Scottish Law Commission consultation on the Tenth Programme of Law Reform – July 2017

RESPONSE FROM THE ASSOCIATION OF BUSINESS RECOVERY PROFESSIONALS' (R3) SCOTTISH TECHNICAL COMMITTEE

July 2017

Scottish Law Commission consultation on the Tenth Programme of Law Reform – July 2017

RESPONSE FROM THE ASSOCIATION OF BUSINESS RECOVERY PROFESSIONALS' (R3) SCOTTISH TECHNICAL COMMITTEE

INTRODUCTION

1. R3, the Association of Business Recovery Professionals, is the leading professional association for insolvency, business recovery and turnaround specialists in the UK. It promotes best practice for professionals working with financially troubled individuals and businesses. It has UK-wide representation and debates key issues facing the profession. Most insolvency practitioners (IPs) operating in Scotland are members.

2. The Association's Scottish Technical Committee ("STC") welcomes the opportunity to respond to the Scottish Law Commission consultation on the Tenth Programme of Law Reform. A number of the Committee's members took part in the Commission's early preparatory work.

3. Disclaimer of onerous property

Issue

3.1 Following the decision of the Inner House in the reclaiming motion by The Scottish Environment Protection Agency and others and in the Note for directions by the Joint Liquidators of the Scottish Coal Company (Scottish Coal case), a liquidator's inability to disclaim onerous property in Scotland has been confirmed.

3.2 The judgement concluded that it was not possible for the liquidator to abandon heritable property to which the company had a right. Similarly, it was not possible for a liquidator in Scotland to disclaim statutory licences.

3.3 Section 178 of the Insolvency Act 1986 provides powers for a liquidator in England & Wales to disclaim onerous property. There is therefore disparity in outcome for a company operating in Scotland depending on whether that company has been registered in England & Wales or in Scotland. Given the propensity to 'off the shelf' company formations there may be substantially different outcomes based on whether or not strategic consideration has been given to the domicile of the company. The Inner House rejected the argument that there is no

anomaly between legislation North and South of the Border since an English liquidator would not have the statutory powers to disclaim unless the lex situ requirements can be met.

3.4 The Scottish Coal case (3.1 above) was not appealed to the Supreme Court. It is understood that this decision may have largely been taken for commercial reasons. As a result, there remains significant lack of clarity on unanswered questions.

3.5 The issue of disclaimer of onerous property was considered previously by the Scottish Law Commission (Memorandum No 16, Insolvency, Bankruptcy and Liquidation in Scotland (1971)) which at that time concluded, "*in the absence of public demand for such a provision and in view also of the impending changes in the law relating to feudal tenure, such a change in the law is not required*". We would suggest that given developments since then, including the abolition of the feudal tenure through the Abolition of Feudal Tenure etc. (Scotland) Act 2000, it is now appropriate for this area to be re-visited by the Scottish Law Commission.

Impact in practice

3.6 It is not clear how the statutory right provided by section 178 of the Insolvency Act 1986 can be applied by English liquidators appointed to companies whose assets include heritable property situated in Scotland.

3.7 The general provision in section 169 of the Insolvency Act 1986 that a liquidator in a winding up by the court in Scotland has the same powers as a trustee on a bankrupt estate now lacks clarity.

3.8 A lack of clarity also exists on how compliance costs relating to obligations under statutory licences will rank in a liquidation and whether those costs will rank as ordinary unsecured claims or whether they will be treated as liquidation expenses, thereby ranking ahead of the claims of all other creditors.

3.9 The inability of a liquidator to disclaim onerous property has potentially serious implications. In the extreme, it may result in an insolvent company being left stranded with its directors unable to take positive action and no insolvency practitioner willing to act as liquidator. The impasse would impact on employees' ability to obtain their statutory entitlements and have a potentially significant impact on the public purse.

3.10 The current position may result in a higher assessment of risk by finance providers to companies operating or wishing to commence operations in certain sectors in Scotland This may result in difficulty for those companies to obtain finance or incur a higher pricing of finance both of which negatively affects the Scottish economy.

3.11 The absence of an orderly winding up leads to chaos and reflects badly on the regulatory framework.

Benefit of law reform

3.12 Law reform in this area would bring clarity to a complicated situation. While the situation may not impact on a high number of insolvencies, it is likely that where the situation is encountered this will involve significant sums.

3.13 Without clarity and resolution there may be situations where no office holder will be willing to be appointed to an insolvent company (due to potential significant personal liability). This would leave a company without an orderly closure and creditors in limbo. In addition, this may impact on employees and their ability to readily access statutory entitlements.

