

**THE AWARD AND RECALL OF  
SEQUESTRATION:  
AN OVERVIEW**

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Wilkins Micawber.

Contrary to appearances, not a Faculty publicity shot

## 1. INTRODUCTORY REMARKS

There's a lot of sequestration about.

The Accountant in Bankruptcy's quarterly report of 22 July 2009 recorded 3,370 sequestrations in the three months to 30 June 2009. That was an increase of 31% on the same period in the previous year.

So I give no apology for offering an overview of grant and recall.

## 2. SEQUESTRATION – SOME DEFINITIONS

Professor G J Bell described the process thus:

'a judicial process for attaching and rendering litigious the whole estate, heritable and moveable, real and personal, of the bankrupt, wherever situated, in order that it may be vested in a trustee elected by creditors, to be recovered managed, sold and divided by him, according to certain rules of distribution....

the peculiarity of the contrivance [i.e. the judicial process] is, that except in those steps of proceeding in which the aid or superintendence of a court is absolutely necessary, the whole operations are extrajudicial. Thus, for the management, sale, and distribution of the estate, the creditors are formed into a united body in the nature of a corporation, acting on some occasions in general meetings, in others by functionaries ... elected with certain precautions, and under the incessant superintendence of a court of law.<sup>1</sup>

Bell emphasized that, except when involvement of the court was 'absolutely necessary', sequestration is an extra-judicial process. Recent reforms (of which more in due course) have expanded the circumstances in which sequestration is available while, simultaneously, reducing the need to involve the courts when sequestration is sought.

The Scottish Law Commission offered the following definition in 1982:

'Sequestration is primarily a coercive procedure initiated by a creditor by which the assets of a debtor who fails or refuses to pay his debts are made available to his creditors towards the satisfaction of their debts. The debtor may however petition the court for the sequestration of his own estate with the object of obtaining in due course a general discharge of his debts, a privilege not granted to debtors in several European legal systems unless they have paid their debts in full. It may be argued, however, that the primary purpose of sequestration is to secure the orderly transfer of the assets of an insolvent debtor – and in principle the whole of those assets – to his creditors generally. It is this transfer of assets for the benefit of creditors generally that distinguishes sequestration from other coercive measures for securing payment of debts in Scots law, notably the ordinary diligences ....<sup>2</sup>

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<sup>1</sup> Commentaries on the Law of Scotland (1804), ii (7<sup>th</sup> ed.) p 283

<sup>2</sup> Scottish Law Commission Report on Bankruptcy and Related Aspects of Insolvency and Liquidation (No 68; 1982, paragraph 2.8)

### 3. THE CONSEQUENCES OF SEQUESTRATION FOR DEBTORS

Historically the consequences of bankruptcy were grave indeed. As Wilkins Micawber famously counselled:

‘Annual income twenty pounds, annual expenditure nineteen pounds six, result happiness. Annual income twenty pounds, annual expenditure twenty pounds ought and six, result misery.’

He was not referring to misery lightly since the upshot of his inability to balance the books was incarceration. King’s Bench Prison was, of course, located far away in a barbarous foreign jurisdiction, but prior to the eighteenth century Scots law dealt with bankrupts equally harshly. The remedies at the disposal of creditors included imprisonment. There was no procedure by which a debtor could obtain a discharge of his liabilities in exchange for having surrendered his estate. Debtors remained personally liable for unpaid debts and were likely to remain destitute.

Times have changed. Imprisonment for debt has long been consigned to history.<sup>3</sup> The general tendency over the years has been to lessen the impact of sequestration on the bankrupt debtor. The Bankruptcy and Diligence (Scotland) Act 2007 fits into that general trend. The Act aimed to reduce the stigma associated with sequestration by reducing its duration and to encourage enterprise by permitting failed traders to return to commerce more quickly. Since the passing of the 2007 Act it has become easier, in certain circumstances, for impoverished individuals to obtain an award of sequestration (by means of an application to the accountant in bankruptcy). Moreover, debtors may now be discharged after one year rather than the previous three.<sup>4</sup>

### 4. THE AWARD OF SEQUESTRATION – PROCEDURE

There are now two distinct routes by which sequestration can be awarded: (a) application to a sheriff (b) application to the Accountant in Bankruptcy.

#### 5. **ROUTE 1: APPLICATIONS TO THE SHERIFF**

Note the coming into force of new Regulations and the repeal of older versions.

*The Bankruptcy (Scotland) Regulations 2008.*

In force 1 April 2008. They replace the Bankruptcy (Scotland) Regulations 1985. They contain, in the main, substantive rules and a number of forms (e.g. statutory demand, oath by creditor etc).

