Judicial Factors (Scotland) Bill – Call for Views

Scottish Parliament – Delegated Powers and Law Reform Committee

R3 Response, March 2024

R3 is the trade association for the UK's insolvency, restructuring, advisory, and turnaround professionals. We represent licensed insolvency practitioners, lawyers, turnaround and restructuring experts, students, and others in the profession. Our members work across the spectrum of the profession, from global legal and accountancy firms through to smaller, local practices. The insolvency, restructuring and turnaround profession is a vital part of the UK economy. The profession rescues businesses and jobs, creates the confidence to trade and lend by returning money fairly to creditors after insolvencies, investigates and disrupts fraud, and helps indebted individuals get back on their feet. Our members have direct experience of insolvencies and their impact on the UK economy and insolvent companies' stakeholders.

This response has been prepared by R3 in collaboration with members of its Scottish Technical Committee. The Committee deals with issues of general importance and significance to the profession in Scotland, keeping under review all UK and EU legislation, prospective and other matters relating to insolvency law. The Committee is multi-disciplinary and is made up of representatives from across the insolvency and restructuring profession, including practising insolvency practitioners, lawyers (including those specialising in advising regulated entities), academics, and others.

We would like to highlight that our response primarily concerns our views of the office of a Judicial Factor in a bankruptcy or a partnership dispute scenario. We have however considered the response provided by Dr Alisdair MacPherson, Prof Donna McKenzie Skene and Dr Euan West who are members of the Centre for Scots Law at the University of Aberdeen. Their response was kindly shared with us by Prof Donna McKenzie Skene who is also a member of the R3 Scottish Technical Committee. Where we support their comments on the Bill, we have duplicated the detail in our response and credited those parties rather than re-writing same.

<u>Question Page 1</u>

1. What is your view on the proposal to update the law in relation to judicial factors? Do you agree with the approach taken? If you would like to, please give reasons for your views.

Currently much of the law relating to judicial factors is derived from a variety of legislation and is dated. We therefore welcome the modernisation and consolidation of the legislation to meet today's requirements of judicial factors.

We acknowledge that there are relatively small numbers in terms of office but nevertheless their role is important in difficult circumstances, for example where there has been deadlock between parties in a partnership. We therefore agree with the decision to proceed with Option 1 as opposed to Option 2 given the diverse range of circumstances in which a judicial factor can be appointed and in particular the fact that specialist expertise is appropriate where there is insolvency.

2. What are your views on the proposals as set out in Part 1 of the Bill relating to the appointment of a judicial factor?

We would support the points raised by Dr Alisdair MacPherson, Prof Donna McKenzie Skene and Dr Euan West. For ease of reference they are quoted in italics as follows:

"For section 1(5)(b)(iii), we agree with the inclusion of place of business but wonder whether a non-natural person's registered office should be included as an additional category or at least specified as being included within the meaning of place of business in this context (as a registered office may not in fact be a place of business as such).

Also with reference to courts, there could be a provision for transfer of the matter to a court in a different location, on cause shown.

In section 3(1)(b)(i), the term "sensible" is ambiguous and implies a value judgement. Although we realise there are potentially issues with alternative terms, perhaps "reasonable" or "appropriate" would be preferable. If a word with a more subjective meaning such as "sensible" is used, it may be desirable to specify that it is to be sensible in the court's view, for example.

We broadly agree with the provisions on the finding of caution. However, "exceptional circumstances" in section 5(2) is a very high threshold. It may be more appropriate to specify that caution is to be provided where the particular appointment makes it "prudent" for it to be provided (or some equivalent to this). A wider understanding of "security" in this context could also be considered to extend beyond caution in the narrow sense of the term, to include e.g. indemnities, depositing an asset or consigning funds in court etc."

If 'caution' is to be understood more broadly for the purposes of legislation on judicial factors than at common law, it would be worthwhile to make that broader meaning explicit. For example, a member of R3 reported that the Accountant of Court has recently allowed them to exhibit their professional indemnity insurance cover and not require caution.

"In section 6(1), the provision ought to state that the clerk of court should send the notice of appointment to the Keeper of the Register of Inhibitions for registration, rather than the clerk of court actually registering the notice in the Register of Inhibitions. See e.g. section 26(1) of the Bankruptcy (Scotland) Act 2016 for an example of wording that could be adapted.

