of affairs which would give a full itemised account of the debtor's income, assets and debts in order to provide the creditors, the court and the administrator with a full picture of the debtor's financial position as a basis for considering his proposals for payment. It should also give all information within the debtor's knowledge relevant to a determination whether the conditions of competence of the application and the criteria for confirmation of a debt arrangement scheme are satisfied. In particular, the statement should include:-

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[1] See para. 2.20 above.

[2] At one time, in England and Wales, proceedings for an administration order were acts of bankruptcy (the nearest English analogue to notour bankruptcy); see Administration of Justice Act 1965, s.21; Attachmentof Earnings Act 1971, s.4(3). But the law was changed by the Insolvency Act 1976.

(a) a list of the creditors, the debts due to each, and the nature of the debts (eg ordinary civil debt; aliment or periodical allowance or criminal fine; and future, contingent or disputed claims);

(b) a full statement of the debtor's present heritable and moveable property and income, and his probable future property and income;

(c) particulars of any creditor's security or other encumbrance (eg a heritable security or a reservation of title under a hire purchase or conditional sale agreement) on his assets with a reasonable estimate of the value of the debtor's interest in each asset;

(d) a list of the continuing expenses requiring to be met by the debtor to enable him and his dependants to maintain a reasonable standard of living;[1]

(e) particulars of any voluntary gift given at any time to a spouse, relative or other person not in the ordinary course of business; any preference given to a creditor within the preceding three months; and any agreement to make a voluntary gift or to grant a preference.[2]

2.24 We envisage that the debtor would himself complete and sign the form of application and statement of affairs. Forms might be distributed by Government or sheriff clerks' departments on request (free of charge or at a nominal charge) so that they are made available to debtors in sheriff clerks' offices, solicitors' offices, Citizens' Advice Bureaux, Consumer Advice Centres and in the premises of other voluntary

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[1] Including not only such items as food, clothing, outgoings on the home (rent, secured loan payments, rates, house insurance premiums, fuel and lighting charges) but also periodic subscriptions to trade unions or professional bodies and the cost of transport to work.

[2] Gratuitous alienations and illegal preferences would be relevant grounds upon which the sheriff could refuse confirmation of a debt arrangement scheme: see para. 2.84.

organisations which provide help for debtors. Where a debtor needs help in completing a form, and is unable to obtain it from a Citizens' Advice Bureau or other voluntary organisation, it may be for consideration whether he should be entitled to enlist the aid and advice of the sheriff clerk's department in the appropriate sheriff court. It is also for consideration whether legal aid should be available in cases where solicitors are involved in helping clients to complete forms of application. The provision of information to debtors covering debt arrangement schemes and of assistance in completing the forms of application and statement of affairs would be central to the success of the legislation and we invite views on how these might best be provided.

2.25 Once the application has been lodged the court would scrutinise the application to ensure that it was properly completed and complied with the rules of competence described in Section B above. The debtor should be given the opportunity to correct any material error unless the error was thought to be deliberate. If the application were found to be prima facie incompetent, intimation would be given to the debtor of that fact, and the sheriff, after giving the debtor an opportunity to be heard, would be empowered to dismiss the application.

(2) Appointment and initial functions of administrator

2.26 In the normal case, however, the sheriff would pronounce an interim order remitting the case to an administrator appointed by the order.[1] The administrator's first duty would be to inverview the debtor with a view to verifying the debtor's statement of affairs. The debtor would be under a duty to

[1] We consider at para. 2.122 et seq questions as to the recruitment, training and remuneration of the administrator who would occupy a central position in the procedure.

disclose to the administrator all relevant information.[1] The administrator would ascertain whether the statement of affairs was prima facie correct: if necessary, he would amend the statement of affairs to correct any mistakes.

2.27 The administrator would also advise the debtor as to the options open to him in making proposals for payment. It is envisaged that there would be three main options:-

(1) an extension of time to pay his debts;

(2) payment of debts only to the extent of a composition, expressed as so many pence in the pound;

(3) a combination of both of the above types of proposal.

In the case of a composition, the creditors would normally be asked to accept a rateable reduction of their debts; in other words, all creditors would receive the same proportion of their debts.

2.28 The administrator would then form a provisional view as to whether, in the circumstances, a scheme would have a reasonable prospect of success, for example, whether after payment of necessary outgoings, the debtor would have a surplus out of which to pay his listed debts or the composition which he proposed to pay. If, in the administrator's view, a scheme was not likely to succeed, he would be entitled to apply to the sheriff for an order dismissing the application.[2]

2.29 Unless he applied for dismissal of the application, the administrator would send by recorded delivery letter to the creditors listed in the debtor's statement of affairs, a copy of the statement of affairs together with a notice in the prescribed form -

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[1] The debtor would be liable to prosecution under the False Oaths (Scotland) Act 1933 for giving false information in his statement of affairs.

[2] See para. 2.36 below.

(a) intimating the interim order and explaining its effect in precluding court proceedings and diligence; and

(b) inviting each listed creditor within a prescribed period (say 21 days) -

(i) to return a prescribed form of claim (with relative vouchers or grounds of debt) endorsing or altering the debt shown in the statement as owed to him; and

(ii) to lodge any objections to the inclusion of any other creditor in the proposed scheme or to the competence of the application.

Notice would also be given to any arrestee listed in the statement of affairs in whose hands property, funds or earnings of the debtor had been arrested.

(3) Effect of interim order in protecting debtor from diligence etc

2.30 Diligence: we envisage that the interim order would operate to sist further proceedings in pending diligences and to preclude new diligences as from the time when the order was intimated to the creditors and arrestees. The following provisions would have effect:

(a) Where a charge had been served, whether or not the days of charge had expired without payment, no further steps by way of poinding or application for civil imprisonment could be taken.

(b) Goods which had been poinded would remain subject to the poinding (subject to orders for disposal in the case of perishables) but no further steps by way of application for warrant of sale, advertisement, or execution of sale would take place.

(c) Where earnings or other funds or property of the debtor had been arrested, they should remain in the hands of the arrestee (subject to orders for disposal in the case of perishable moveables), but no action of furthcoming should be competent and any pending action of furthcoming should be sisted.

(d) The debtor would remain liable for the expenses of steps of diligence which had taken place up to the time when the creditor was notified of the sist.

(e) It is for consideration whether a sequestration for rent under the landlord's hypothec should be sisted[1] but the heritable creditor's diligence of poinding of the ground should probably not be affected.

If and when a debt arrangement scheme is confirmed by the sheriff the temporary sist would be replaced by more permanent measures which we describe at para. 2.86 below. If the debt arrangement scheme is not prepared or not confirmed, then the rights of creditors would revive and, to avoid prejudice to creditors, the period of the sist would be disregarded in calculating the time limits on the taking of further steps in diligence imposed by any rule of law or practice[2] or any enactment, and in calculating periods of prescription.

2.31 Actions to constitute disputed claims: where an action to constitute a disputed claim is in dependence when the application is lodged, it is for consideration whether the debtor should be entitled to apply to have the case sisted if the creditor's claim is among the debts listed in the statement of affairs. We suggest below that the administrator should not have power to deal with claims of this type and that creditors should obtain decree and apply for late inclusion in the scheme.[3] A sist of these actions would therefore seem inappropriate. It would be incompetent for a creditor listed in the statement of affairs whose debt was admitted to raise an action to constitute the debt.

2.32 Discontinuance of gas and electricity supplies? It is for consideration whether an interim order in debt arrangement scheme

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[1] See para. 2.64 below.

[2] The period after poinding within which an application for a warrant of sale must be made to the sheriff is currently prescribed by Practice Notes of the sheriffs-principal.

[3] See paras. 2.70, 2.103, and 2.120.

proceedings should have the effect of restraining the electricity boards and the British Gas Corporation from discontinuing the supplies. (There are precedents for this in the Australian and Canadian legislative proposals[1] though not in the English legislation on administration orders.) The powers of the fuel authorities to discontinue supplies[2] are now exercised in accordance with a code of practice in which the fuel authorities inter alia state that they will not cut off supply if the defaulting customer agrees to make regular payments for electricity or gas and to pay off the debt by instalments in a reasonable period, or if there is real hardship and it is safe and practical to instal a slot meter.[3] Unpaid charges for gas and electricity are recoverable as ordinary civil debts[4] and have no preference in the consumer's sequestration.

2.33 If a restraint were to be imposed on powers of disconnection following an interim order in debt arrangement scheme proceedings, then the arrears of the gas and electricity charges should be paid (in full or by way of composition) in priority to other debts so that the default is rectified within a prescribed period (say one year) from the commencement

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[1] ALRC Report, para. 49; Canadian Bill S-11, clause 94(5) which provides: "No public utility may alter its service, refuse service or otherwise discriminate against a debtor or his estate on the ground that (a) a proposed arrangement is to be or has been filed in respect of the debtor; (b) an arrangement has been made in respect of the debtor; or (c) a debt owed to the utility for services rendered to the debtor prior to the date of the proposed arrangement in respect of the debtor has not been paid." This subsection, however, "does not preclude a public utility from discontinuing service if the debtor does not pay for services rendered subsequent to the date of the proposed arrangement" (clause 94(6).

[2] Electricity Lighting Act 1882, s.21; Electricity Act 1947, s.57(1), Sch. 4, Part I; Gas Act 1972 Sch. 4, para. 17.

[3] Code of Practice issued by the Electricity and Gas Industries (re-issued December 1978).

[4] Gasworks Clauses Act 1871, s.40 as read with Electric Lighting Act 1882, s.12; Gas Act 1972, Sch. 4 para. 13.

of the scheme. This priority would be justified having regard partly to the essential nature of fuel supply for heating, lighting and cooking, and partly as a consideration for the continuance of the supply despite the arrears. We doubt however, whether a mandatory restraint on the discontinuance of fuel supplies would be a practical solution, and we think that there should be as few priority creditors as possible in debt arrangement schemes. We would expect the fuel authorities to be willing to give time to pay in cases where the debtor was applying for, or had obtained, a debt arrangement scheme.

2.34 To sum up, (1) it is suggested that an interim order appointing an administrator to prepare a debt arrangement scheme should operate to sist or preclude new diligences or further proceedings in pending diligences against the debtor by creditors listed in the debtor's statement of affairs as from the time when the order is intimated to the creditors or arrestees. (2) Actions by creditors listed in the statement of affairs to constitute disputed claims should not be sisted but undefended actions by such creditors for payment should be sisted and new actions by them for payment should be incompetent. (3) It is suggested that the order should not have the effect of restraining the electricity boards and British Gas Corporation from discontinuing supplies. (Proposition 8).

(4) Protection of creditors

2.35 Creditors would be protected inter alia by the proposed rule against repeated applications for debt arrangement schemes except at reasonable intervals,[1] and by the proposed rule that a creditor's petition for sequestration should not be barred by an application but only when the scheme has been confirmed by the sheriff.[2]

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[1] See paras. 2.7 and 2.13.

[2] See paras. 2.20 (Proposition 6(3)) and 2.86.

2.36 Administrator's power to apply for dismissal of proceedings: as an additional protection for creditors, we suggest that the administrator should be entitled to apply to the sheriff for an order dismissing the debtor's application on the grounds:-

(a) that the application is not competent; or

(b) that, having regard to all the circumstances a scheme would have no reasonable prospect of success; or

(c) that the debtor has failed to disclose all relevant information or to give assistance reasonably requested by the administrator in connection with the proceedings or has otherwise failed to carry out his duties in connection with the application.

(Proposition 9). This power is needed for the protection of creditors but we would expect that, in most cases, the power would not require to be exercised.

2.37 Restraints on disposal of assets: as a further protection for creditors, the debtor might be prohibited from making a voluntary disposal of his assets to evade his creditors' claims Some assets, while not sufficiently valuable to make sequestration attractive to creditors, might nevertheless be realised to increase the source of payments under the scheme. The debtor's assets would not vest in the administrator for the purpose of realisation and distribution to creditors, but the debtor should not be permitted to dispose of his property while remaining free from the diligence of creditors. In our view, the administrator should be empowered to register an inhibition in the Register of Inhibitions rendering the debtor's heritable property "litigious",[1] that is to say, incapable of voluntary disposal to third parties. There is no process in Scots law whereby a similar prohibition against disposal of moveables can be imposed, but a restraint might be imposed in other ways.

[1] Cf. Conveyancing (Scotland) Act 1924, s.44.

2.38 To elicit views, we suggest that (1) the administrator should be empowered to register an inhibition in the personal registers rendering the debtor's heritable property incapable of voluntary disposal or encumbrance. The appropriate sheriff court should have power to restrict or recall the inhibition on cause shown subject to conditions. Unless previously recalled the inhibition should be recalled on termination of the debt arrangement scheme proceedings and should in no case endure behond the normal five year period for the prescription of inhibitions. (2) The debtor might be required to give an undertaking not to dispose of his moveable property, after the date of the interim order appointing the administrator, without the consent in writing of the administrator. Breach of this undertaking would be a ground of refusal of the application or termination of the scheme and a disposal might be challengeable by the administrator without prejudice, however, to the rights of a third party transacting in good faith and for value. (Proposition 10).