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<sup>3</sup> Debtors (Scotland) Act 1880

<sup>4</sup> Section 54 of the 1985 Act, as amended

*Act of Sederunt (Sheriff Court Bankruptcy Rules) 2008 ('the Sheriff Court Bankruptcy Rules 2008')*

In force 1 April 2008. They replace the Sheriff Court Bankruptcy Rules 1996. They contain, in the main, procedural rules and forms.

5.1 Form of petitions

Petitions for sequestration must be in the form prescribed in Appendix 1 of the Sheriff Court Bankruptcy Rules 2008. For example, Form 1 = petition for sequestration by a qualified creditor; Form 2 = petition by a temporary administrator; Form 3 = petition by trustee acting under trust deed.

5.2 Time limits

A qualified creditor's petition must be presented within 4 months of the apparent insolvency of a living debtor.<sup>5</sup>

In the case of a deceased debtor, an executor may present a petition at any time; a creditor may present a petition at any time where the apparent insolvency was constituted within four months of death; in any other case a creditor must wait until at least six months after the debtor's death.<sup>6</sup>

5.3 Jurisdiction

Sequestration is now competent only before a sheriff, the one-time jurisdiction of the Court of Session having been abolished.<sup>7</sup>

Broadly speaking, a sheriff has jurisdiction to sequester the estate of an individual if the debtor had an established place of business within the sheriffdom or was habitually resident there at the 'relevant time', i.e. at any time in the year immediately preceding the date of presentation of the petition.<sup>8</sup> Accordingly this may include a debtor who has actually left the sheriffdom at the time the petition is presented. The necessary averments anent jurisdiction should be contained in statement of facts 1 of the petition.

To comply with the requirements of Council Regulation (EC) 1346/2000 on Insolvency Proceedings statements of fact 2 and 3 should specify (a) the location of the debtor's centre of main interests (b) the location of any

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<sup>5</sup> Section 8(1) of the 1985 Act

<sup>6</sup> Section 8(3) of the 1985 Act

<sup>7</sup> Section 9 of the 1985 Act; section 16 of the Bankruptcy and Diligence Scotland Act 2007.

<sup>8</sup> Section 9 of the 1985 Act

places where the debtor has 'establishments', and (c) whether to the knowledge of the petitioner other insolvency proceedings have been opened and if so where. Article 3.1 of the Regulation provides that the courts of the Member State within the territory of which the centre of the debtor's main interests is located has jurisdiction to open main proceedings (those which have extra-territorial effect and encompass all of a debtor's assets). Article 3.2 allows secondary proceedings to be opened in parallel to main proceedings in any place where a debtor has an establishment. The determination of the location of the centre of main interests may require an enquiry into the facts in any given case.

#### 5.4 Service and appearance

Where a petition is presented by a qualified creditor the sheriff shall grant warrant to cite the debtor to appear on not less than 6 and not more than 14 days notice from the date of citation to show cause why sequestration should not be avoided.<sup>9</sup>

The warrant to cite will order the debtor to appear on a specified day.

Service is normally by Sheriff Officers.

#### 5.5 Who can be sequestrated?

Individuals, living or dead.<sup>10</sup>

A trust; a partnership including a dissolved partnership; a limited partnership; a body corporate or an unincorporated body.<sup>11</sup>

Note that the sequestration of a partnership proceeds separately from sequestration of the partner's individual estates, although such petitions can be combined if the individual partners are apparently insolvent.<sup>12</sup>

#### 5.6 Who can apply to the sheriff?

*Inter alios:*

(a) A debtor who obtains the concurrence of a qualified creditor or creditors;<sup>13</sup>

(b) A debtor, lacking the concurrence of a qualified creditor, who meets the following conditions: (i) the total amount of his debts is not less than £1,500 (ii) there has been no award of sequestration in the last

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<sup>9</sup> Section 12(2) of the 1985 Act

<sup>10</sup> Section 5 of the 1985 Act

<sup>11</sup> Section 6 of the 1985 Act

<sup>12</sup> Section 6(5) of the 1985 Act

<sup>13</sup> Sections 5(2), 6(3), 6(4) of the 1985 Act

five years (iii) he is apparently insolvent or has granted a trust deed which has failed to become protected;<sup>14</sup>

- (c) A qualified creditor who (i) at the date of presentation of the petitions is owed not less than £3,000 (it cannot be a contingent or future debt) when (ii) the debtor is “apparently insolvent”.