Section 6(3) should refer to sending for re-registration in the Register, rather than specifying that the judicial factor actually does the re-registration of the notice in the Register.

More broadly, attention should be given as to whether the effect of registration should have the effect of an inhibition – and thereby be more than just for advertising and information purposes only. This is a particularly pertinent issue given that vesting in the appointee in this context (see section 7) is analogous to vesting of property in a trustee in sequestration. There are various circumstances, especially with respect to non-natural persons, where an inhibition effect would be of value. It seems from paragraphs 43 and 44 of the Policy Memorandum that there is an assumption that mere registration in the Register of Inhibitions would have the effect of an inhibition; however, this is not certain without a provision to that effect. For example, for sequestration, there is a provision at section 26(3) of the Bankruptcy (Scotland) Act 2016 expressly specifying that recording has the effect of an inhibition.

However, there may need to be consideration of circumstances in which it is not appropriate for there to be an inhibition effect, i.e. where a party should still have the ability to deal with the property in

spite of the appointment of a judicial factor (but maybe this should not be permitted given the vesting of the estate in the judicial factor).

In section 7(1) it is unclear whether the reference to the "whole estate on which a judicial factor is appointed" means that it will always be the case that the entirety of an estate will vest in a judicial factor, or whether this is actually just referring to the extent of an estate that vests with the judicial factor (i.e. that it might be possible for less than the entirety of a party's estate to vest). We assume that the intention is for the entirety of an estate to vest; however, it may be desirable to clarify what precisely is meant by this (whether in a provision or in the Explanatory Notes).

Given that there is to be vesting of an estate in a judicial factor, attention should be given as to whether any of the additional provisions relating to e.g. a trustee in sequestration should also apply here. For example, should there be a limitation on the ability of a judicial factor to acquire title to heritable property within a certain time period, as there is for trustees in sequestration under section 78(3) and (4) (to give disponees a head start in the "race to the register")?"

3. What are your views on the proposed functions of a judicial factor as set out in Part 2 and schedule 1 of the Bill?

We would like to see a simplification and standardisation with accounting standards be applied to the submission of reports to the Accountant of Court.

We would also support the points that were raised by Dr Alisdair MacPherson, Prof Donna McKenzie Skene and Dr Euan West. For ease of reference they are quoted in italics as follows:

"It may be desirable to provide more clarity as to the fiduciary nature of the judicial factor's role in relation to the management of the estate (as per trustees, directors etc).

Under section 10(6), there should be consideration of whether "vest" is the appropriate word to use here – as there could be confusion with vesting of the estate outlined in section 7. Instead, it could just be said that "[o]n the appointment date the judicial factor has the standard powers" or "[o]n the appointment date the standard powers are conferred on the judicial factor". See also the reference to vesting of functions in Schedule 1, which should be amended as well.

In section 10(7), "the factory functions" is defined for the purposes of sections 10 and 11; however, there is no reference to "the factory functions" as such in section 11. We note that section 11 relates to specifying and varying functions, but also refers to the standard powers, and in section 10(7) the factory functions includes the standard powers, but apart from in section 11(1) there are only references to functions and not to powers. We consider that this requires clarification. We note what is stated in the Policy Memorandum, para 55, but we do not think the desired effect has been achieved.

With reference to section 12, attention should be given to whether there should be additional exclusions. While the exclusion of commercially sensitive information might be a possibility this could be misused in some cases, a stronger argument could be made in favour of excluding information on the basis of professional privilege. Perhaps the most appropriate approach would be to also exclude disclosure of information where there is "any other statutory provision or rule of law which prevents or excuses its disclosure."

In section 13(4), "financial assets" is defined as meaning "cash accounts", "share certificates" and "other assets of a similar nature". It is not entirely clear to us why these particular assets have been singled out and why there is only specific reference to cash accounts and share certificates."

Question page 2

1. Part 3 of the Bill covers the legal relationships which, as part of the process of managing the estate, the judicial factor might create with individuals or organisations not otherwise connected to the estate. What are your views on Part 3 of the Bill?

