RESPONSE TO
CONSULTATION ON
TENTH PROGRAMME OF LAW REFORM

SCOTTISH LAW COMMISSION
Introduction

1 The Institute of Chartered Accountants of Scotland (ICAS) is the oldest professional body of accountants and represents over 21,000 members who advise and lead business across the UK and in almost 100 countries across the world. ICAS is a Recognised Professional Body (RPB) which regulates insolvency practitioners (IPs) who can take appointments throughout the UK. We have an in-depth knowledge and expertise of insolvency law and procedure.

2 ICAS’s Charter requires it to primarily act in the public interest, and our responses to consultations are therefore intended to place the public interest first. Our Charter also requires us to represent our members’ views and protect their interests. On the rare occasion that these are at odds with the public interest, it is the public interest that must be paramount.

3 ICAS is interested in securing that any changes to legislation and procedure are made based on a comprehensive review of all of the implications and that alleged failings within the process are supported by evidence.

4 ICAS is pleased to have the opportunity to submit its views in response to the Scottish Law Commission consultation on their Tenth Programme of Law Reform. We shall be pleased to discuss in further detail with the Scottish Law Commission any of the matters raised within this response.

Response

5 An effective insolvency regime is a significant factor in providing a functioning and growing economy and capital market. Insolvency regimes are largely driven by statute and therefore effective legislation in this area underpins the effectiveness of the insolvency regime in Scotland.

6 Legislation in respect of insolvency is partly devolved to the Scottish Parliament. Personal insolvency and receivership is fully devolved to the Scottish Parliament along with the process of winding up.

7 We would suggest three areas or project which could benefit from law reform, two of which are insolvency specific and one which has an insolvency specific application but has potentially a much wider scope. The three areas are:
   • Disclaimer of onerous property
   • Trust deeds
   • Retention of records

8 Further details on the problems and weaknesses with the current law; the impact this is having in practice; and the potential benefits of law reform in respect of each of these areas are provided in Appendices 1 to 3.

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Disclaimer of onerous property

Issue
The situation in relation to a liquidator’s ability to disclaim onerous property has been turned on its head following the decision of the Inner House following a reclaiming motion by the Scottish Environmental Protection Agency and others against a Note for directions by the Joint Liquidators of The Scottish Coal Company Limited [2013] CSIH 108 (the Scottish Coal case).

In short, the judgement concluded that it was not possible for the liquidator to abandon heritable property to which the company had a right. In the same way, it was not possible for a liquidator in Scotland to disclaim statutory licences.

Section 178 of the Insolvency Act 1986 provides powers for a liquidator in England & Wales to disclaim onerous property and therefore there is disparity in outcome for a company operating in Scotland depending simply on whether that company has been registered in England & Wales or Scotland. Given the propensity of ‘off the shelf’ company formations where the intra-UK registration may not be given strategic consideration the impact on creditors may be substantially different in all but the same circumstances.

The Scottish Coal case was not appealed to the Supreme Court. It is understood that this decision may have largely been taken as a commercial decision. As a result, there remains significant lack of clarity with unanswered questions.

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)). It concluded, at that time, "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, that it is now appropriate for this area to be re-visited by the Scottish Law Commission.

Impact in practice
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.

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.

There exists a lack of clarity 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.

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 being unable to take positive action and no insolvency practitioner willing to act as liquidator. The impasse would impact on employee’s ability to obtain their statutory entitlements and a potentially significant impact on the public purse.

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

**Benefit of law reform**

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.

Without clarity and resolution there may be situations where no office holder will be willing to be appointed to an insolvent company (due to significant personal liability) leaving 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.

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 simply due to whether the company is registered in Scotland or not. 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.
Trust deeds

Issue

The Scottish Law Commission has previously completed a review of bankruptcy in Scotland which has resulted in a consolidation Bill being laid in the Scottish Parliament and ultimately the Bankruptcy (Scotland) Act 2016 which came into effect on 30 November 2016.

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.

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

Over time, changes in legislation have also blurred the distinction between trust deeds and bankruptcy making it less evident the purpose they are intended to serve and consequently the situations in which they are appropriate.

The economic situation and advancement of consumer debt has 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 with consumer debt only, may be more appropriate to modern day Scotland.

Impact in practice

The legislation governing trust deeds has resulted in a hybrid debt solution which lacks clarity. This is evident in scenarios which have recently 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.

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

Reform of trust deed legislation would provide significant clarity through bringing together insolvency law, trust law, common law and case law into a single statutory code in a similar way to that which the recent consolidation of bankruptcy legislation has achieved.

The opportunity to bring clarity to consumers will be of immense benefit to the people of Scotland, many of those who require access to debt relief are the most vulnerable in society.
Appendix 3

Retention of records

Issue

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.

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

Receivership

Where no subsequent insolvency proceeding 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

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

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

In a member’s 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

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

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

Tax

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 your 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

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.

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

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

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

Insolvency practitioner 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 who require to retain books papers and records.

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

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.

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

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.