A qualified creditor must produce an oath in the prescribed form to the effect that the debtor owes the sum in question and it is payable.<sup>15</sup>

It is up to the creditor to prove apparent insolvency, for example by producing a statutory demand or charge for payment. Section 7 of the 1985 Act offers various ways in which apparent insolvency may be constituted. Amongst the most significant are:

- (i) sequestration or bankruptcy granted in England, Wales or Northern Ireland;
- (ii) the debtor giving written notice to his creditors that he has ceased to pay his debts in the ordinary course of business;
- (iii) the debtor becoming subject to main insolvency proceedings in another member state;
- (iv) the debtor granting a trust deed;
- (v) a charge for payment has been served and the days of charge have expired without payment;
- (vi) following service of a statutory demand (for payment of not less than £750) 21 days have elapsed without the debtor making payment or intimating that he disputes the debt is due.

The creditor must satisfy himself that the debtor is not subject to an approved debt payment programme. He must lodge a statement in the prescribed form stating that he has carried out a check of the Debt Arrangement Scheme Register.<sup>16</sup>

The creditor must also have provided the debtor with a debt advice and information pack 14 days before presentation of the petition.<sup>17</sup>

- (d) The trustee in a trust deed. If the debtor has not co-operated with obligations imposed on him by the trust deed or if it would be in the bankrupt’s best interests the trustee may petition for sequestration.<sup>18</sup>

## 5.7 Consideration of petition by a qualified creditor

A petition by a debtor will not normally call.

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<sup>14</sup> Section 5(2B) and 5(4) of the 1985 Act

<sup>15</sup> Section 11 of the 1985 Act; Bankruptcy (Scotland) Regulations 2008, Form 2

<sup>16</sup> Rule 12, Act of Sederunt (Sheriff Court Bankruptcy Rules) 2008

<sup>17</sup> Section 5D of the 1985 Act; Rule 14(1) of the Bankruptcy (Scotland) Regulations 2008

<sup>18</sup> Section 5(2) of the 1985 Act

Subject to a number of (newish) statutory exceptions (see below), when a petition by a creditor or a trustee under a trust deed calls and the sheriff is satisfied about certain procedural matters he shall 'award sequestration forthwith'.<sup>19</sup>

Historically sequestration procedure was summary in nature. Petitions had to be dealt with on the day. There was no statutory provision for continuing to another occasion.

To some extent that position has been relaxed. But it is worth noting that in section 12(3) of the 1985 Act the word 'forthwith' has been retained.

*Procedural matters to be considered by court*

The procedural matters about which the sheriff must be satisfied before he may grant sequestration are *inter alia*:<sup>20</sup>

- (a) has there been proper citation;
- (b) has the petition been presented in accordance with the provisions of the 1985 Act (e.g. is the creditor's oath in appropriate form?);
- (c) is the creditor a 'qualified creditor' within the meaning of section 5(6);
- (d) is the debtor apparently insolvent
- (e) has the creditor sent a copy of the petition to the Accountant in Bankruptcy?<sup>21</sup>

5.8 Exceptions in sub-section 12(3A) – when sequestration need not be granted

- (a) Notwithstanding that the sheriff is satisfied on other matters sequestration shall not be granted if the debtor shows cause why it cannot competently be awarded.<sup>22</sup>

'Incompetent' is not defined in the 1985 Act.

By way of example, service of contradictory demands for payment in the form of a charge for payment followed by a statutory demand rendered the petition incompetent in *Unity Trust Bank plc v Ahmed (Sh Ct) 1993 SCLR 53*.

As one would expect, the onus is on the debtor to establish incompetency.

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<sup>19</sup> Section 12(3) of the 1985 Act

<sup>20</sup> Section 12(3) of the 1985 Act

<sup>21</sup> Section 5(6) of the 1985 Act

<sup>22</sup> Section 12(3A)(a) of the 1985 Act

- (b) Sequestration shall not be granted where the debtor pays the debt; or produces written evidence of payment; or shows that there is sufficient security for the debt.

Again the onus falls on the debtor.

#### 5.9 Exceptions in sub-section 12(3B) – further cases in which sequestration need not be granted

If the debtor satisfies the sheriff that he will pay the debt within 42 days of the hearing, the sheriff may continue the petition for a period of no more than 42 days.

The power to continue a petition is a relatively new one, introduced by the Bankruptcy and Diligence (Scotland) Act 2007 and in force since 1 April 2008.

Previously, it was (probably) incompetent to continue a petition for sequestration even where, for example, this would have enabled a cheque to clear.