D. Admissibility, valuation and ranking of creditors' claims: position of secured creditors

(1) Admission of creditors' claims

2.39 Where a creditor does not dispute the sum specified in the statement of affairs as owed to him, that sum should be deemed to be the amount of the creditor's claim. On the expiry of the period for lodging claims,[1] the administrator should adjudicate on and admit or reject the claims. On rejecting a claim, he should notify the creditor concerned forthwith and the creditor should be entitled to prove his claim in an appeal to the sheriff against the administrator's decision. We suggest that, as a general rule, all debts which would be admissible by a trustee in a sequestration should be admissible in a debt arrangement scheme, including debts due to the Crown, rates and tax arrears. To this general rule, there are certain specific exceptions which we describe below.

[1] See para. 2.29.

2.40 Interest on claims: we suggest that creditors should be entitled to claim any interest accrued on their debts up to the date of the interim order appointing the administrator. Interest is calculated on a day-by-day basis and, if payments to account of a debt have been made at different times, the computation may be somewhat difficult to make. We understand that, perhaps for this reason, creditors rarely seek to recover interest on consumer debts. We suggest that it should be for the creditor to claim interest rather than for the debtor to include it in his statement of affairs. In order to keep the procedure simple, we suggest that interest accruing after the date of the interim order should not be payable. Creditors would only be prejudiced where the debts were to be paid in full. A secured creditor would be entitled to interest out of the proceeds of sale of his security but if he lodged a claim in the debt arrangement scheme for any deficiency, interest on the deficiency claim would only be payable so far as accrued up to the date of the interim order. To sum up, in a debt arrangement scheme, interest accrued on unsecured creditors' claims up to the date of the interim order appointing the administrator should be payable, but not interest accrued after that date. It should not be necessary for the debtor to specify the interest due in his statement of affairs, but a creditor should specify in his claim whether he is claiming interest and specify the amount of interest due. 'Deficiency claims' by secured creditors should be treated in the same way as claims by unsecured creditors. If, however, it is thought that interest should be payable on claims, then we suggest it should be at a fixed rate prescribed by statute and variable by statutory instrument. (Proposition 11).

2.41 Claims based on extortionate credit bargains: we have considered whether the administrator should have power to reject a claim based on a credit bargain to the extent that the bargain would be liable to be set aside as extortionate in terms of sections 137 to 140 of the Consumer Credit Act 1974, subject to a right of appeal to the sheriff. A similar provision is containe

in clause 84(3) of the Canadian Bill S-11.[1] The criteria laid down by section 138 of the 1974 Act, however are extremely general and discretionary in character and, in our view, should only be applied by the sheriff, in whom, in any event, the Act vests jurisdiction to set aside obligations imposed by extortionate credit bargains. Views are invited on the question whether as a matter of procedure the debtor should be entitled to make an incidental application to the sheriff in the debt arrangement scheme proceedings for an order under the Consumer Credit Act 1974 setting aside an obligation imposed by an extortionate credit bargain. (Proposition 12).

(2) Possible priorities in debt arrangement schemes

2.42 In English administration orders, New Zealand instalment orders, and in the Canadian and Australian legislative proposals on debtor's arrangements or plans, the general (but not universal) rule is that creditors included in the proceedings rank equally and we think that this general rule should be adopted so far as reasonable in debt arrangement schemes to avoid legal and administrative complexities.

2.43 Certain sequestration priorities not to apply: it would be inappropriate to apply without modification to debt arrangement schemes the rules of ranking applicable in sequestrations under the Bankruptcy (Scotland) Act 1913. In sequestrations several different classes of creditors are recognised apart from ordinary creditors. First, certain creditors are entitled to a preference in terms of section 118 of the Bankruptcy (Scotland) Act 1913 (as amended and extended). Apart from liability for rates, taxes and certain other duties, these preferences are wholly or mainly relevant to business or commercial sequestrations

[1] This provides that "... where the cost of money borrowed by a debtor is excessive or the terms of a transaction are harsh and unconscionable the administrator may disallow any claim in respect of the money borrowed to the extent that the loan is unenforceable or may be reduced under any Act of Parliament or of the legislature of a province governing harsh and unconscionable transactions."

and can therefore be ignored. In the case of rates, taxes and other privileged duties, we suggest below that the claims should rank equally with ordinary debts. Second, in a sequestration certain creditors can obtain a preference by virtue of securities over specific assets[1] and the treatment of these claims in debt arrangement schemes is discussed below. Third, at one time the Crown could obtain a preference in a sequestration by using diligence on an Exchequer decree until the debtor was divested of his estate in favour of the trustee.[2] Since no divestiture occurs in a debt arrangement scheme the Crown could enforce such a decree (eg for tax arrears) unless special provision were made to prevent this occurring. It is, however, doubtful whether Exchequer diligence is competent because of the provisions of section 26 of the Crown Proceedings Act 1947; we understand that it is now rarely, if ever, used (even against commercial debtors) and we shall consider in a future Memorandum whether it should be retained or abolished. Meantime we suggest that the general rules for the sist, suspension and stoppage of diligence discussed elsewhere in the Memorandum should apply to Crown diligence on Exchequer decrees (assuming such diligence to be still competent) so that the Crown could not obtain a preference in a debt arrangement scheme by the use of such diligence. (Proposition 13). Fourth, in a sequestration, the wife of a bankrupt may lodge a claim in respect of property lent or entrusted to the bankrupt or inmixed with his funds. Such a claim is postponed to the claims of ordinary creditors under section 1(4) of the Married Women's Property (Scotland) Act 1881. In our forthcoming Bankruptcy Report, we shall recommend that the rule in section 1(4) should be extended to the husbands of bankrupt wives, but should be applied only where the property

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[1] E.g. heritable securities; landlord's hypothec for rent; rights of retention, lien or compensation (set-off).

[2] Exchequer Court (Scotland) Act 1856, The Admiralty v. Blair's Trustee 1916 S.C. 247.

has been entrusted to the bankrupt for the purpose of any business carried on by him or her. Since we envisage that debt arrangement schemes would not apply to business debts or business debtors, section 1(4) would not be relevant. For this reason and for the sake of simplicity, we suggest that subject to our proposals on aliment and periodical allowance in Proposition 17 below, claims by a spouse of the debtor should not be postponed to other claims. (Proposition 14).

2.44 Possible priorities for certain debts: following a precedent in the Canadian legislative proposals, we have considered whether it would be desirable to give priority to certain claims to prevent the withdrawal of goods and services necessary for the standard of living of the debtor and his family. The claims might consist of the following:-

(a) arrears of rent in respect of the tenancy of the debtor's home;

(b) arrears on building society loans or other debts heritably secured over the debtor's home;

(c) arrears of charges for gas and electricity supplied to the debtor's home; and

(d) arrears in respect of the hire or price of household goods held by the debtor on hire purchase or conditional sale, being goods which would be exempt from poinding as necessary to enable the debtor to continue living in the dwelling house without undue hardship.[1]

Such a priority would enable the debtor to rectify a prior default within a prescribed period (eg a year) following the order confirming the scheme as consideration for a restraint on the withdrawal of essential goods and services currently needed by the debtor. Presumably the whole arrears, and not merely a proportion thereof by way of composition, would have to be paid within the prescribed period. We think, however, that such priorities

[1] Law Reform (Diligence)(Scotland) Act 1973.

might unduly prejudice unsecured creditors. It may be that the debtor would be able to claim an urgent needs payment under the Supplementary Benefits Act 1976 for arrears of rent, secured loan instalments, fuel debts or the price of essential goods. On balance, therefore, we suggest that priority should not be given in a debt arrangement scheme to claims for arrears of debts due in respect of accommodation and essential goods and services (viz rent, secured loan interest, fuel debts and debts in respect of goods necessary for the debtor's subsistence) to prevent the loss of the accommodation, goods or services. (Proposition 15). We revert below to claims by secured creditors and sequestration for rent under the landlord's hypothec.

(3) Priority by exclusion of criminal fines etc

2.45 For a variety of reasons, and following precedents in other legal systems, we suggest that priority should in effect be given to criminal fines, by excluding these debts from debt arrangement schemes and by permitting their enforcement notwithstanding the stoppage of other diligences.

2.46 Criminal fines already have a special status in insolvency law: thus in a sequestration they are not discharged by the bankrupt's discharge.[1] Moreover default in payment of the fine might result in the debtor's imprisonment with the result that the debtor could no longer earn wages or salary to make payments to creditors. This problem is not present in the case of most civil debts. We note the opinion of the Scottish Council on Crime that general debtor-oriented relaxations of the law of diligence should not, or not necessarily, apply in the case of enforcement of fines.[2] The effect of exclusion of criminal fines from a scheme would be that the debtor would have to pay

[1] Bankruptcy (Scotland) Act 1913, s.147.

[2] Report on Fines (1974) (published by Scottish Home and Health Department) para. 3.13.

his criminal fines before meeting his civil liabilities. Accordingly the administrator in considering whether a debt arrangement scheme would have a reasonable prospect of success, should allow for the payment of criminal fines as a priority and, as already mentioned, the debtor should specify liability for a fine in his statement of affairs.[1] If insufficient surplus income remained after payment of a fine (or other excluded debts), then the application should be refused.

2.47 We prefer this approach to the alternative approach of including fines in debt arrangement schemes as prior debts,[2] and we suggest that the same approach should be adopted in relation to certain other debts arising out of criminal proceedings. To sum up, we suggest that priority should in effect be given to criminal fines by excluding these debts from debt arrangement schemes and by permitting their enforcement notwithstanding the stoppage of other diligences. The same rule should apply to other debts arising in criminal proceedings such as sums due under bonds of caution, or as security, for good behaviour and possibly sums due under a compensation order against an offender in terms of the Criminal Justice (Scotland) Bill presently before Parliament. (Proposition 16).

(4) Aliment and periodical allowance

2.48 Aliment and periodical allowance on divorce due by the debtor raise a number of problems. In a sequestration an alimentary creditor of the bankrupt ranks as an ordinary

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[1] See para. 2.23 above.

[2] In England and Wales criminal fines may be included as prior debts in attachment of earnings orders under the Attachment of Earnings Act 1971 but there appears to be no express exclusion of fines from administration orders. Criminal fines are excluded from arrangements or plans under the Australian and Canadian federal legislative proposals.

creditor in respect of arrears of aliment due at the time of sequestration, but cannot rank as a contingent creditor for future aliment accruing during the sequestration.[1] The reason is that the latter claim is inconsistent with the nature of aliment, which is due only when the alimentary debtor has a surplus. There can be no surplus if he is insolvent: so a wife must follow her husband's fortunes.[2] On the other hand, a different approach is adopted where the court makes an order under section 98(1) of the Bankruptcy (Scotland) Act 1913, for the payment of instalments to creditors out of the bankrupt's earnings. In making such an order the court will allow the debtor to retain a proportion of earnings not only for his own subsistence but also for the support of his alimentary dependants.[3] The effect of these apparently inconsistent approaches is that a wife does not compete with ordinary creditors in the distribution of the bankrupt's assets, but may be supported by him out of current earnings. The practical justification for the difference in approach seems to be that, whereas it is possible to divest a bankrupt of his assets compulsorily in order to distribute tham to his creditors, it is not possible (as we have already indicated) to compel him "to work for his creditors". The policy of the law should be to encourage him to earn while he remains an undischarged bankrupt and he is unlikely to do so if his creditors are preferred to the alimentary claims or needs of his wife and children living in family with him. On the other hand, if the alimentary dependant in question is a separated or divorced wife living apart from him, then he may have much less incentive to pay her aliment out of earnings. And if he has acquired a second family as well as being insolvent, he is most unlikely to be able to meet his obligations to his first family.

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[1] Matthews v. Matthews' Tr. 1907, 15 S.L.T. 326; Barnes v. Tosh (1913) 29 Sh.Ct.Rep. 340: see our Memorandum No. 22 on Aliment and Financial Provision (1976) para. 2.118.

[2] Reid v. Moir (1866) 4 M. 1060, 1063.

[3] Caldwell v. Hamilton 1918 S.C. 677; 1919 S.C. (H.L.) 100; Birrell's Tr. v. Birrell 1957 S.L.T. (Sh.Ct.) 6.

2.49 To elicit views on this difficult problem we suggest that (1) an alimentary creditor claiming pecuniary aliment and an ex-spouse claiming periodical allowance should be entitled to rank in a debt arrangement scheme for arrears accrued to the date of the application for the scheme. (2) It should be a ground for refusing to confirm a scheme that the debtor would not be able to continue to support his alimentary dependants in fact dependent on him or living in family with him. (3) No claim for pecuniary aliment or periodical allowance accruing while a debt arrangement scheme subsists should be included in a scheme, and an alimentary dependant or an ex-spouse claiming periodical allowance should not be entitled to enforce a claim by diligence while such a scheme subsists without the leave of the court. (Proposition 17).

