



FACULTY OF ADVOCATES
Response to consultation on
Scottish Government Proposals for Changes to Protected Trust
Deeds

INTRODUCTION

The Faculty of Advocates is pleased to respond to the Scottish Government's document entitled "Scottish Government Proposals for Changes to Protected Trust Deeds". We set out below our answers to the questions which were posed in that document. Before coming to those answers, however, we wish to highlight a number of key matters which, in our view, form a necessary background to any proposals to alter the present Scottish régime governing trust deeds for creditors (or "TDs") and the protection whereby they become protected trust deeds for creditors (or "PTDs").

First of all, when a debtor grants a TD this is an entirely voluntary act by the debtor. This stands in marked contrast to a formal sequestration under the Bankruptcy (Scotland) Act 2016 (the "2016 Act") under which, although a debtor may indeed make a "debtor application" for the sequestration of his or her estate¹, the most common route to sequestration is the presentation of a creditor's petition: an event over which the debtor has no control. It is a corollary of the voluntary nature of the TD that, in proposing it, the debtor enjoys a broad degree of freedom as to what precisely his or her proposals to creditors are (though if the debtor uses a money adviser, he or she will be recommended a particular style of proposed deed). Indeed a debtor might be advised to seek a debt payment programme under the terms of

¹ Section 2(1)(a).

DAS. But the key point is that TDs are options alternative to either DAS or sequestration. No debtor requires to grant a TD.

Secondly, the effectiveness of a TD depends on whether it binds all of the debtor's creditors in their claims for payment and prevents them from unilaterally enforcing their debts against the debtor. The binding nature of a TD on creditors arises through either (a) all of the debtor's creditors acceding to (i.e., accepting) the TD or (b) the TD becoming "protected", i.e., becoming a PTD, whereby non-acceding creditors are forced to accept the TD. The requirements for a TD becoming a PTD are imposed, now, (not by regulations as suggested in para. 14 of the Scottish Government's document) by sections 163 onwards of the Bankruptcy (Scotland) Act 2016 not the least of which is the requirement for the deed to be registered in the register of insolvencies. We do not propose to examine those requirements here other than to note that the more stringent the requirements for protection, the less attractive TDs are likely to be as a debt relief solution. A TD which is unlikely to become a PTD (and therefore not bind all creditors) is not likely to be attractive to a debtor or their advisers. The effect of that would be the loss of choice open to a debtor in seeking debt relief.

Thirdly, where a TD becomes a PTD that status confers a number of protections upon the debtor. The precise nature of those protections is expressed in the 2016 Act in fairly technical language², but in essence they secure the debtor's possessions from attachment and protect the debtor's estate from an intervening sequestration. But even that latter form of protection is limited in one important respect. In contrast to the provisions of Schedule B1 to the Insolvency Act 1986 which, in the case of the administration of a company, give the company the benefit of an extensive (and potentially renewable) moratorium against various actions by creditors, only a more restricted form of moratorium for PTDs (restricted, that is, both in terms of its duration and in terms of its effect) is available under the 2016 Act³.

We are not aware of any statistics which show the number or percentage of sequestrations pronounced, in respect of a debtor under a PTD, before the scheme under the PTD has run its course. We are inclined to suspect that the number or percentage is relatively modest. Assuming that that is correct, we consider that,

² See sections 172 to 178 of the 2016 Act.

³ See sections 195 to 198 of the 2016 Act.

from the debtor's point of view, the major advantage of granting a TD which becomes a PTD is the ability to benefit from a structured payment of part of his or her debts, followed by a cancellation of the unpaid residue after a certain number of years, whilst enjoying at least some degree of freedom from the fear of an intervening sequestration provided he or she continues to comply with the obligations imposed upon him or her in terms of the trust deed.

If certain of the proposals upon which the Scottish Government is now consulting come into effect, we consider that two consequences may ensue: first, that many new trust deeds will not enjoy protected status and, secondly, that the prospect of their proposed trust deeds' not enjoying protected status will discourage debtors - or at least those who are acting upon professional advice - from granting the deeds in the first place.