Notwithstanding the extension of their discretion most sheriffs are in practice likely to require firm evidence from a debtor confirming that a debt is to be settled before agreeing to a continuation.

Once again, the onus is on the debtor.

#### 5.10 Exception in sub-section 12(3C) – further exception

Where a sheriff is satisfied that a debtor will apply for a debt payment programme he may continue the hearing for such period as he thinks fit.

#### 5.11 Concurrent proceedings?

If in the course of sequestration proceedings any party becomes aware of concurrent proceedings for sequestration or similar proceedings in relation to the debtor that party must inform the sheriff, who may dismiss the petition before him.<sup>23</sup>

#### 5.12 Right of appeal - petitioner

If a petition is refused the petitioner has a right of appeal exercisable within 14 days. Appeal lies to the sheriff principal or the Court of Session.<sup>24</sup>

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<sup>23</sup> Section 10 of the 1985 Act

<sup>24</sup> Section 15(3) of the 1985 Act and regulation 8 of the Sheriff Court Bankruptcy Rules 2008

### 5.13 The award of sequestration

If an awarded, the date of sequestration is the date of the actual award when the petition is by a debtor.<sup>25</sup>

If it is a petition by a creditor the date of sequestration is the date upon which warrant to cite was granted by the court.<sup>26</sup>

## **ROUTE 2: APPLICATION TO THE ACCOUNTANT IN BANKRUPTCY**

### 6.1 The Bankruptcy and Diligence (Scotland) Act 2007 made it possible for debtors to obtain an award of sequestration by application to the Accountant in Bankruptcy.<sup>27</sup>

Debtor applications have proved popular. Out of 3,730 awards of sequestration in the three months to 30 June 2009 3,012 were as a result of such applications. This was an increase of 49% on the same quarter last year.

An application can be submitted for a modest fee (£100) and there is no need to prepare a formal petition.

The procedural rules are primarily within the Bankruptcy (Scotland) Regulations 2008, particularly regulation 14. Applications are by means of the relevant prescribed forms.

Taking an application by a debtor without concurrence as an example, the following must be submitted.

Form 9 – Debtors application form without concurrence of creditors

Form 12 – Statement of Assets and Liabilities

Form 13 – Form of undertaking to act as trustee (required only where the debtor nominates an insolvency practitioner to act as trustee).

It is a criminal offence to make a false declaration or to fail to disclose any material fact when completing the application forms (£5,000 fine or three months imprisonment on summary conviction).<sup>28</sup>

### 6.2 To qualify for an award of sequestration a debtor must satisfy certain general conditions.

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<sup>25</sup> Section 12(4)(a) of the 1985 Act

<sup>26</sup> Section 12(4)(b) of the 1985 Act

<sup>27</sup> Section 14(3)(b) of the 2007 Act; section 5(4B) of the 1985 Act

<sup>28</sup> Section 5(9) of the 1985 Act

He must:

- (a) owe a total debt of £1,500 or more; and
- (b) be living in Scotland or have lived in Scotland sometime during the last year;
- (c) not have been made bankrupt in the last 5 years; and
- (d) pay the application fee.

In addition a debtor must satisfy one of the following conditions:

- (a) there must be at least one creditor concurring, or;
- (b) the debtor must be able to prove his apparent insolvency, for example by producing evidence that he has been charged or served with a statutory demand and the period of notice has expired without payment or;
- (c) the debtor must have 'low income and assets'.

### 6.3 'Low Income / Low Assets' means:

- (a) Low income = gross weekly income of no more than the standard minimum wage for a forty hour working week (£229.20 a week). Pensions or maintenance payments are counted as income.

A debtor who receives income support, income-based jobseekers' allowance or working tax credits is treated as meeting the low income test, even if actual income is more than £229.20 a week.

No account is taken of other social security benefits or tax credits nor is account taken of income paid to another member of a debtor's family.

- (b) Low assets = a debtor has no single asset worth more than £1,000 and total assets are not worth more than £10,000. In addition, it means that the debtor must not own (or jointly own) a house or any other property or land.

Low income / low asset applications are a low cost means of obtaining an award of sequestration for individuals who are in debt but cannot obtain creditor concurrence, nor prove apparent insolvency.