We would support the points raised by Dr Alisdair MacPherson, Prof Donna McKenzie Skene and Dr Euan West. For ease of reference they are quoted in italics as follows:

"The wording "stands in place of the factory estate" does not seem to be appropriate. The judicial factor does not stand in place of the estate, which itself has no legal personality. Rather, they stand in the place of the debtor, or other party in whom the estate was previously vested. More appropriately, the judicial factor could be considered to be an agent/representative in relation to the estate. In addition, consideration should be given to whether the wording of section 21(a) and (b) would also need to be re-worded as a result.

With reference to Schedules 2 and 3, there are other sections of the Bankruptcy (Scotland) Act 2016 that refer to judicial factors appointed under the 1889 Act. See sections 25, 98-100, 107 and Schedule 8, paragraph 1. It may be planned to deal with these under consequential amendments but it is important that these matters are actually addressed."

2. Part 4 of the Bill sets out the procedures for distributing the estate and ending a judicial factor's involvement in an estate. What are your views on Part 4 of the Bill?

Whilst the distribution of an estate where the debtor is insolvent is separately catered for elsewhere in legislation, our members may well be involved in matters outwith insolvency legislation, for example partnership disputes. In that regard, we would support the views of Dr Alisdair MacPherson, Prof Donna McKenzie Skene and Dr Euan West. For ease of reference they are quoted in italics as follows:

"In relation to the distribution of an estate, we wonder whether any consideration has been given to the ongoing status of a non-natural person in whom the estate was previously vested. For example, if there was a partnership or company and their estate was vested in a judicial factor and this was followed by a distribution, can the partnership or company continue in existence, with e.g. the capability of acquiring new estate (for example, after discharge of a judicial factor)? Perhaps you may wish to take the view that this should be dealt with by the normal rules of partnership law or company law but clarity would be desirable.

In section 33(1), should the use of "and" between (b) and (c) actually be "or"? In other words, should the section apply only where the Accountant is satisfied that there are insufficient funds to meet the expenses of (a), (b), and (c) or should it also apply where, for example, there are sufficient funds for (a) and (b) but not (c).

The interrelationship between section 34 (on the ending of a judicial factor's accountability on discharge) and section 38 (on the misconduct or failure of a judicial factor) could be clearer. Presumably it is intended that if a judicial factor is discharged but certain forms of misconduct later come to light and are reported to the court, then the court "may dispose of the matter in whatever manner it considers appropriate" and thereby hold the discharged judicial factor accountable/liable, perhaps most likely on an individual basis. If this is the intention, it should be made more express, with e.g. a statement that section 38 can apply (at least in some instances) irrespective of whether a judicial

factor's accountability has been discharged under section 34. By way of a comparator, the Insolvency Act 1986, section 212, provides that it is possible to bring misfeasance proceedings against an officeholder following their release but only with the leave of the court. In relation to judicial factors, we do not think that restricting the exception to freedom from liability following discharge to criminal liability is the best approach. Presumably it should also extend to conduct falling within s 38 which is only reasonably discovered after discharge.

In addition, while section 38(6)(b) notes that a disposal by the court under section 38(5)(b) does not affect any right which any other person may have in respect of loss consequent upon a judicial factor's conduct, the relationship between such rights and the discharge of a judicial factor may also benefit from an express statement."

3. What are your views on the proposal that the Accountant of Court should continue to supervise judicial factors, as set out in Part 5 of the Bill? If you would like to, please include any suggestions for alternative approaches to the supervision of judicial factors.

We are supportive of this proposal.

Question page 3

1. What are your views on the detailed arrangements relating to the Accountant of Court as set out in Part 5 of the Bill?

We are supportive of the proposals outlined.

2. The Bill retains two existing terms, 'judicial factor' and 'Accountant of Court.' What are your views on the suitability of those terms to describe the two roles? Please give details of any alternative terms which you think might suit these roles.

We have no concerns over the retention of the two existing terms which we believe to be understood in current practice.

3. Is there anything you think should have been in the Bill which is not in the Bill?

We have not identified anything in particular, except the points noted above.

Question page 4

1. Is there any other comment you would like to make on the Bill more generally?

We have no further comments.