In the light of these observations we now turn to the "Key Questions" which were posed in the consultation document.

1. **CONSIDERING IF A PTD IS THE BEST OPTION.**

Question 1(a): Do you agree that protection should be refused where the full debt in a trust deed could be repaid in 60 months, through the debtor's contributions?

Yes [] No [X]

Question 1(b): If you answered no to Q1(a), what do you consider an appropriate timescale?

Answer: A 60 month timescale is appropriate but the current flexibility for 48 months should continue to apply to the 60 month period. Two reasons are given for this Scottish Government proposal (in paragraphs 14 to 18 of the Proposals document).

The first reason is based on prejudice to creditors with "low debt" PTDs [i.e., £7,000 or below] through receiving substantially less under PTDs than under DAS. While it is asserted that DAS returns at least 90p/£ to creditors in contrast with PTD returns of under 20p/£ the Faculty notes that Table 1 in Appendix A (which deals with 100p/£

distributions) does not support this assertion. Furthermore the 49% figure appears to be inaccurate or of unclear origin. Nevertheless the Faculty is prepared to accept that as stated in paragraph 7, small creditors such as Credit Unions may be prejudiced through PTDs.

However the proposal is an unduly rigid “straightjacket” solution to the issue. It also appears to be based on a misunderstanding of the current position – as set out in sections 167 and 168 of the 2016 Act (*and not in any revoked regulations*). The current position is that for protection a TD must state that the debtor’s estate will be acquired by the trustee over a period of 4 years (s.167) and that the debtor will pay contributions from income to the trustee for a period of 4 years, or shorter if the trustee thinks that less time will be required for 100p/£ to creditors, or longer as decided by the trustee if there has been a period when contributions have not been paid over the 4 years, or longer if agreed between trustee and debtor (s.168). It is *not* the case (as stated in paragraph 14) that the Act prevents protection where the proposed contribution would pay off the debt in 4 years or less. Rather the matter is left by section 168, sensibly, to the trustee to determine if a lesser period is appropriate. If there is distribution of 100p/£ before the expiry of 4 years, the trust will come to an end, even with section 167.

The proposal seeks, presumably, to increase the period in section 167 to 5 years, but also in section 168 to exclude the possibility of the trustee deciding under section 168 for a lesser time than (as proposed) 5 years. In effect it seeks to exclude the discretion of the trustee, who is the person best placed to decide what would or would not be a reasonable time. This is, in the Faculty’s view, unduly rigid.

The second reason for the proposal, in paragraph 17, is difficult to understand. As section 168(2)(c)(ii) makes clear a debtor may be asked to contribute income for a period of more than 4 (or as proposed 5) years, but he or she does not require to agree. If there is agreement then the creditors will recover more. If there is no agreement, then they will recover less. The choice is that of the debtor and the trustee. On either view the Faculty is unable to see any reason for the removal of the choice in section 168(2)(c)(ii) and its replacement with a rigid requirement for contributions to end at the end of 5 years. There is no “anomaly” as suggested. Again, there are no “regulations” to be changed. They have already been revoked.

2. PAYMENT OF DEBTOR'S CONTRIBUTION - REGULATION 8

Question 2(a): Do you agree that a trust deed should not be eligible for protection where the value of contributions over its extended period is equal to or greater than the level of debt present when it was granted?

(Protected trust deeds are typically extended to allow payments to be made in lieu of property equity.)

Yes [] No [X]

Question 2(b): If you answered no to Q2(a), why not?

Answer: The heading to this question is misplaced. Regulation 8 has been revoked – presumably what is meant is section 168 of the 2016 Act.

As noted in answer to Question 1(b) above, section 168(2)(c) allows the trustee to extend the payment period for income of a TD to beyond the current 4 years in certain limited circumstances. No reason has been demonstrated as to why that discretion should be taken away. What has been stated in answer to Question 1(b) applies here also.

In addition the question is unclear. Where the value of contributions is likely to give creditors a return of 100p/£ that can be no reason to deny the debtor protection from individual creditors' claims and prevent him or her from pursuing a TD debt solution. The mischief prompting the question is not apparent from the Proposals document.