3.14 The apparent lack of parity between Scotland and the rest of the UK for the liquidator to disclaim onerous property means that there is a significant difference in outcome for creditors

due to whether or not the company is registered in Scotland. This differential does not support the Scottish economy and does not appear to have arisen as a matter of policy but as an unintended consequence of developments in legislation.

3.15 There is a need to ensure that the UK including Scotland is a good place to do business.

4. Trust deeds

Issue

4.1 The Scottish Law Commission in recent years completed a consolidation of bankruptcy legislation in Scotland a process which also considered the correction of some existing anomalies. The outcome of the exercise is the Bankruptcy (Scotland) Act 2016 which came into effect on 30 November 2016.

4.2 We consider that it would now be beneficial to continue that stream of work with a specific review of the law in relation to trust deeds.

4.3 Trust deeds (including protected trust deeds) are governed by a mixture of insolvency legislation, trust law and common law. This has led to uncertainty and ambiguity relating to their operation.

4.4 With the passage of time, changes in legislation have blurred the distinction between trust deeds and bankruptcy making less evident the purpose trust deeds are intended to serve and consequently the circumstances in which they are appropriate.

4.5 The economic situation and advancement of consumer debt have also changed substantially in recent years and the possibility of a more flexible voluntary debt relief solution, or alternatively a debt relief solution specifically meant to deal only with consumer debt, may be more appropriate to modern day Scotland.

Impact in practice

4.6 The legislation governing trust deeds has resulted in a hybrid debt solution which lacks clarity. This is evident in scenarios which recently have come to the fore through issues such as whether it is possible for a trustee to be re-appointed to deal with undiscovered assets following discharge, the status of unrealised assets conveyed as part of the trust, and the balancing of accounts (set off) in relation to debts included in a trust deed.

4.7 The lack of distinction in debt relief solutions and the inflexibility of scope in trust deeds results in confusion for debtors and may in certain instances lead to debtors entering debt relief solutions which are not the most appropriate for their circumstances.

Benefit of law reform

4.8 Providing a single complete statutory code for trust deeds by bringing together insolvency law, trust law and common law, would provide significant clarity in much the same way as has been achieved by the recent consolidation of bankruptcy legislation.

4.9 The opportunity to bring clarity to consumers will be of immense benefit to the people of Scotland. Since many of those who require access to debt relief are among the most vulnerable in society, this would promote further the Scottish Government policy of a Financial Health Service and delivering a system of Bankruptcy and Debt Advice fit for the 21st century.

5. Retention of records

Issue

5.1 When appointed as an office holder, an insolvency practitioner will take steps to obtain possession of the insolvent's records as a means of identifying assets to be recovered for the benefit of creditors and to enable the insolvency practitioner to report on the conduct of the directors in corporate insolvency.

5.2 Once the administration of the case has concluded, the insolvent's records will no longer be required, however an insolvency practitioner is required by insolvency law and otherwise to continue to keep and store these records as follows:

Receivership

5.3 Where no subsequent insolvency proceedings have commenced within 6 months of the receivership terminating, the receiver may only dispose of the books, papers and records of the company after the expiry of that period with the consent of the court or the members of the company by extraordinary resolution (Rule 7.34(2) Insolvency (Scotland) Rules 1986)

Administration

5.4 In an administration, the administrator must obtain directions from the creditor committee or the court to destroy or otherwise dispose of the company's records. If no such direction is given by 12 months after the date of dissolution of the company (which will be approximately 14 months after the termination of the liquidator's appointment) then the administrator may dispose of the books, papers and records of the company in a way they deem appropriate (Rule 7.34(4) Insolvency (Scotland) Rules 1986).

Court liquidation

5.5 In a court liquidation, the liquidator must obtain directions from the liquidation committee or the court to destroy or otherwise dispose of the company's records. If no such direction is given by 12 months after the date of dissolution of the company (which will be approximately 14 months after the termination of the liquidator's appointment) then the liquidator may dispose of the books, papers and records of the company in a way they deem appropriate (Rule 7.34(3)(a) Insolvency (Scotland) Rules 1986).

Members' Voluntary liquidation

5.6 In a members' voluntary liquidation, the liquidator must obtain directions from the members by extraordinary resolution to destroy or otherwise dispose of the company's records. If no such direction is given by 12 months after the date of dissolution of the company (which will be approximately 14 months after the termination of the liquidator's appointment) then the liquidator may dispose of the books, papers and records of the company in a way they deem appropriate (Rule 7.34(3)(b) Insolvency (Scotland) Rules 1986).