(5) Secured creditors

2.50 It is for consideration whether, following an application or confirmation of a scheme, a secured creditor should be entitled to repossess or realise his security and exercise the other remedies available to him or whether restraints should be imposed upon his rights and, if so, what form these restraints should take. It is convenient to discuss heritable securities separately from securities in respect of moveables.

(a) Heritable securities

2.51 As we have indicated, a loan secured over the debtor's heritable property should be disregarded in applying any upper limit of indebtedness.[1] Payments of instalments to the heritable creditor should be made outside the scheme and not to the administrator in accordance with the scheme. In assessing whether a scheme has a reasonable prospect of success, regard would be had to the question whether the debtor could purge any past default and continue with payments of future instalments, or would require to move to a smaller house, or to apply to a housing authority for a public sector tenancy.

[1] Para. 2.13.

2.52 At present, the statutory standard conditions of a standard security provide that the debtor is held to be in default where "the proprietor of the security subjects has become insolvent."[1] It is expressly enacted that for this purpose, the proprietor is taken to be insolvent if he has become notour bankrupt, executed a trust deed for creditors, or made a composition contract or arrangement with his creditors.[2] These provisions should be amended to make it clear whether or not proceedings for a debt arrangement scheme are to be treated as insolvency and therefore as a default.

2.53 Generally speaking, a heritable creditor's remedies depend on whether the standard security has a non-default calling-up clause (which allows the security to be called up on one month's notice even in the absence of default)[3] or whether his remedies become available only on the debtor's default. If there is a non-default calling-up clause, then a restraint on enforcement would seem out-of-place: since default is not the legal basis of enforcement, giving the debtor time to purge the default could not logically be allowed to prevent or delay enforcement. Even where the heritable creditor's remedies depend on default, the owner-debtor's right to contest enforcement proceedings is much more limited than in English law. The loan agreement will normally stipulate that on default, the whole unpaid balance of the principal sum, together with interest accrued, will become immediately payable. The heritable creditor can proceed to sell on one month's notice without judicial warrant.[4] He can raise an action of ejection

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[1] Conveyancing and Feudal Reform (Scotland) Act 1970, Sch.3, para. 9(1)(c).

[2] Ibid., para. 9(2).

[3] Ibid., s.19, Sch.3, para. 8.

[4] 1970 Act, Sch.3, para. 10.

immediately on default[1] and the court has no discretion to refuse or delay warrant of ejection.[2] By contrast, in England and Wales, the court can relax a requirement of the mortgage that, on default, the whole outstanding balance of the loan may become due,[3] and, in proceedings to enforce a mortgage, if the court considers that the mortgagor is likely to be able to pay within a reasonable period what is due to the mortgagee or to remedy any other default, the court may, by order subject to conditions, delay enforcement proceedings for a period which the court thinks reasonable.[4] These provisions apply quite apart from administration orders.

2.54 The Australian Law Reform Commission have proposed restraints on enforcement linked with their proposed regular payment plans. The Commission observed:[5]

> "Although it is not envisaged that real estate debts themselves be included in a plan, there must be some protection given to a debtor against the sale of his home by the mortgagee or by a person possessing a statutory charge during the period of initiation and operation of a plan. From the moment of initiation, there should be a stay of proceedings relevant to a proposed mortgagee sale, and a prohibition on the use of administrative procedures connected therewith. The mortgagee himself, like a creditor with security over chattels is entitled to priority over unsecured creditors and special provision must be made for him in the proposal and plan if the stated restrictions are to operate beyond the initiation period. Adequate protection would be given if the proposal were to provide for maintenance of the mortgage payments during the currency of the scheme, together with correction of prior default within a year of entry upon the scheme. Correction should commence, however, from the time of the first mortgage payment made in accordance with the plan. Contractual provision for distraint of chattels, for acceleration of payments in the event of default and for the payment of penalty interest should be rendered ineffective."

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[1] 1970 Act, s.24.

[2] United Dominions Trust Ltd. v. Site Preparations Ltd. (No.1) 1978 S.L.T. (Sh.Ct.) 14.

[3] Administration of Justice Act 1973, s.8.

[4] Administration of Justice Act 1970, s.36(1): See Payne Report para. 1389 et seq.

[5] ALRC Report, para. 52.

Moreover, the Canadian Study Committee considered that to cater for cases where the debtor has immoveable property which he should be allowed to keep in order to facilitate an arrangement with his creditors, the debtor should be given temporary relief. The Committee therefore recommended:[1]

> "that there should be a procedure permitting the temporary suspension of the principal payments on immoveable property, any amount not paid during the suspension, however, to be made up by the debtor when the period of suspension is lifted."

A provision on these lines, however, could not be reconciled with non-default calling-up clauses where default is not the legal basis of enforcement.

2.55 In the light of these remarks we suggest that (1) provision should be made amending the Conveyancing and Feudal Reform (Scotland) Act 1970, Schedule 3, paragraph 9 (which makes it a standard condition in a standard security that the debtor shall be held in default inter alia where the proprietor of the security subjects has become insolvent) to make it clear whether the proprietor should be held insolvent for the purposes of that paragraph by reason of the fact that he has applied for a debt arrangement scheme. (2) We have considered whether there should be a procedure whereby a debtor applying for a debt arrangement scheme should be entitled to apply to the sheriff for an order suspending the obligation to repay the instalments of capital due under a loan agreement heritably secured over the debtor's home for a time not exceeding a prescribed period the amount not paid being made up on the expiry of the period of suspension. Such a procedure, however, would be inconsistent with the rights of heritable creditors to enforce securities even in the absence of default and therefore should not be introduced unless and until these rights are changed. (3) Payments to a heritable creditor should be made outside a debt arrangement scheme but the administrator

[1] Op.cit., p.98.

should have power to negotiate arrangements with a heritable creditor, including power to invite him to suspend repayment of capital for the duration of the scheme, the amounts not paid during suspension to be made up after the suspension expires. (Proposition 18).

(b) Goods on hire purchase and conditional sale

2.56 In the American system and the Canadian and Australian legislative proposals, special provision is made in respect of "securities" over corporeal moveables, including goods held on hire purchase or conditional sale. Under Scots law, securities over corporeal moveables cannot be created by contract unless followed by delivery, and the main non-possessory securities are generally not relevant to consumer transactions.[1] The main relevant cases in debt arrangement schemes would therefore be cases where the debtor holds goods under a hire purchase or conditional sale agreement. Under a hire purchase or conditional sale agreement the creditor (viz. the owner or lender) retains ownership until completion of the contract[2] and accordingly such an agreement is not in form a security over moveables. But the effect of the agreement is to place the creditor in broadly the same position as if he held a security over the goods.

2.57 It is for consideration whether the creditor under a hire purchase or conditional sale agreement should be entitled both to repossess the goods, with or without a court order as required by existing law following an application for a debt arrangement scheme, and also to lodge a claim with the administrator for the balance remaining due after the repossessed goods have been realised.

[1] The main non-possessory securities are mortgages of ships and aircraft; certain special statutory securities e.g. under the Agricultural Credits (Scotland) Act 1929; and floating charges over the assets of incorporated companies. Bills of sale are not competent. We revert below to the main relevant security arising by operation of law, sequestration for rent under the landlord's hypothec.

[2] Hire purchase is a contract of hire terminable at the will of the hirer coupled with a condition in his favour that if he elcts to retain the goods until he has made a certain number of payments as they fall due, the goods will become his property. A conditional sale is a contract of sale incorporating the condition that the property in the goods is not to pass until the price, or a certain number of instalments of the price, has been paid.

2.58 The solution may be of considerable importance to a consumer debtor. Many consumer debtors possess goods on hire purchase or conditional sale, such as a car and furniture and plenishings in the home. The debtor may need the car for work and some of the other articles may be needed to allow the debtor to maintain a reasonable or minimum standard of living. Some articles held on hire purchase would be exempt from poinding but can be repossessed by the creditor subject to the existing statutory restrictions.

2.59 Further, the "use value" of the goods to the debtor will normally be much higher than the repossession value. The Crowther Committee noted that most goods taken on hire purchase are motor vehicles or household goods and that both types of goods have little repossession value.[1] Though the creditor must mitigate his loss by selling repossessed goods at the best price which can reasonably be obtained,[2] the price is likely to be significantly lower than the replacement value. The Crowther Committee found that "repossession, whilst causing hardship to the debtor, is often of little value to the secured party."[3]

[1] Report of the Departmental Committee on Consumer Credit (1971) Cmnd. 4396, para. 6.6.46.

[2] Guest, Law of Hire Purchase, paras. 618-619; Bridge v. Campbell Discount Co [1962] A.C. 600, 635.

[3] Supra, para. 6.6.45. The Committee, however, received evidence from the finance houses to the effect that:

> "... the reservation of title under a hire-purchase agreement was a valuable remedy, not so much because of the ability to repossess as because of the psychological inducement this gave to the hirer to maintain punctual payment of the instalments. The threat of repossession thus had an independent value in keeping debtors up to the mark, and the benefit of the right to repossess could not be measured solely by reference to the sums obtained from sale of repossessed goods."

(Para.6.6.47) Other reasons for retaining the remedy of repossession were that security enabled credit to be given to those who might be unable to obtain credit on their rating alone, and that taking security did not necessarily make credit more costly but in some circumstances made it cheaper by diminishing the likelihood of bad debts. (Idem.).

2.60 Election of remedies: to meet this problem one type of provision which has been adopted in some North American jurisdictions is that creditors with security over moveables should be put to an 'election of remedies." Thus, a secured creditor may choose between repossession or suing under the personal obligation in the credit agreement. Having chosen one remedy, he would not be entitled to pursue the other. The same principle underlies a provision in a recent EEC Draft Directive.[1] The Australian Law Reform Commission considered whether the election of remedies principle should apply in the case of their proposed regular payment plans but while sympathetic to the proposal did not feel able to recommend its adoption "at this stage" because of lack of empirical information.[2]

2.61 Other solutions: two other solutions are found in other systems. In the United States,[3] if a debtor wishes to retain property subject to a security in favour of a creditor, he must make separate arrangements for continuing payments to the secured creditor outside the wage-earner's plan. Some courts, however, have made injunctions prohibiting creditors from recovering possession in respect of defaults prior to the plan when the plan provides for continuance of payments under the security agreement and early rectification of the default.

2.62 The Canadian Study Committee proposed rather more severe restrictions on the rights of secured creditors to repossess moveables.[4] They suggested that under an arrangement for payment in full the secured creditor could not repossess or realise the secured

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[1]Draft EEC Directive No. C80/7 of 27.3.1979, article 9 of which provides: "1. A credit agreement shall be void from the time the creditor repossesses, either on the basis of the right of ownership or any other right, the goods supplied under a credit management. 2. Member States shall lay down rules to ensure that repossession of goods does not lead to unjustified disadvantages to any of the parties involved."

[2]ALRC Report, pp.28-30 and Appendix A.

[3]See US Bankruptcy Commission Report, pp.165-6.

[4]Op.cit., pp.93-94.

moveable unless the security was given within 60 days prior to the filing of the petition for an arrangement and less than two-thirds of the amount owing has been paid. As a safeguard against abuse by the debtor, the secured creditor should be entitled to choose between filing a claim under the plan or maintaining his rights under the contract. The Committee proposed however that, in a "composition arrangement", since the creditors would not be paid in full, the secured creditor should have the right to choose between filing a claim under the plan or maintaining his rights under the contract, in every case where the debtor has not already paid two-thirds of the amount owing.

2.63 Questions for consideration: we invite views on the following proposals:- (1) in the case of a hire purchase or conditional sale agreement, unless the debtor is otherwise in default, the mere fact that he has applied for a debt arrangement scheme should not permit the creditor either to require accelerated payment of sums due under the contract or to repossess or realise the goods. (2) An application for, or confirmation of, a debt arrangement scheme should not by itself cut off the rights of the creditor to repossess or realise goods on hire-purchase or conditional sale. It is for consideration, however, whether in addition to the restrictions under the Hire Purchase (Scotland) Act 1965, further restrictions should be imposed in connection with debt arrangement schemes. In particular should the creditor be entitled both to repossess or realise the goods and to lodge a claim in the debt arrangement scheme for the deficiency, or should he be compelled to elect between these two remedies? (Proposition 19).

(c) Sequestration for rent under landlord's hypothec

2.64 Views are invited on the question whether a debt arrangement scheme should affect the right of the debtor's landlord to sequestrate moveable goods for rent under the landlord's hypothec. (Proposition 20). On the analogy of the privileged position

of the landlord's hypothec in a tenant's sequestration under the Bankruptcy (Scotland) Act,[1] and of the landlord's right to levy distress for rent under English law where the tenant is subject to an administration order,[2] the landlord should continue to be entitled to sequestrate the tenant debtor's moveable goods under the hypotehc notwithstanding an application for, or confirmation of, a debt arrangement scheme. On the other hand, the exercise of this right may severely prejudice the prospects of success of any scheme, and we should be grateful for comments.