3. MINIMUM DEBT LEVEL – REGULATION 4

Question 3(a): Do you think that the minimum debt level allowed in a PTD should be increased from £5000?

Yes [X] No []

Observation: The heading to this question is misplaced. Regulation 4 has been revoked – presumably what is meant is section 164 of the 2016 Act.

Question 3(b): If you answered yes to Q3(a) at what level would you set the minimum debt level at?

£7500 [] £8000 [] £10000 [] Other [X]

(please state your preferred level) **Question 3(c):** If you answered other to Q3(b) what do you think the minimum debt level should be?

ANSWER : £15,000, subject to increase from time to time by Statutory Instrument. We consider that a threshold in the range £7,500 to £10,000 might lead to the cost of administering a PTD being disproportionately high in relation to the benefits expected to flow to the creditors. We also consider that, whatever threshold is ultimately chosen, it should be subject to upward revisal from time to time, in order to counteract inflation and thus preserve the "real" value of the threshold.

4. REMUNERATION PAYABLE TO TRUSTEE UNDER PROTECTED TRUST

DEED – REGULATION 23

Question 4(a): Do you agree that category one and two disbursements should be included in the fixed fee?

Yes [] No [X]

Question 4(b): If you answered no to Question 4(a), why not?

Answer: Once again heading to this question is misplaced. Presumably what is meant is section 183 of the 2016 Act. We are not aware of any empirical basis for assuming that the fixed fee would generally be sufficient to cover both category one and category two disbursements. Our experience of PTDs is naturally coloured by the fact that the cases in respect of which members of the Faculty of Advocates are instructed tend to require the resolution of questions of some complexity, the disbursements for which - whether they be those of an advocate or of a solicitor - are unlikely to be comprehended within the fixed fee.

**5. VOTING PROCEDURE IN PTD SECTION 170 (2) OF THE BANKRUPTCY
(SCOTLAND) ACT 2016**

Question 5(a): Should the voting system for PTDs be restructured where a trust deed would only be protected if out of the creditors who have voted those who own 75 % of the value of debt have actively accepted the terms of the trust deed?

Yes [] No [X]

Question 5(b): If you answered no to Question 5(a), what should the terms be?

Answer: We recommend a creditor threshold which mimics that which is provided for in section 899(1) of the Companies Act 2006 in order to approve a scheme of arrangement (between, for example, a company and its creditors). That section requires approval by "a majority in number representing 75% in value of the creditors ... voting". This approach has the twofold advantage of (1) ignoring the creditors who do not bother to vote and (2) striking a balance between the wishes of potentially large numbers of minor creditors and those of possibly small numbers of major creditors.

Question 5(c): Do you believe that AiB should be given general powers to refuse the protection of a trust deed?

Yes [] No [X]

Question 5(d): If you answered yes to Question 5(c) should these general powers to refuse the protection of a trust deed only be introduced if the creditor voting procedure does not change?

Yes [] No []

Question 5(e): If no creditors respond to the trust deed proposal do you agree that the trust deed should become automatically protected?

Yes [] No [X]

Please use the box below for any other comments you may have, or anything you feel is not covered in the consultation questions.

We notice that the consultation document refers on a number of occasions to the provisions of the Protected Trust Deed (Scotland) Regulations 2013. Our understanding is that those Regulations do not apply to trust deeds granted after the coming into force of the provisions of the 2016 Act regulating trust deeds (see in particular section 162 of that Act).

We respectfully consider that the Scottish Government should keep under review the desirability of continuing to make special legislative provision for trust deeds for creditors. We say this because, in recent years, the legislative landscape has changed. Whereas in the past a debtor in embarrassed circumstances had a binary choice between granting a trust deed on the one hand and being sequestrated on the other hand, there is now a third way, namely, a debt arrangement scheme. Given the availability of such a scheme, we consider that there now exists a serious question as to the purpose which trust deeds for creditors are supposed to serve and whether that purpose is one which should receive legislative support.