Such individuals cannot make a debtor application to the sheriff because without creditor concurrence or proof of apparent insolvency the sheriff lacks the power to sequester an individual.<sup>29</sup>

The Accountant in Bankruptcy shall award sequestration forthwith if he is satisfied that the debtor's application has been made in accordance with

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<sup>29</sup> Section 5(2) and 5(2B) of the 1985 Act

the relevant provisions of the 1985 Act and that either (a) a qualified creditor concurs or that (b) the debtor is apparently insolvent or (c) the debtor meets the criteria for a low income / low asset application.<sup>30</sup>

## **7. RECALL**

### **7.1 The right of recall**

There is no right to appeal an award of sequestration. The 1985 Act provides a statutory right to petition the sheriff for recall.<sup>31</sup>

### **7.2 Who can petition?**

The debtor, any creditor, any other person having an interest, the trustee or the Accountant in Bankruptcy (section 16(1)).

### **7.3 Outline of procedure**

Service of the petition for recall upon (a) the debtor (b) the petitioner (c) anyone who concurred in the original petition (d) the trustee (e) the accountant in bankruptcy.

Publication of a notice in the Edinburgh Gazette stating that a petition for recall has been presented.

In the meantime sequestration continues as if the petition had not been presented.<sup>32</sup>

### **7.4 Time limits**

Ordinarily a petition for recall must be presented within 10 weeks of sequestration.

A petition may, however, be presented at any time on the following grounds:

- (a) the debtor has paid his debts in full or given adequate security;
- (b) a majority in value of the creditors reside in a country other than Scotland and it is appropriate for the estate to be managed elsewhere;
- (c) one or more other awards of sequestration have been granted.<sup>33</sup>

Where the estate includes a matrimonial home (or a family home) a non-entitled spouse (or a non-entitled partner in terms of the Civil

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<sup>30</sup> Section 12(1) of the 1985 Act

<sup>31</sup> Section 16 of the 1985 Act

<sup>32</sup> Section 16

<sup>33</sup> Section 16(4)

Partnership Act 2004) can present a petition under section 16 of the 1985 Act within 10 weeks of the grant of sequestration.<sup>34</sup> The sheriff may recall the sequestration or make such order as is appropriate to protect the occupancy rights of the non-entitled spouse or partner.

#### 7.5 Grounds for recall - general

The sheriff may recall the award where he is satisfied that it is appropriate to do so in all the circumstances of the case (including those circumstances arising after the award of sequestration).<sup>35</sup>

This is a wide discretion. The court can look at circumstances since the award was made.

Irregularity in the award of sequestration may justify recall.

However, there are relatively few cases of recall for reasons unrelated to such irregularities.

See *Grantly Developments and others v Clydesdale Bank plc and others [2002] ScotSC 66* - the case is noteworthy for the Extra Division's discussion of the scope of the court's discretion and of the procedural course followed.

#### 7.6 Effect of recall

So far as possible, recall should have effect of restoring the debtor to the position he was in before sequestration was awarded.

The court will ordinarily make an order for payment of the expenses of the trustee.<sup>36</sup>

### **8. A LATER THROW OF THE DICE**

#### 8.1 Action of Reduction

When the time limit for recall has expired a debtor may attempt to have sequestration reduced by means of an action of reduction in the Court of Session.

#### 8.2 Test when decree granted *in foro contestioso*?

Reduction is an equitable remedy. So when other means of review (such as recall) are available and have not been used, reduction is unlikely to be granted.

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<sup>34</sup> Sections 41 and 41A of the 1985 Act

<sup>35</sup> Section 17(1) of the 1985 Act

<sup>36</sup> Section 17(3) & (4) of the 1985 Act

It is necessary to aver (and prove) “exceptional circumstances” justifying reduction of an award of sequestration granted in absence.

This is a difficult test to satisfy.

### 8.3 Test if sequestration granted in absence?

When a decree is granted in absence the test on reduction may be slightly less exacting.

However it is still necessary to aver and prove that in the whole circumstances of the case decree in absence was not justified in fact and in law and the pursuer must put forward a full explanation of why it was sequestration came to be awarded unopposed (*Nunn v Nunn 1997 SLT 182*).

### 8.4 Are you going to succeed?

You should, at the very least, contemplate the possibility that an action of reduction will not succeed.

There is to my knowledge no reported case in which an award of sequestration has been successfully reduced.

Delay may count against the pursuer. In *Arthur v SMT Sales and Service Co Ltd 1999 SC 109* a delay of 12 years in seeking reduction of award of sequestration was fatal.

But (adopting Micawber’s motto) ... ‘Never Despair!’ *Barlow v City Plumbing Supplies Holdings Ltd [2009] CSOH 5* is noteworthy because the pursuer, seeking *inter alia* reduction of an award of sequestration, cleared the first hurdle when proof before answer was allowed.