Creditors' Voluntary liquidation

5.7 In a creditors' voluntary liquidation, the liquidator must obtain directions from the liquidation committee or the creditors at or before the final meeting held under section 106 of the Insolvency Act 1986 to destroy or otherwise dispose of the company's records. If no such direction is given by 12 months after the date of dissolution of the company (which will be approximately 14 months after the termination of the liquidator's appointment) then the liquidator may dispose of the books, papers and records of the company in a way they deem appropriate (Rule 7.34(3)(c) Insolvency (Scotland) Rules 1986).

Bankruptcy

5.8 In a bankruptcy, there are no specific provisions relating to when a trustee may destroy or otherwise dispose of the bankrupt's records.

Tax

5.9 Notwithstanding the insolvency practitioner's ability to destroy the records as set out above, tax law requires the tax payer (for all practical purposes, the insolvency practitioner in this situation) to keep their records as follows:

- Individuals (not carrying on a business) are required to keep their records for 22 months from the end of the tax year to which they relate.
- Self-employed or in partnership are required to keep records for at least five years from 31 January following the tax year that the tax return relates to.
- Companies - the records for an accounting period will normally have to be kept for six years from the end of that period.
- VAT - a trader registered for VAT is obliged to retain certain records, for a period of six years from their creation.

Insolvency practitioner records

5.10 In addition to the company books and records, the insolvency practitioner will create their own books, papers and records relating to the administration of the insolvency proceeding. This will comprise working papers and the sederunt book. Legislation requires the sederunt book to be retained as follows:

- Company voluntary arrangement – 10 years from the date of completion of the voluntary arrangement
- Administration – 10 years from the date administration ends
- Receivership – 10 years from the termination of the receivership
- Liquidation – 10 years from the date of dissolution of the company

(all under Rule 7.33(5) and (7) Insolvency (Scotland) Rules 1986)

- Trust deeds – certain documents set out in legislation must be retained for a minimum of 12 months after the trustee's discharge (section 182 Bankruptcy (Scotland) Act 2016)
- Bankruptcy – no provision is made in legislation. The trustee is required to send the sederunt book to the Accountant in Bankruptcy prior to obtaining their discharge. The policy of the Accountant in Bankruptcy is that this shall be retained for a period of 6 months and thereafter destroyed.

5.11 The insolvency practitioner is also required to maintain a record of the insolvency proceedings under Regulation 13 of the Insolvency Practitioners Regulations 2005 which must be retained for a period of 6 years. This applies to all insolvency processes.

Other records

5.12 It is also accepted practice to keep certain other records for longer periods until the limitation period for a potential legal action has expired. Guidance issued to insolvency practitioners by R3, the professional association for insolvency, business recovery and turnaround specialists in the UK, suggests that the following records be kept for longer periods:

- Contracts executed as a deed - 12 years from the relevant date
- Leases - 6 years from the relevant date (12 years in England & Wales)
- Property related documents such as planning permission - 6 years from the relevant date (12 years in England & Wales)
- Labour agreements - 10 years from the relevant date
- Litigation papers - 7 years from the relevant date
- Health and safety records - Where there is the likelihood of personal injury claims, until the claim has been dealt with or has lapsed by reason of The Prescription and Limitation (Scotland) Act 1973.

Other factors

5.13 The complicated landscape for record keeping is further enhanced when consideration is given to the requirements under the Data Protection Act 1998 and the forthcoming introduction in May 2018 of the General Data Protection Regulations.

Impact in practice

5.14 Insolvency practitioners will tend to err on the side of caution and keep records for the longest period, which results in increased storage costs. We consider that there is a wider application of this principle to all businesses and entities that require to retain books, papers and records.

5.15 Having to keep records is an issue faced by all businesses and Government departments, but in an insolvency proceeding, the costs of the storage of records for extended periods will have to be met from the insolvent estate which will impact on the funds available for distribution to the insolvent's creditors.

Benefit of law reform

5.16 There needs to be an alignment of the periods for which records need to be kept, in particular after the completion of an insolvency procedure where the records are no longer required by the insolvency practitioner.

5.17 This submission is from the perspective of the insolvency profession, but the differing requirements for keeping records will affect many businesses and entities.

5.18 Alignment of record keeping requirements will bring clarity to a confused landscape and help reduce unnecessary costs to business ultimately bringing economic benefit to Scotland.

Eileen Blackburn, CA
Chair
R3 Association of Business Recovery Professionals
Scottish Technical Committee

July 2017