(6) Preferences created by inhibitions

2.65 An inhibition gives the inhibiting creditor a preference in the proceeds of sale of the debtor's heritable property in a competition with secured or adjudging creditors whose rights in the property were created after the registration of the inhibition in thepersonal registers. It is desirable however that the rules of ranking of inhibitions should not have to be applied in debt arrangement schemes, because of the extreme complexity of these rules. Moreover, these rules are appropriately applied in a sequestration because the sequestration is treated as an adjudication of the debtor's heritable property, whereas a debt arrangement scheme would not be treated as an adjudication of such property. In principle, therefore, the rules of ranking of inhibitions ought not to apply in debt arrangement schemes.

2.66 Accordingly we suggest that, (1) where a creditor has registered an inhibition in the personal registers,whether

[1] See Bankruptcy (Scotland) Act 1913, s.115 under which a sequestration does not affect the landlord's hypothec.

[2] Under the County Courts Act 1959, s.152 a landlord may distrain upon the debtor's goods for rent due by the debtor before or after an administration order is made; but distress levied after the date of the administration order is available only for six months rent accrued before that date and is not available for rent accrued after the date when the distress was levied. The landlord may also prove for any balance of rent arrears outstanding in the administration order.

before or after the debtor's application for a debt arrangement scheme has been made, the creditor should be compelled to elect between (a) working out his preference or completing his security by commencing proceedings outwith the debt arrangement scheme proceedings, eg a petition for sequestration or an action for adjudication, or (b) claiming a ranking in the debt arrangement scheme on a basis of equality with other creditors. (2) Where, however, the administrator has registered an inhibition (see Proposition 10 above) prior to the registration of the creditor's inhibition, it should not be competent for the inhibiting creditor to raise an action for the adjudication of the property to himself while the debt arrangement scheme proceedings are in dependence but otherwise the inhibition should have effect in the ordinary way. (Proposition 21).

(7) Co-debtors and cautioners (guarantors) of debtor

2.67 The debtor may be bound along with a co-debtor or cautioner pro rata, or jointly and severally, in respect of the whole or part of a particular debt included in a debt arrangement scheme. Following the statutory provision in sequestrations and the common law,[1] a co-debtor or cautioner of a debtor subject to a debt arrangement scheme who pays the debt in question should be entitled to require an assignation of the debt from the creditor and to rank for the debt in the debt arrangement scheme. (Proposition 22).

2.68 The question arises whether the rule against double ranking should apply. Under this rule, ranking by two (or more) creditors is not permitted for the same debt.[2] So, if the creditor ranks on the estate of the debtor, a co-debtor or cautioner cannot also rank for the same debt. This principle applies where the bankrupt has been divested of his

[1] See Bankruptcy (Scotland) Act 1913, s.52; Gloag, Contract (2nd edn.) p.210.

[2] Goudy, Bankruptcy (4th edn.) p.562; Gloag op.cit., p.209.

estate for distribution to creditors eg by sequestration or trust deed, but does not apply in the case of a composition contract where he retains his assets.[1] A specific provision seems desirable to avoid uncertainty as to which rule applies. We suggest therefore that the rule against double ranking for the same debt should apply in a debt arrangement scheme as in a sequestration. (Proposition 23).

(8) Rights of compensation (set-off), retention and lien

2.69 In sequestrations, a party who is a debtor of the bankrupt for a liquid sum and has an illiquid claim against the bankrupt may retain the liquid sum until the illiquid debt due by the bankrupt has been constituted, and may then set off the two sums.[2] This principle is designed to avoid unfairness to a creditor who would otherwise pay a sum in full but obtain only a dividend. We suggest that (1) the same principle of compensation (set-off) should apply in a debt arrangement scheme as applies in a sequestration. (2) It is also for consideration whether creditors having a preference over other creditors by virtue of a right of retention of lien[3] should have a preference in a debt arrangement scheme. (Proposition 24).

(9) Exclusion of future, contingent and disputed claims

2.70 The existence of future, contingent and disputed liabilities may well prejudice the prospects of success of any debt arrangement scheme and, for this reason, we have suggested

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[1] Goudy, loc.cit.; Mackinnon v. Monkhouse (1881) 9 R.393.

[2] Bell Commentaries vol. ii, 122; Goudy, op.cit., p. 553

[3] E.g. a repairer's lien for the price of his services; or a solicitor's lien over the debtor's papers for the cost of his fees or the unpaid seller's right of retention over goods.

that they should be specified in the debtor's statement of affairs. In a sequestration, account is taken of the future and contingent liabilities of the bankrupt by a system in which the creditor's claims are valued for voting and ranking purposes.[1] The underlying principle appears to be that the debtor, by reason of the voluntary or compulsory surrender of his whole estate, should be entitled to be relieved of his whole liabilities, present and future, other than alimentary obligations. We do not think that this principle can be appropriately extended to debt arrangement schemes which are primarily designed for the payment of current debts out of current income.

2.71 Accordingly we suggest that contingent creditors should be entitled to apply to be included in a debt arrangement scheme only after the event occurs which renders the debtor's liability certain. Disputed debts should be included in such a scheme only after the debts have been constituted. Debts payable at a future time (eg the repayment of a personal loan) should not be included until the time for payment has arrived. (Proposition 25).

E. Preparation and confirmation of debt arrangement scheme

(1) The debtor's proposals for payment

2.72 Before preparing and circulating to creditors a draft debt arrangement scheme, the administrator must ascertain the debtor's proposals for payment. As mentioned at para. 2.27 above, a scheme may provide for an extension of time to pay the debts, or a composition, or both an extension and composition.

2.73 Extension of time for payment: we think that limits should be imposed on the extension of time for payment (the duration of a scheme) and that in the normal case the maximum

[1] Bankruptcy (Scotland) Act 1913, ss.48-50.

period should be three years. We note that in England and Wales, it was at one time provided that no administration order should be made under which the payment of instalments, if kept up without default, would extend over a period of more than ten (formerly six) years from the date of the order. Following a recommendation in the Payne Report,[1] however, the maximum duration of an administration order is not unlimited.[2] The Payne Committee argued -

> "The period of instalments payable under an administration order should, in our view, depend on the amount of the debt and the assets, means and circumstances of the debtor, and we do not think it justifiable that a debtor in comparatively modest circumstances should be refused an administration order and left at the mercy of his creditors indefinitely, whereas a man who is a proper subject of bankruptcy proceedings should be able to obtain his final discharge in due course".[3]

We do not think, however, that it is realistic to expect a scheme to have effect indefinitely or for a long period of years. We note that three years is the limit prescribed for instalment orders in New Zealand;[4] that it is the normal limit in the United States;[5] that it was accepted by the Canadian Federal Study Committee (who observed that "this period of time is as long as one can reasonably expect most debtors and their families to accept the discipline of the financial restrictions imposed by an arrangement,")[6] and by the Australian Law Reform Commission (who remarked that "this period is believed to be an appropriate time limit if the necessary will and self-discipline of the debtor are to be maintained").[7]

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[1] See Payne Report, para. 791.

[2] The limitation was contained in the County Court Rules 1936, Order 22, Rule 9(8) but a new Order 22 was substituted by S.I. 1977/2194 which makes no provision imposing a limit of time.

[3] Para. 791.

[4] The Insolvency Act 1967 (N.Z.) s.146(12) provides: "No summary instalment order shall be made under which the payment of instalments if kept up without default would extend over a period of more than three years from the date of the order."

[5] U.S. Bankruptcy Commission Report, p.160.

[6] Supra. p.93.

[7] ALRC Report, para. 56.

2.74 We suggest therefore that the period allowed by a debt arrangement scheme for the payment by the debtor of instalments should not normally exceed three years from the date of the order confirming the scheme. (Proposition 26). We suggest below that the period of a scheme might be extended in certain cases.

2.75 Income and other assets available for payments: we envisage that debtors will make payments out of their future earnings or other income. The systems we have examined adopt different approaches to the definition of the source of payments. Although the statutory provisions on administration orders in England and Wales do not limit the source of payments, the orders are designed for debtors with small assets and we understand that the main source of payments is the debtor's earnings.[2] In the United States, the Bankruptcy Act contemplates that a plan under Chapter XIII of that Act should provide for the payment of debts only out of "future earnings or wages". The US Bankruptcy Commission, however, recommended an amendment authorising the payment of debts out of the proceeds of sale of the debtor's non-exempt assets as well as future income.[3]

2.76 While creditors might not object to the debtor's retention of non-exempt assets if the debt arrangement scheme provided for payments of the debts in full, they might have cause to object if the debtor retained all his non-exempt assets and yet proposed to pay only a composition of his debts. We therefore conclude that some at least of the non-exempt assets must be taken into account in preparing a debt arrangement scheme. Two questions then arise: first, what future income and other assets (in addition to a proportion of future earnings) should be available as a source of payments? Second, how can payment out of that income or those assets be secured?

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[1] See para. 2.121.

[2] See Payne Report, para. 738.

[3] Report (supra), pp.163-4.

2.77 As regards the first question, where the debtor has a pension exempt by statute from the diligence of his creditors and from sequestration, or (what is less common today) an alimentary provision under a trust deed, we envisage that such income should be taken into account in determining the instalments payable to creditors since he may have other assets or income which makes the inclusion of exempt income possible without undue hardship. This accords with the principle that a debtor's alimentary provision should not be exempt from diligence or a sequestration to the extent that it is in excess of a reasonable aliment for the debtor.

2.78 As regards other assets, the exemptions from diligence and sequestration are not over-generous, being limited to wearing apparel, tools of the debtor's trade, and by statute essential household goods.[1] Clearly a debtor should be permitted to retain his exempt property. A debt arrangement scheme, however, might make provision of some kind for the sale of non-exempt property to reduce the amounts of the debts which will require to be paid out of future earnings.

2.79 We suggest that the debtor's assets and non-exempt income should be taken into account in fixing the level of payments under the debt arrangement scheme, thereby compelling the debtor in certain cases to realise specific assets under threat of refusal of the application or revocation of the scheme. It is however for consideration whether the court should be given power to order the sale by the administrator or the debtor of specific assets. (Proposition 27).

[1] Law Reform (Diligence) (Scotland) Act 1973.

(2) Content of draft debt arrangement scheme

2.80 Having admitted the creditors' claims and obtained the debtor's proposals for payment, the administrator should proceed to prepare a draft debt arrangement scheme. The draft scheme, which should be in a prescribed form, should (a) set out the debtor's financial position in sufficient detail to enable the creditors to make an informed decision on whether to consent to the scheme; (b) state whether or not the debts are to be paid in full and in the case of a composition, the portion or amount of the debt proposed to be paid to each creditor, together with a statement of the total amount which the debtor proposes to pay;[1] (c) state what periodical payments are to be made by the debtor to the administrator or sheriff clerk's department; and (d) give the details of when and how disbursements to creditors of collected sums would be made, being dividends payable within prescribed periods eg at intervals not exceeding six months.

(3) Obtaining confirmation of the scheme by the court

2.81 We suggest that (1) within a prescribed period (say seven days) after the end of the period for lodging claims, the administrator should send a copy of the draft debt arrangement scheme to each of the creditors listed as included in the scheme (ie those whose claims have been admitted) together with a notice requesting the creditor to state, on the pre-paid postage form enclosed, whether he objects to the scheme. (2) An opportunity might also be given to the creditors to make representations for amendment of the draft scheme. If a majority in number and value of the creditors object to the draft scheme, it should not be confirmed and the proceedings should be dismissed by the sheriff. (3) If such a majority do not object, application should be made to the sheriff for an order confirming the draft scheme in the form submitted to the creditors or with amendments made by the administrator

[1] If priority debts are permitted (see para. 2.44 above) the scheme should specify these priority debts which would be paid before the other debts.

with the debtor's consent, pursuant to objections or representations by a listed creditor. (4) A hearing before the sheriff should then be fixed at which any listed creditor may object to confirmation of the draft scheme or make representations for its amendment. (Proposition 28).

2.82 In our view, meetings of creditors to be included in a scheme should not be called. Such meetings would unduly complicate the procedure and legislation since elaborate provision would be required regulating the calling of meetings, proxies, quorums, adjournments and the like. In the United States, where wage-earners' plans must be accepted by a majority in number and value of creditors, experience showed that few creditors bothered to attend meetings or ever qualified to vote by lodging claims. The US Federal Bankruptcy Commission recommended the abolition of creditors' meetings and argued that an independent determination by the court that a plan meets certain statutory standards provides the best protection for creditors. We find this argument convincing. In England and Wales, and in New Zealand, the grant or refusal of an order depends on judicial discretion and the creditors have only a right to be heard. But we think that in Scotland some statutory criteria are desirable for the guidance not only of sheriffs deciding applications for such schemes but of administrators preparing schemes.

2.83 We invite views on the statutory criteria suggested in the next paragraph. We do not think that proof of facts which would bar the discharge of a bankrupt should preclude the confirmation of a debt arrangement scheme.

2.84 To sum up (1) the sheriff should have power to confirm a scheme with or without modifications, to refuse to confirm the scheme, or to continue the case to allow agreement to be reached. (2) We suggest that the sheriff

should make an order confirming a draft scheme only if he is satisfied -

(a) that the scheme has a reasonable prospect of success;

(b) that the public interest does not require the sequestration of the debtor's estate; and

(c) that it would otherwise be reasonable to make such an order having regard to all the circumstances, including the interests of any objecting creditor.

(3) If the sheriff refused to confirm the scheme, this fact would be intimated to creditors listed as included in a scheme and to arrestees listed in the debtor's statement of affairs, and the creditors' rights of action and of enforcement by diligence would revive. (Proposition 29).

F. Operation and termination of debt arrangement scheme

(1) Effect of sheriff's confirmation of scheme

2.85 When a debt arrangement scheme is confirmed by the sheriff's order, it should bind the debtor and all creditors listed in the scheme as included in the scheme. The stoppage of new diligence effected by the application would continue to have effect against other creditors.[1]

2.86 Legal proceedings: as regards pending diligences sisted by the interim order as mentioned at paras. 2.30 and 2.34, the confirmation of the scheme would operate to replace the sist by the suspension of any charge and the termination of any poinding already executed, the recall of any warrant of sale already granted and the loosing of any arrestments already laid, but subject to payment to the creditors by or on behalf of the debtor of the expenses of the diligences rendered ineffective by the scheme. Actions sisted by the interim order as mentioned at para. 2.31 would be dismissed. The administrator would notify confirmation of the scheme to

[1] See para. 2.34 above and paras. 2.100-2.106 below.

creditors and arrestees. It would not be competent for a creditor listed as included in a scheme to apply for the debtor's sequestration for so long as the debt arrangement scheme was in operation.

2.87 Publication: we consider that the fact of confirmation of a scheme, and indeed the fact of the application and the interim order appointing the administrator should be available from public court records to the public eg credit rating agencies, in the interests of existing and prospective creditors. Advertisement might also be made in the Edinburgh Gazette. No advertisement however should be made in the newspapers because the resulting intrusion on privacy and embarrassment might deter debtors from applying for a scheme.

2.88 Restrictions on credit: since the further obtaining of credit would endanger the success of a scheme or be unfair to the creditors concerned, it should be made a criminal offence for a debtor who has applied for or obtained confirmation of a debt arrangement schemeto obtain credit to the extent of a prescribed sum from anyone without disclosing the fact to that person. The sum prescribed might be the same as in the case of an undischarged bankrupt (which is currently £50).[1]

2.89 Certain disqualifications not to apply: the sequestration of a bankrupt disqualifies him from holding certain public offices and other positions, including membership of either House of Parliament[2] or of a local authority,[3] and certain

[1] Bankruptcy (Scotland) Act 1913, s.182 as amended.

[2] Bankruptcy Act 1883 s.32 as read with Bankruptcy (Scotland) Act 1913 s.183.

[3] Local Government (Scotland) Act 1973, s.31(1)(b).

statutory positions.[1] He is also disqualified from acting as a director or manager of a company[2] and from practising as a solicitor.[3] An administration order in England does not have these effects. In our provisional view, to make a debtor subject to such provisions would discourage debtors from applying for schemes which might be beneficial for themselves and creditors.

2.90 Proposals: to sum up (1) the sheriff's order confirming a debt arrangement scheme should operate to terminate pending diligences subject to payment of the expenses. (2) The making of an order should be a matter of public record but no advertisements thereof should be made in the newspapers. (3) It should be an offence for a debtor who has applied for or obtained confirmation of a scheme to obtain credit without disclosing that fact. (4) The disqualifications from public office applying to an undischarged bankrupt should not affect a debtor subject to a debt arrangement scheme. (Proposition 30).

(2) Collection and disbursement of payments

2.91 In-payments: it will be for consideration whether the debtor should be required to make payment of periodic instalments to the administrator or possibly to the sheriff clerk's department. Already the sheriff clerk or his department collects payments of criminal fines and if the administrator is not himself an official of the sheriff clerk's department, it may be appropriate that that department should act as the administrator's agent in receiving and accounting for in-payments, and by making disbursements to the creditors on the administrator's instructions.

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[1] E.g. Consumer Credit Act 1974, ss. 37 and 38 (licence under Act terminates on licencee's sequestration).

[2] Companies Act 1948, s.187: leave of the court is required.

[3] Solicitors (Scotland) Act 1949, Sch. 5, para. 3, and see also para. 2(b) (registrar has discretion to refuse practising certificate).

2.92 Disbursements and appropriations: provision might be made by statute or statutory instrument regulating the times of disbursement of dividends to the creditors (eg not less than once every six months) and perhaps the minimum amounts of dividends other than the final dividend. Provision would also be needed for payment of prescribed sums to the Exchequer in respect of the cost of administration of the scheme. We suggest below that a scheme may require to be varied to include creditors inadvertently omitted from the scheme or creditors whose debts are incurred or constituted, while the scheme is in operation. The administrator should have power to retain sufficient moneys to pay a dividend to such a creditor who applies for inclusion in a scheme. Where a scheme is superseded by sequestration, the administrator would hand over any balance in hand to the trustee in the sequestration, and unclaimed dividends on termination would be consigned into court for a period before payment to the Exchequer.

2.93 Earnings transfer orders: all the systems which we have examined make provision enabling the administrator to attach and intercept instalments of the debtor's wage or salary by a continuing diligence or order directed to the employer, or by a compulsory assignation of earnings intimated to the employer. In our Memorandum No. 49 on Arrestment and Judicial Transfer of Earnings we suggest that earnings transfer orders, one of two new continuing diligences against earnings described there, would be appropriate for use in connection with a debt arrangement scheme.

2.94 Administration by debtor? one of the primary aims of debt arrangement schemes is to promote the financial rehabilitation of the debtor. It is not, however, desirable that the debtor should become dependent on support or tutelage by the administrator: he should be encouraged to budget and manage his own affairs. It seems expedient

therefore that there should be a power to allow the debtor to make payments directly to his creditors. We note that in New Zealand (unlike the present English procedure) the debtor may administer a summary instalment order from the beginning.[1] We would prefer, however, a provision on the lines of the Federal Canadian clause which provides:-[2]

> "The administrator may, on such conditions as he thinks fit to impose onthe debtor, permit a debtor who has complied for at least six months with the terms of an arrangement ... to act as his agent for the collection and distribution of the moneys that the creditors are entitled to receive under such arrangement."

2.95 (1) Views are invited on the method of in-payments and disbursements discussed at paras. 2.91-2. (2) The court should be empowered to grant an order requiring payment of a proportion of the debtor's wages or salary to the administrator or sheriff court, being an earnings transfer order such as is discussed in Memorandum No. 49. (3) It is for consideration whether the administrator should have power to permit a debtor who has complied with a scheme for a prescribed period to act as his agent in collecting and disbursing the moneys due to the creditors. (Proposition 31).

(3) Variation of debt arrangement scheme

(a) Included creditor's right to variation and information

2.96 It should be competent for any creditor listed as included in the scheme to apply to the court for variation of the scheme, eg for an increase in in-payments and disbursements, where there is a material change in the debtor's financial position which might make such a variation reasonable. The debtor and perhaps other creditors should be entitled to oppose the application.

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[1] Insolvency Act 1967, s.146(7).

[2] Bill S-11 (1978), clause 87(4).

2.97 Disclosure of information: in addition to the disclosure made in his statement of affairs, the debtor should be under a duty to disclose to the administrator any material change in his assets, income, and liabilities, at least when requested to make such a disclosure by the administrator. The administrator might be required to send at prescribed times, (say) once every six months, to each creditor included in the scheme a brief report on the manner in which the debtor is performing his obligations under the scheme. Further the administrator, on a listed creditor's request, should be bound to report on the debtor's performance of his obligations.

(b) Debtor's application for variation

2.98 We propose that the debtor should also have a title to apply for a variation of a scheme where there has been a change in his financial position (for example, through sickness or unemployment).

2.99 Most of the systems which we have examined enable the court or administrator to vary the scheme where a debtor is unable to continue payments. In the English administration order system, if at any time it appears to the court that the debtor is unable from any cause to pay any instalment, the court may suspend the order for such time and on such terms as it thinks fit, or vary the amount of instalments.[1] Under the proposed Canadian legislation,[2] it is provided that:

> "... where the administrator is of the opinion that a debtor cannot reasonably be expected to fulfil the obligations imposed on him by an arrangement ..., the administrator may vary the term, the amounts to be paid or the times of payment but not so as to extend the term beyond four years from the date of the proposed arrangement."

The administrator then gives notice of the variation to the creditors but the variation does not take effect if creditors

[1] Administration Order Rules, rule 14.

[2] Bill S-11 of 1978, clause 95(2).

having more than 50 per cent in value of the admitted claims require a meeting. At the meeting, the creditors (if there is a quorum) may accept, amend or reject the arrangement but the concurrence of the administrator and debtor is needed to any amendment. We think, however, that any variation of a scheme should also be made by the sheriff without prior meetings of creditors.

(c) Variation where creditors omitted or included in error

2.100 There will be cases where a creditor having an admissible claim has been wrongly omitted from the scheme through some error. The debtor may have deliberately failed to disclose the existence of the debt in his statement of affairs, or he may have forgotten or overlooked it. In such cases, we suggest that the creditor should be entitled to apply for inclusion in the scheme but should not be entitled to execute diligence to recover his debt if he knew, or ought reasonably to have known, that the scheme was in operation. If he does instruct diligence, the debtor should be entitled to have the diligence stopped subject to an award of expenses against him if the creditor neither knew, nor ought reasonably to have known, of the scheme's subsistence. On the other hand, the court should have power to make an order terminating the scheme on the omitted creditor's application where the creditor establishes that the debtor deliberately failed to disclose the debt.

2.101 Conversely, there may be cases where it comes to light that a debt, or part of a debt, has been wrongly included in a scheme. The debt may have been accepted as valid by the debtor in good faith and listed in his statement of affairs. In such a case, it may be that the scheme should be varied by the court at the instance of the administrator or a creditor. On the other hand, where the debtor has listed the debt to

give an illegal preference at the expense of the other creditors, that fact should be a ground for revoking the scheme.[1] In either case, the administrator might have a statutory title to raise an action of repetition for recovery of the dividends paid in error.

(e) Inclusion of debts incurred, constituted, or made absolute while scheme subsists

2.102 Subsequent debts: notwithstanding the restrictions on credit,[1A] the debtor may incur a new debt to another creditor subsequent to the confirmation of the scheme. At present, subsequent creditors cannot rank in sequestrations[2] nor execute diligence on pre-sequestration assets though in certain circumstances they may execute diligence on post-sequestration assets and rank in a second sequestration relating to those assets.[3] In England and Wales, a subsequent creditor may be scheduled to an administration order but will not be entitled to any dividend under the order until the pre-order creditors are paid to the extent provided by the order.[4] On the other hand, the Australian Law Reform Commission recommended that a subsequent creditor if so advised should be entitled to apply for inclusion in a regular payments plan.[5]

2.103 Disputed and contingent claims: where a disputed debt is constituted by decree or a contingent claim is made absolute the creditor in question should be entitled to apply for inclusion in a scheme and to rank equally with other ordinary creditors for dividends falling to be paid thereafter. We revert below[6] to the question whether the debtor should obtain a complete discharge from debts included late or whether some other solution might be adopted.

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[1] See para. 2.110 below.

[1A] See para. 2.88 above.

[2] Bankruptcy (Scotland) Act 1913, s.117.

[3] Grant v. Green's Tr. (1901) 3 F.1016.

[4] County Courts Act 1959, s.149(d).

[5] ALRC Report para. 76.

[6] Para. 2.120.

2.104 Disposal of application by "late" creditor: it seems unlikely that there will be many cases in which the debtor will be able to increase his payments to yield the same dividend following inclusion of a new debt. If he can, the creditor's inclusion should be automatic. Otherwise, the disposal of the merits of the application should depend on the effect of inclusion on the dividends. The Australian Law Reform Commission proposed that where the inclusion of the additional claim, in conjunction with similar claims would not increase the total of the original liabilities by more than 20 per cent, the additional claim should be included automatically; an existing creditor would be entitled to object; if the original liabilities were increased by more than 20 per cent, inclusion would not be automatic but the "late" creditor would be entitled to apply for termination or amendment of the plan.[1] Other options are to allow the administrator to value contingent claims at the commencement of the procedure; to provide for termination of the scheme; or to postpone the claims of the creditors in question till the scheme is revoked.

2.105 We suggest, however, that the court should decide whether a "late" creditor should be included in a scheme having regard to the effect of the inclusion of the claim on the dividends, the length of time which the scheme has yet to run and all the circumstances of the case.

(e) Proposals on variation of schemes

2.106 (1) Any listed creditor and the debtor should be entitled to apply to the court for variation of the scheme on a material change in the debtor's circumstances. The debtor should report any such change to the administrator. The administrator should make a report periodically or on request to the listed creditors on the debtor's performance of his obligations.

[1] ALRC Report, para. 60.

(2) Views are invited on the proposals at paras. 2.100 and 2.101 for dealing with cases where creditors have been erroneously or wrongfully omitted from, or included in, a scheme. (3) Where during the subsistence of a scheme, the debtor incurs liability for a new debt, the creditor should be entitled to apply for inclusion in the scheme unless he knew, or ought reasonably to have known, of the existence of the scheme when the liability was incurred. If the creditor instructs diligence before termination of the scheme, the court should be empowered to recall or terminate the diligence on the administrator's application, and the expenses of the diligence should be payable to the creditor only if the creditor neither knew, nor ought reasonably to have known, of the existence of the scheme. (4) It should be competent for disputed and contingent claims to be included in a scheme as mentioned in para. 2.103. (5) In disposing of an application for inclusion of a creditor's late claim, the court should have a discretion whether to admit or refuse to admit the claim having regard to its effect on the dividends, the length of time which the scheme has still to run and all the circumstances. (Proposition 32).

(5) Revocation of debt arrangement scheme and sanctions

(a) Default and other grounds of revocation

2.107 It is likely that many debtors will default at some point in the life of a scheme because of the high level of self-discipline which compliance with the scheme will require: the mortality rate of English administration orders, New Zealand summary instalment orders and American wage earner plans is quite high. In considering what default should justify revocation of a scheme, a balance must be struck between the need to prevent a debtor's abuse of the procedures for the purpose of delaying diligence and the need to give the debtor sufficient opportunity to comply with the scheme notwithstanding crises which interfere with his ability to pay. The proper course for a debtor in difficulties would be to apply for a variation, but he may neglect to do so.

2.108 In Scotland, the outstanding balance of a summary cause decree becomes immediately due if the debtor defaults in payment of two instalments.[1] In England and Wales an administration order may be revoked where the debtor defaults in payment of two or more instalments.[2] In the Australian legislative proposals, the plans or arrangements would be terminated in the event of default for two months,[3] and in theCanadian proposals the period of default is three months in the case of monthly or shorter payment periods.[4]

2.109 We suggest that where the debtor is in arrears for seven days in the case of four-weekly or longer instalments, or is two instalments in arrears in the case of shorter instalment periods, the administrator should investigate the reasons for default and report the matter to the sheriff. The sheriff should have power to revoke the scheme or to extend the default period for a further period not exceeding (say) two months (after allowing the parties an opportunity to make representations) if it seems likely that the debtor will be able to resume regular payments. If at the end of the extended period, the debtor still cannot or does not resume regular payments, then the administrator should issue a notice intimating to creditors included in the scheme and all other known creditors that the scheme is, in terms of the sheriff's order, revoked by reason of default.

2.110 Following precedents elsewhere, specific grounds of revocation other than default should also be prescribed and these might be on the following lines, namely (a) that the debtor has given false information to the administrator in his statement of affairs (eg particulars of a creditor or debt) or otherwise; (b) that the debtor has obtained credit without

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[1] Summary Cause Rules, Form U2.

[2] Administration Order Rules 1971, rule 18(1).

[3] ALRC Report, para. 77.

[4] Bill S-11, clause 96(3).

informing the creditor concerned in breach of the duty discussed above; (c) that the scheme amounts to a fraud on a particular creditor or creditors; (d) that the debtor has failed to fulfil his duties under the scheme, or to obey a direction by the administrator or an order of the court; (e) that the debtor has absconded or is likely to abscond or leave the jurisdiction. Revocation on these grounds should be competent quite apart from default.

2.111 The procedure should be the same as for revocation on default except possibly in the case of the absconding debtor where time is important. In such a case, an application for revocation should be made to the sheriff who should have power to interdict removal of property from the jurisdiction and make other orders securing property pending disposal of the application.

(b) Effect of revocation

2.112 We consider that, where a scheme is revoked, it should not be replaced automatically by the sequestration of the debtor. The expenses of a sequestration may swallow up the debtor's non-exempt assets and it may be to the advantage of the creditors to instruct diligence. On revocation of the scheme, the creditors' rights of enforcement by diligence and other remedies would revive and these remedies include sequestration. In some cases, however, it might be appropriate that there should be no time-lag between the date of revocation of a debt arrangement scheme and an award of sequestration. Accordingly where default or some other ground of revocation has occurred, the sheriff might have power, exercisable on application by the creditor or even the debtor with concurrence of a creditor, to award sequestration at the same time as he pronounces an order revoking the scheme. The administrator would hand over any unpaid dividends to the trustee in the sequestration. If seques-

tration is not awarded the court might also have power to make or continue in force an earnings transfer order in favour of the creditors,[1] at the same time as it revokes the scheme. We doubt however whether such a power would be exercised very frequently.

2.113 Apart from a sequestration or an earnings transfer order, the creditors would be entitled to instruct diligence anew and for this purpose the running of prescription would be interrupted for the period of the debt arrangement scheme.[2]

(c) Sanctions against debtor for default

2.114 The main sanction against a debtor should be sequestration or renewed diligence. Where the debtor had made a false statement or was guilty of fraud, then he would be liable to prosecution under the False Oaths (Scotland) Act 1933 or at common law. It may be for consideration whether on the analogy of the Bankruptcy (Scotland) Act 1913, ss.178 and 179, provision should be made creating specific offences by the debtor or a creditor, eg where the debtor fails to inform the administrator of a false claim, or if he prepares to abscond, or makes a gift of property to defraud creditors; or when a creditor wilfully and with intent to defraud makes a false claim or untrue affidavit or statement.

(d) Proposals on revocation and sanctions

2.115 (1) Provision should be made for the revocation of a scheme on the debtor's default on the lines discussed at para. 2.109 and on the other grounds mentioned at para. 2.110. (2) On revocation, creditors' rights to instruct diligence and to apply for sequestration should revive and there should be a procedure whereby the court could award sequestration at the same time as revoking a debt arrangement scheme. (3) In

[1] See para. 2.93 and Memorandum No. 49.

[2] See Prescription and Limitation (Scotland) Act 1973.

framing sanctions against breach by the debtor of his duties, the emphasis should be on revocation of the scheme and liability to renewed diligence or to sequestration rather than on the creation of specific criminal offences. (Proposition 33).

(6) Discharge of debtor

(a) Requirements of discharge

2.116 Where the debtor has fulfilled all his obligations under the debt arrangement scheme, he should be entitled to obtain a discharge. After the final dividends have been distributed application for a discharge should be made to the sheriff with a report by the administrator certifying that the debtor has complied with the provisions of the scheme. The application should be intimated to the creditors. If no objections are made, the sheriff should then make an order discharging the debtor from the debts comprised in the scheme. Objections by creditors would be limited to the factual question whether the debtor has complied with the scheme.

2.117 In the USA, a debtor may obtain a discharge from debts comprised in a wage-earner's plan where failure to complete the plan was due to circumstances outside his control. This is similar to the conditions for granting a discharge in a Scottish sequestration where the dividend is less than 25p in the pound viz that the failure to pay such a dividend has, in the opinion of the court, arisen from circumstances for which the bankrupt cannot justly be held responsible.[1] The Australian Law Reform Commission have suggested that a debtor should be entitled to an automatic

[1] Bankruptcy (Scotland) Act 1913, 2.146.

discharge if he has been subject to a plan for three and a half years and the creditor does not object. If a creditor does object the Commission proposes that the court may order the discharge of the debtor if the debtor has substantially complied with the plan, or otherwise, if the court is satisfied that the extent of his compliance has been reasonable in all the circumstances.[1]

2.118 We suggest that where a debtor has failed to comply with a scheme he should nevertheless be entitled to apply for a discharge at the end of the period of the scheme.

(b) Effect of discharge

2.119 A discharge should free the debtor from all liability for debts included in the scheme. It is a general common law rule that an unqualified discharge by a creditor of a co-debtor or principal debtor operates as a discharge of the other co-debtors or the cautioners.[2] In a sequestration, however, the Bankruptcy (Scotland) Act 1913, s.52 expressly provides that a co-obligant of the bankrupt is not freed from liability for any debt where the creditor votes or draws a dividend in the bankrupt's sequestration or assents to a discharge, composition or deed of arrangement. A discharge on payment of a composition in a trust deed for creditors will also normally preserve the creditor's rights of recourse against co-debtors and cautioners.[3] On these analogies we think that a discharge in a debt arrangement scheme should not operate as a discharge of cautioners or co-debtors of the debtor. In order to protect the debtor from pressure by cautioners, co-debtors and others and to preserve the principle of discharge, it might be appropriate to make provision

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[1] ALRC Report, para. 79.

[2] Gloag Contract (2nd edn.) pp.215-7: the reason is that the creditor is not entitled unilaterally to prejudice their right of relief.

[3] Morton's Trs. v. Robertson's J.F. (1892) 20 R.72.

rendering null and unenforceable any bond of corroboration or novation or any other agreement promise or acknowledgment by the debtor purporting to provide that a discharged debt is resting owing, and also provision ensuring that a person becoming indebted to the debtor cannot claim as compensation or set-off the amount of any discharged debt.[1]

(c) Discharge of debts included after commencement of scheme

2.120 A creditor who was included late in a debt arrangement scheme, (eg where his debt was omitted wrongly or was contingent or disputed at the commencement of the scheme), would obtain a smaller number of dividends than creditors included from the beginning, and it may be thought that such a debt should not be fully discharged. A creditor omitted from a scheme need not apply for late inclusion; he has two further options, namely to await termination of the scheme and raise an action at that stage; or seek revocation of the scheme. The Australian Law Reform Commission believed that these possibilities sufficiently protected the interests of omitted creditors and recommended against the special protection of their interests at the stage of discharge.[2] This solution achieves simplicity at the expense of that equality of treatment which ought to be accorded to creditors. An alternative solution might be that where a debt included in a scheme after its commencement had been omitted from the scheme through the fault of the debtor, the sheriff should be empowered to attach a condition to the debtor's discharge that he must pay the creditor the same proportion of the debt as the total dividend payable to a creditor included in the scheme at its commencement. But the sheriff should also have power to order that the debt should be payable in instalments of such amounts and at such periods as the court thinks fit on the analogy of a summary cause instalment decree

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[1] Compare the Canadian Bill S-11 of 1978, clause 94(2) and (3).

[2] ALRC Report para.

(d) Proposals on debtor's discharge

2.121 (1) The sheriff should have power to grant a discharge of the debtor if he has substantially complied with a debt arrangement scheme, or if his failure to comply is due to circumstances for which he cannot justly be held responsible. If the sheriff refuses a discharge he should have power to extend the period of the scheme subject to such conditions as to payment as he thinks reasonable. (2) A discharge should not operate as a discharge of cautioners or co-debtors of the debtor, and any deed by the debtor purporting to provide that he is liable for a discharged debt should be null. (3) Where a debt was omitted from a scheme through the debtor's fault and later included, the debtor's discharge might be conditional on the debtor paying the creditor by instalments the same proportion of the debt as the total dividend payable to creditors included in the scheme from its commencement. (Proposition 34).

G. Functions, recruitment, remuneration etc. of administrators of debt arrangement schemes

2.122 Because of the central position of the administrator in preparing and obtaining confirmation of a draft scheme and thereafter in keeping the operation of the scheme under review, it would be essential to ensure that suitable persons were appointed to act as administrators.

2.123 In allocating functions as between the sheriff and the administrator, regard must be had to the fact that there are no 'judicial officers' within the Scottish Court Service equivalent to the English county court registrars. Accordingly, we have suggested that almost all the main decisions and orders on the confirmation, variation, and termination of a scheme, and the discharge of the debtor, should be made by the sheriff, and that the few remaining adjudicatory decisions made by the administrator (eg as to the admission and rejection of creditors' claims) should be subject to an appeal to the sheriff.

2.124 The main functions of the administrator would be 'executive' rather than 'adjudicatory' in character. In summary, these functions would include the following[1]:-

(i) to interview the debtor and verify his statement of affairs;

(ii) to intimate the interim order sisting diligence to the creditors and any arrestees;

(iii) to invite the listed creditors to lodge claims;

(iv) to adjudicate on and admit or reject the creditors' claims (subject to an appeal to the sheriff);

(v) to prepare a draft debt arrangement scheme and circulate it to the creditors to be included in the scheme;

(vi) to report to the sheriff seeking confirmation of the draft scheme;

(vii) to attend any hearing before the sheriff on objections to the scheme or on any other matter;

(viii) to receive payments of instalments and to disburse them in dividends to the creditors periodically;

(ix) to keep the operation of the scheme under review;

(x) to make reports to the creditors included in the scheme on the manner in which the debtor is performing his obligations under the scheme;

(xi) to apply to the sheriff for revocation of the scheme if the debtor defaults; and

(xii) to apply to the sheriff for the debtor's discharge on the termination of a successful scheme.

2.125 Before considering whether the administrator should perform additional functions, it is necessary to consider what type of person would be suitable or qualified to perform the

[1]The list relates to a debtor's application and the functions would differ slightly in a creditor's application in the early stages.

essential functions. We do not think that the provision of administrators should be a local authority function since the local authority will often be an important creditor. Further, it is questionable whether administrative duties of this kind would be the best way of employing the professional skills of local authority social workers, especially as they are already over-extended by their present duties. They might be regarded by creditors as over-sympathetic to debtors and conversely their relationship with their client - the debtor - might be prejudiced. These are points on which we would especially welcome views from social workers themselves. The appointment of a sheriff officer would be inconsistent with his duty of executing diligence against the debtor. There would be little incentive for accountants and solicitors (who act as trustees in bankruptcy) to act as administrators unless their fees were paid by the State and we doubt whether funds would be available for this purpose.

2.126 In our provisional view, the choice seems to lie between, on the one hand, an official of the sheriff clerk's department of the relevant court, and on the other hand, a "volunteer" appointed by the sheriff, perhaps from a list or panel of persons recruited from the community and known to be suitable persons for performing the functions after a period of training.

2.127 A sheriff clerk or one of his deputes or officials would be technically well equiped to perform the functions of administrator, because of his knowledge and experience of court procedures, and the closely related fields of diligence and bankruptcy proceedings. He would perform the functions as part of his normal duties and would show the same impartiality as between the parties as he shows in discharging his other functions. The facilities of the sheriff clerk's department would be readily available to him for correspondence and

intimation of documents, for communication with the debtors and creditors, for the receipt and disbursement of periodic payments, and for performing his other functions.

2.128 On the other hand, it seems desirable not to increase the work-load of the sheriff clerks if that can be avoided. It has been represented to us that an administrator should be a person with a special aptitude for giving debtors advice on budgeting or 'money management' and for negotiating instalment arrangements between debtors and creditors; that he should be a dedicated volunteer, not unduly concerned with remuneration, who would have tact and understanding in dealing with debtors and would be prepared to interview the debtor in informal surroundings, outwith normal office hours, and who would at the same time have the requisite detachment and other qualities needed to win the confidence and respect of creditors.

2.129 We note that the Royal Commission on Legal Services in Scotland recommended that high priority should be given to developing a money management counselling service in Scotland, in consultation with Citizens Advice Bureaux and social workers.[1] Such a service might provide ultimately a source for the recruitment of persons qualified to act as administrators, but since it is not known whether or when the proposal will be implemented, other provision would require to be made at least in the meantime.

2.130 The Report of the Scottish Office Central Research Unit on Debt Counselling in Scotland (1980) shows that several non-specialist and voluntary debt counselling organisations (such as Citizens Advice Bureaux) in addition to giving persons with debt problems information as to legal rights, social

[1] (1980; Cmnd. 7846) para. 12.10: the Report recommends that the function of developing the service is to be entrusted to a newly constituted Legal Services Commission.

security and other matters, give more active assistance to help to solve those problems. This assistance often takes the form of -

(a) establishing the facts relevant to solving the debt problem, especially ascertaining the debtor's assets, income and liabilities, a step which the client himself may never have taken; helping the client to check bills if he is doubtful about his liability; and explaining in layman's terms the contents and implications of court documents and of correspondence from creditors and solicitors;

(b) checking whether the client is entitled to social security benefits;

(c) acting as a channel of communication between the client and his creditors and negotiating arrangements for payment of the debts usually by instalments out of income;

(d) providing advice and assistance on budgeting and money management to prevent default on the instalment arrangement and, if possible, to prevent default on other debts in the future.

The role of debt counselling organisations in acting as a channel of communication between debtor and creditor is very important. Often debtors find it difficult to approach creditors to discuss an instalment arrangement even though they are willing to pay the debt. Creditors also are often willing to make an instalment arrangement which will avoid court actions or diligence but their only contact with the debtor is correspondence to which the debtor does not respond. Voluntary organisations bridge this communication gap and it appears that creditors are generally responsive to suggestions made by representatives of these organisations about instalment arrangements and are willing to accept them as negotiators on behalf of debtors or 'brokers' of instalment arrangements.

2.131 The skills and aptitudes of debt counsellors in voluntary organisations resemble to some extent those which would be required of administrators of debt arrangement schemes though an administrator would require to operate formal procedures and would not regard the debtor as his "client". It may be that voluntary organisations could provide a pool of experienced personnel from whom potential administrators might be recruited, and after training, appointed by the courts. It would not, however, be possible to rely wholly on such personnel since the voluntary organisations have an incomplete coverage of Scotland.

2.132 There would, moreover, be considerable difficulties and risks in appointing voluntary personnel as administrators. First, the need for strict adherence to the procedural rules over an extended period of years, and the routine and often frustrating nature of the work, would impose considerable burdens on part-time, unpaid volunteers. Schemes would impose mandatory limits on creditors' rights and it would be essential to ensure that they were administered efficiently. Yet it would be difficult to frame and impose appropriate sanctions against a negligent administrator if he acted part-time for little or no remuneration. Second, suitable office accommodation and ancillary secretarial, accounting and record-keeping services would require to be provided. Though the public image of the sheriff court is not that of an 'approachable' organisation giving help to debtors, the accommodation and services could only be appropriately provided within the sheriff clerk's department. There might be difficulties in integrating a part-time unpaid official into the work of that department. Third, there would necessarily be a wide margin of error in the statistical estimates of the potential case-load of administrators. This would cause transitional problems in planning the recruitment of personnel in the appropriate numbers - there should be neither too few (lest they lose interest through lack of case-work) nor too many (lest they cannot cope with the case-load).

2.133 Since debt is very often associated with other problems such as matrimonial, employment and health problems, it has been represented to us that administrators should be 'generalist' advisers who can give advice to debtors on a wide range of topics. We would expect that most applicants for a debt arrangement scheme would already have contacted a Citizens Advice Bureau or other advisory agency, and though an administrator, like any other public official, should seek to be as helpful as possible by giving advice on matters within his knowledge, we do not think that an administrator should officially assume a general advisory or helping role similar to that of the Citizens Advice Bureaux, eg in checking whether the debtor is entitled to social security benefits.

2.134 To sum up, practical considerations seem to require that administrators of debt arrangement schemes should be full-time officials of the sheriff clerks' departments, rather than unpaid part-time volunteers appointed from a list of persons recruited from the community. We seek views, however, on this provisional conclusion and on the type and qualifications of persons who should be eligible for appointment as administrators. We do not consider that administrators should act as general advisers of debtors applying for debt arrangement schemes. (Proposition 34).

PART III: SUMMARY OF PROPOSALS AND QUESTIONS FOR CONSIDERATION

Para.

We invite views on the following proposals and questions for consideration:-

The need for debt arrangement schemes

1. It would be desirable to introduce in Scotland a relatively simple and inexpensive process whereby an employed person, faced with a plurality of debts which he cannot pay, would normally be able to apply for a court order confirming a scheme (called a "debt arrangement scheme") under which the debtor would enter into officially supervised and legally regulated arrangements, short of sequestration, for making orderly and regular payments of his debts out of his future earnings or other income. 1.4

Procedure in applications for debt arrangement schemes

2. Comments are invited on the procedure set out in paragraph 2.2 above. 2.2

Jurisdiction

3. (1) The sheriff court should have jurisdiction in an application for a debt arrangement scheme if the debtor is "domiciled" in Scotland as the term "domicile" may be defined for the purpose of the European Judgments Convention and is either domiciled in that sense or habitually resident within the territorial jurisdiction of the court. (2) The Court of Session should not have original jurisdiction but an appeal from a sheriff's decision should lie to the Court of Session, or to the sheriff principal and thereafter to the Court of Session, on a question of law only. 2.5

Para.

Other limits on competence of applications

4. An application by a debtor for a debt arrangement scheme should be competent only if the following conditions are satisfied:- 2.13

(a) that the debtor is in practical insolvency (but not necessarily absolute insolvency) ie that he cannot pay his debts as they fall due;

(b) that an earlier application for a debt arrangement scheme has not been refused on the merits or abandoned within a prescribed period (say, six months) before the making of the current application, or that a subsisting scheme has not been revoked within that period;

(c) that his whole indetedness (excluding heritably secured debts) does not exceed a prescribed sum (of, say, £3,000); and

(d) possibly, that his debts do not consist of or include debts incurred in the course of a profession, trade or business.

Creditor's title to apply and debtor's consent to application

5. (1) A creditor should be entitled to apply for a debt arrangement scheme without the concurrence of the debtor. (2) It is for consideration whether the creditor must have constituted his debt by decree. (3) The sheriff would make an interim order appointing an administrator and, if the debtor consented to the application, sisting diligence against him. (4) The administrator would, if possible, interview the debtor and, if the administrator thought fit and the debtor consented to the application, the administrator would elicit information on the debtor's financial position and frame a statement of affairs which the debtor would sign. The administrator would intimate the 2.17

interim order sisting diligence to the creditors and any arrestees listed in the statement of affairs and invite the listed creditors to lodge claims. (5) Thereafter, the procedure would continue as if the application had been made by the debtor.

Relationship between debt arrangement schemes and sequestrations

6. (1) Unless and until the law of bankruptcy is reformed to ensure that in the normal case a bankrupt will receive a discharge within a reasonable time on surrendering his assets, the fact that the debtor is an undischarged bankrupt should not by itself bar him from making an application for a debt arrangement scheme. It should, however, be a condition rendering an application by an undischarged bankrupt incompetent that an award of sequestration has been made and either (a) that a trustee has been appointed on the bankrupt's estate; or (b) where no trustee has been appointed, that the award of sequestration was made within the period of (say) six months preceding the application. (2) A debtor applying for a debt arrangement scheme, or a creditor to whom such an application is notified, should be required to furnish the administrator with such particulars within his knowledge as may be prescribed relating to any petition for or award of sequestration of the debtor's estate, and any other prescribed particulars of which he has knowledge relating to any sequestration or analogous insolvency proceedings whether within or furth of Scotland. (3) An application for a debt arrangement scheme should not bar a creditor's petition for the debtor's sequestration. Such a petition should be competent following the application, notwithstanding that the debtor is not notour bankrupt, at any time 2.20

Para.

until a debt arrangement scheme is confirmed by the court. An application for a debt arrangement scheme should be sisted if a petition for the debtor's sequestration is proceeding concurrently. If the application and the petition are in different courts, the court dealing with the petition should (after such intimation, hearings and inquiry as it thinks fit) determine which proceedings should continue. (4) The court should not have power either to refuse a debtor's petition for sequestration, or to recall an award of sequestration, on the ground that a debt arrangement scheme would be more appropriate unless the debtor concurs.

Notour bankruptcy

7. Provided creditors are allowed to petition for sequestration in appropriate circumstances notwithstanding proceedings for a debt arrangement scheme, such proceedings should not be treated as the constitution of the debtor's notour bankruptcy. If, however, a debt arrangement scheme is superseded by sequestration of the debtor's estate, the debtor should be deemed to have been rendered notour bankrupt at the date of his application for a debt arrangement scheme for the purpose of the equalisation or cutting down of prior diligences under sections 10, 103 and 104 of the Bankruptcy (Scotland) Act 1913 and the challenge of illegal preferences at common law or by statute. 2.22

Effect of interim order in protecting debtor from diligence etc.

8. (1) It is suggested that an interim order appointing an administrator to prepare a debt arrangement scheme should operate to sist or preclude new diligences or further proceedings in 2.34

pending diligences against the debtor by creditors listed in the debtor's statement of affairs as from the time when the order is intimated to the creditors or arrestees. (2) Actions by creditors listed in the statement of affairs to constitute disputed claims should not be sisted but undefended actions by such creditors for payment should be sisted and new actions for payment should be incompetent. (3) It is suggested that the order should not have the effect of restraining the electricity boards and British Gas Corporation from discontinuing supplies.

Administrator's power to apply for dismissal of proceedings

9. The administrator should be entitled to apply to the sheriff for an order dismissing the debtor's application on the grounds:- 2.36

(a) that the application is not competent; or

(b) that, having regard to all the circumstances, a scheme would have no reasonable prospect of success; or

(c) that the debtor has failed to disclose all relevant information or to give assistance reasonably requested by the administrator in connection with the proceedings or has otherwise failed to carry out his duties in connection with the application.

Restraints on disposal of assets

10. (1) The administrator should be empowered to register an inhibition in the personal registers rendering the debtor's heritable property incapable of voluntary disposal or encumbrance. The appropriate sheriff court should have power to restrict or recall the inhibition on cause shown subject to conditions. Unless previously recalled the inhibition should 2.38

Para.

be recalled on termination of the debt arrangement scheme proceedings and should in no case endure beyond the normal five year period for the prescription of inhibitions. (2) The debtor might be required to give an undertaking not to dispose of his moveable property, after the date of the interim order appointing the administrator, without the consent in writing of the administrator. Breach of this undertaking would be a ground of refusal of the application or termination of the scheme and a disposal might be challengeable by the administrator without prejudice, however, to the rights of a third party transacting in good faith and for value.

Interest on claims

11. In a debt arrangement scheme, interest accrued on unsecured creditors' claims up to the date of the interim order appointing the administrator should be payable, but not interest accrued after that date. It should not be necessary for the debtor to specify the interest due in his statement of affairs, but a creditor should specify in his claim whether he is claiming interest and specify the amount of interest due. 'Deficiency claims' by secured creditors should be treated in the same way as claims by unsecured creditors. If, however, it is thought that interest should be payable on claims, then we suggest it should be at a fixed rate prescribed by statute and variable by statutory instrument. 2.40

Extortionate credit bargains

12. Views are invited on the question whether as a matter of procedure the debtor should be entitled to make an incidental application to the sheriff in the debt arrangement scheme proceedings for an order under the Consumer Credit Act 1974 setting aside an obligation imposed by an extortionate credit bargain. 2.41

Para.

Possible priorities in debt arrangement scheme

13. The general rules for the sist, suspension and stoppage of diligence discussed elsewhere in the Memorandum should apply to Crown diligence on Exchequer decrees (assuming such diligence to be still competent) so that the Crown could not obtain a preference in a debt arrangement scheme by the use of such diligence. 2.43

14. Subject to our proposals on aliment and periodical allowance in Proposition 17 below, claims by a spouse of the debtor should not be postponed to other claims. 2.43

15. Priority should not be given in a debt arrangement scheme to claims for arrears of debts due in respect of accommodation and essential goods and services (viz rent, secured loan interest, fuel debts and debts in respect of goods necessary for the debtor's subsistence) to prevent the loss of the accommodation, goods or services. 2.44

Criminal fines

16. Priority should in effect be given to criminal fines by excluding these debts from debt arrangement schemes and by permitting their enforcement notwithstanding the stoppage of other diligences. The same rule should apply to other debts arising in criminal proceedings such as sums due under bonds of caution, or as security, for good behaviour and possibly sums due under a compensation order against an offender in terms of the Criminal Justice (Scotland) Bill presently before Parliament. 2.47

Aliment and periodical allowance

17. (1) An alimentary creditor claiming pecuniary aliment and an ex-spouse claiming periodical allowance should be entitled to rank in a debt 2.49

arrangement scheme for arrears accrued to the date of the application for the scheme. (2) It should be a ground for refusing to confirm a scheme that the debtor would not be able to continue to support his alimentary dependants in fact dependent on him or living in family with him. (3) No claim for pecuniary aliment or periodical allowance accruing while a debt arrangement scheme subsists should be included in a scheme, and an alimentary dependant or an ex-spouse claiming periodical allowance should not be entitled to enforce a claim by diligence while such a scheme subsists without the leave of the court.

Heritable securities

18. (1) Provision should be made amending the Conveyancing and Feudal Reform (Scotland) Act 1970, Schedule 3, paragraph 9 (which makes it a standard condition in a standard security that the debtor shall be held in default inter alia where the proprietor of the security subjects has become insolvent) to make it clear whether the proprietor should be held insolvent for the purposes of that paragraph by reason of the fact that he has applied for a debt arrangement scheme. (2) We have considered whether there should be a procedure whereby a debtor applying for a debt arrangement scheme should be entitled to apply to the sheriff for an order suspending the obligation to repay the instalments of capital due under a loan agreement heritably secured over the debtor's home for a time not exceeding a prescribed period, the amount not paid being made up on the expriy of the period of suspension. Such a procedure, however, would be inconsistent with the rights of heritable creditors to enforce securities even in the absence of default and therefore should not be introduced unless and until these rights are changed. (3) Payments to a heritable creditor should be made outside a debt arrangement scheme but the

2.55

administrator should have power to negotiate arrangements with a heritable creditor, including power to invite him to suspend repayment of capital for the duration of the scheme, the amounts not paid during suspension to be made up after the suspension expires.

Goods on hire purchase and conditional sale

19. (1) In the case of a hire purchase or conditional sale agreement, unless the debtor is otherwise in default, the mere fact that he has applied for a debt arrangement scheme should not permit the creditor either to require accelerated payment of sums due under the contract or to repossess or realise the goods. (2) An application for, or confirmation of, a debt arrangement scheme should not by itself cut off the rights of the creditor to repossess or realise goods on hire purchase or conditional sale. It is for consideration, however, whether in addition to the restrictions under the Hire Purchase (Scotland) Act 1965, further restrictions should be imposed in connection with debt arrangement schemes. In particular should the creditor be entitled both to repossess or realise the goods and to lodge a claim in the debt arrangement scheme for the deficiency, or should he be compelled to elect between these two remedies? 2.63

Landlord's hypothec

20. Views are invited on the question whether a debt arrangement scheme should affect the right of the debtor's landlord to sequestrate moveable goods for rent under the landlord's hypothec. 2.64

Preferences created by inhibitions

21. (1) Where a creditor has registered an inhibition in the personal registers, whether before or after the debtor's application for a debt 2.66

Para.

arrangement scheme has been made, the creditor should be compelled to elect between (a) working out his preference or completing his security by commencing proceedings outwith the debt arrangement scheme proceedings, eg a petition for sequestration or an action for adjudication, or (b) claiming a ranking in the debt arrangement scheme on a basis of equality with other creditors. (2) Where, however, the administrator has registered an inhibition (see Proposition 10 above) prior to the registration of the creditor's inhibition, it should not be competent for the inhibiting creditor to raise an action for the adjudication of the property to himself while the debt arrangement scheme proceedings are in dependence but otherwise the inhibition should have effect in the ordinary way.

Co-debtors and cautioners of debtor

22. A co-debtor or cautioner of a debtor subject to a debt arrangement scheme who pays the debt in question should be entitled to require an assignation of the debt from the creditor and to rank for the debt in the debt arrangement scheme. 2.67

23. The rule against double ranking for the same debt should apply in a debt arrangement scheme as in a sequestration. 2.68

Compensation (set-off), retention and lien

24. (1) The same principle of compensation (set-off) should apply in a debt arrangement scheme as applies in a sequestration. (2) It is also for consideration whether creditors having a preference over other creditors by virtue of a right of retention of lien should have a preference in a debt arrangement scheme. 2.69

Para.

Exclusion of future, contingent and disputed claims

25. Contingent creditors should be entitled to apply to be included in a debt arrangement scheme only after the event occurs which renders the debtor's liability certain. Disputed debts should be included in such a scheme only after the debts have been constituted. Debts payable at a future time (eg the repayment of a personal loan) should not be included until the time for payment has arrived. 2.71

Duration of debt arrangement scheme

26. The period allowed by a debt arrangement scheme for the payment by the debtor of instalments should not normally exceed three years from the date of the order confirming the scheme. 2.74

Income and other assets available for payment

27. The debtor's assets and non-exempt income should be taken into account in fixing the level of payments under the debt arrangement scheme, thereby compelling the debtor in certain cases to realise specific assets under threat of refusal of the application or revocation of the scheme. It is however for consideration whether the court should be given power to order the sale by the administrator or the debtor of specific assets. 2.79

Obtaining confirmation of the scheme by the court

28. (1) Within a prescribed period (say seven days) after the end of the period for lodging claims the administrator should send a copy of the draft debt arrangement scheme to each of the creditors listed as included in the scheme (ie those whose claims have been admitted) together with a notice requesting the creditor to state, on the pre-paid postage form enclosed, whether he objects to the scheme. (2) An opportunity might also be given to the creditors to 2.81

Para.

make representations for amendment of the draft scheme. If a majority in number and value of the creditors object to the draft scheme, it should not be confirmed and the proceedings should be dismissed by the sheriff. (3) If such a majority do not object, application should be made to the sheriff for an order confirming the draft scheme in the form submitted to the creditors or with amendments made by the administrator with the debtor's consent, pursuant to objections or representations by a listed creditor. (4) A hearing before the sheriff should then be fixed at which any listed creditor may object to confirmation of the draft scheme or make representations for its amendment.

29. (1) The sheriff should have power to confirm a scheme with or without modifications, to refuse to confirm the scheme, or to continue the case to allow agreement to be reached. (2) We suggest that the sheriff should make an order confirming a draft scheme only if he is satisfied - 2.84

(a) that the scheme has a reasonable prospect of success;

(b) that the public interest does not require the sequestration of the debtor's estate; and

(c) that it would otherwise be reasonable to make such an order having regard to all the circumstances, including the interests of any objecting creditor.

(3) If the sheriff refused to confirm the scheme, this fact would be intimated to creditors listed as included in the scheme and to arrestees listed in the debtor's statement of affairs, and the creditors' rights of action and of enforcement by diligence would revive.

Para.

Effect of sheriff's confirmation of scheme

30. (1) The sheriff's order confirming a debt arrangement scheme should operate to terminate pending diligences subject to payment of the expenses. (2) The making of an order should be a matter of public record but no advertisements thereof should be made in the newspapers. (3) It should be an offence for a debtor who has applied for or obtained confirmation of a scheme to obtain credit without disclosing that fact. (4) The disqualification from public office applying to an undischarged bankrupt should not affect a debtor subject to a debt arrangement scheme. 2.90

Collection and disbursements of payments

31. (1) Views are invited on the method of in-payments and disbursements discussed at paras. 2.91-2. (2) The court should be empowered to grant an order requiring payment of a proportion of the debtor's wages or salary to the administrator or sheriff court, being an earnings transfer order such as is discussed in Memorandum No. 49. (3) It is for consideration whether the administrator should have power to permit a debtor who has complied with a scheme for a prescribed period to act as his agent in collecting and disbursing the moneys due to the creditors. 2.95

Variation of debt arrangement scheme

32. (1) Any listed creditor and the debtor should be entitled to apply to the court for variation of the scheme on a material change in the debtor's circumstances. The debtor should report any such change to the administrator. The administrator should make a report periodically or on request to the listed creditors on the debtor's performance of 2.106

his obligations. (2) Views are invited on the proposals at paras. 2.100 and 2.101 for dealing with cases where creditors have been erroneously or wrongfully omitted from, or included in, a scheme. (3) Where during the subsistence of a scheme, the debtor incurs liability for a new debt, the creditor should be entitled to apply for inclusion in the scheme unless he knew, or ought reasonably to have known, of the existence of the scheme when the liability was incurred. If the creditor instructs diligence before termination of the scheme, the court should be empowered to recall or terminate the diligence on the administrator's application, and the expenses of the diligence should be payable to the creditor only if the creditor neither knew, nor ought reasonably to have known, of the existence of the scheme. (4) It should be competent for disputed and contingent claims to be included in a scheme as mentioned in para. 2.103. (5) In disposing of an application for inclusion of a creditor's late claim, the court should have a discretion whether to admit or refuse to admit the claim having regard to its effect on the dividends, the length of time which the scheme has still to run and all the circumstances.

Revocation of debt arrangement schemes and sanctions

33. (1) Provision should be made for the revocation of a scheme on the debtor's default on the lines discussed at para. 2.109 and on the other grounds mentioned at para. 2.100. (2) On revocation, creditors' rights to instruct diligence and to apply for sequestration should revive and there should be a procedure whereby the court could award sequestration at the same time as revoking a debt arrangement scheme. (3) In framing sanctions against breach by the debtor of his duties, the emphasis should be on revocation of the scheme and liability to 2.115

renewed diligence or to sequestration rather than on the creation of specific criminal offences.

Discharge of debtor

34. (1) The sheriff should have power to grant a discharge of the debtor if he has substantially complied with a debt arrangement scheme, or if his failure to comply is due to circumstances for which he cannot justly be held responsible. If the sheriff refuses a discharge he should have power to extend the period of the scheme subject to such conditions as to payment as he thinks reasonable. (2) A discharge should not operate as a discharge of cautioners or co-debtors of the debtor, and any deed by the debtor purporting to provide that he is liable for a discharged debt should be null. (3) Where a debt was omitted from a scheme through the debtor's fault and is later included, the discharge might be conditional on the debtor paying the creditor by instalments the same proportion of the debt as the total dividend payable to creditors included in the scheme from its commencement. 2.121

Administrators of debt arrangement schemes

35. Practical considerations seem to require that administrators of debt arrangement schemes should be full-time officials of the sheriff clerks' departments, rather than unpaid part-time volunteers appointed from a list of persons recruited from the community. We seek views, however, on this provisional conclusion and on the type and qualifications of persons who should be eligible for appointment as administrators. We do not consider that administrators should act as general advisers of debtors applying for debt arrangement schemes. 2.134