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COMMERCIAL DISPUTE RESOLUTION
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DILIGENCE UPDATE: BANKRUPTCY AND DILIGENCE ETC (SCOTLAND) ACT 2007 – WHERE ARE WE NOW?

Implementation of the Bankruptcy and Diligence etc (Scotland) Act 2007 continues apace.

22 April 2009 saw the most recent instalment with the passing of Commencement Order No.4 including Parts 5 and 10 of the Act: namely the parts relating to inhibition, arrestments in execution and actions of forthcoming.

Part 5 - Inhibition

A warrant to inhibit is a court order preventing the debtor from voluntarily disposing of his land, e.g. by concluding a missive of sale or granting a standard security over it. Before 22 April 2009 inhibition also affected debts incurred after it was served; a prior inhibition giving a preference in the inhibittee's land upon liquidation or other insolvency process.

As regards procedure, after 1 April 2008 it was no longer necessary to obtain letters of inhibition in the Court of Session - such a warrant could be obtained from the sheriff.

However, when it came to registering and serving the inhibition, prior to 22 April 2009, the general rule was that the inhibition took effect only when it was recorded - unless a notice of inhibition was recorded, served, and then recorded again within 21 days in which case the inhibition was effective from the date the notice was first recorded. This became the common practice as a means of bringing forward the effective date and to prohibit land disposal as soon as possible. However, this was particularly crucial as the Insolvency Act 1986 and Bankruptcy (Scotland) Act 1985 provided that no inhibition or arrestment would be effective if it took effect less than 60 days before a sequestration/winding up.

Post 22 April 2009, the effective date is the date upon which the inhibition is served, regardless of whether a notice of inhibition is registered previously.

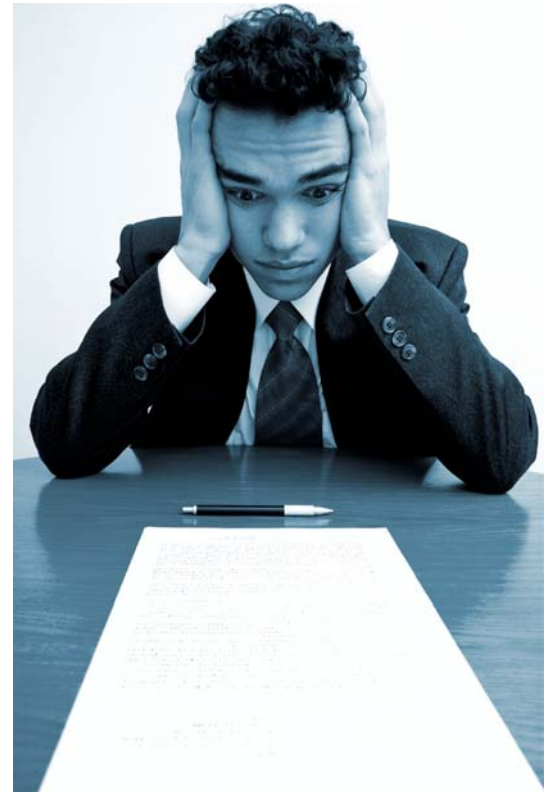
This could cause some concern in light of the 60 day rule mentioned above. However, the position is worse than that; post-22 April 2009, inhibitions no longer confer any preference in insolvency proceedings at all!

The Scottish Law Commission's reasoning behind this is more practical, rather than legalistic. In short, their report suggested that the ranking rules were too difficult to enforce and (perhaps more pertinently) created too great a preference for the inhibiting creditor over, for example, trade creditors who cannot be expected to check for the existence of an inhibition before supplying goods and services.

Part 10 - Arrestments

Arrestments secure funds owed to the debtor in the hands of third parties. The most common example is the freezing of bank accounts.

Prior to 22 April 2009, the frustrating aspect of arrestments was that the creditor did not know what was caught; Scottish banks would not divulge any information in line with their duties of confidentiality to their customers. The new provisions state that the arrestee (e.g. a bank) will now have to disclose the value of assets attached within 3 weeks of it being served.



The consequence of a failure to make such disclosure can be extreme: the arrestee can be ordered to pay to the creditor the lesser of either (i) the sum due by the debtor to the creditor or (ii) the amount representing the minimum protected balance. The arrestee will not be able to recover this sum from the debtor. Furthermore, failure to disclose can be treated as a contempt of court.

Moreover, prior to 22 April 2009, an arrestment did nothing more than ring-fence the arrested sums for the benefit of the creditor; he would then have to raise a separate action to recover the sums caught - without even knowing whether or not anything had actually been caught. As a result, such actions could prove to be a waste of time and money. Now, such actions are no longer necessary as funds will be automatically released after 14 weeks if no objection is lodged.

In conclusion, whilst the changes do, in many respects, streamline the procedures involved this has been at the expense of the abolition of ranking of inhibitions upon insolvency which must be regarded as a major blow to creditors.



(SOME) GOOD NEWS FOR CREDITORS: MRK 1 LTD V SARA PROPERTIES

In the last edition of our Commercial Dispute Resolution newsletter we offered a fairly pessimistic view for creditors on the prospects of obtaining security at the outset of a court action, following on from the implementation of certain sections of the Bankruptcy and Diligence etc (Scotland) Act 2007. Prior to the Act coming into force, a Pursuer had to show that their case had some merit and that granting a warrant to carry out such arrestment or inhibition was "proportionate". The 2007 Act replaced this test with a more stringent one. In order to obtain such a warrant, a Pursuer will still have to show that he has a case of some merit. However, it is no longer sufficient to show that the granting of a warrant to arrest on the dependence will be proportionate. The Pursuer must now show that there is a real and substantial risk that enforcement of any decree in the action would be defeated or prejudiced by:

- i. The debtor being insolvent or verging on insolvency; or
- ii. The likelihood of the debtor removing, disposing of, burdening, concealing or otherwise dealing with all or some of the debtor's assets.

There is also an overarching test that it must be reasonable in all the circumstances that the Pursuer be allowed the benefit of such security. The recent case of *MRK 1 Ltd v Sara Properties & Others* provides some

cause for optimism for the Pursuers. In this case the Defenders asked the court to recall warrants for background diligence on the dependence that had been granted on the basis that the statutory test was not met.

MRK 1 and Sara Properties had entered into an options agreement in terms of which the latter was granted an option to purchase property owned by the former. Sara Properties later decided to exercise that option and transferred certain properties of their own to MRK 1 in part satisfaction of the price. However, Sara Properties failed to pay the balance of the price and so MRK 1 Ltd raised an action against them for an order that they comply with the terms of the contract. Sara Properties defended that action, alleging that they had been induced into entering the contract as a result of a fraud perpetrated by, amongst others, MRK 1.

At the hearing relating to recall of the warrants, affidavits and other documentary evidence were presented to Lord Pentland relating to the Defenders' financial position. MRK 1 asked the court to allow the warrants to remain in place on the basis that Sara Properties were close to insolvency and that there was the likelihood of them dealing with their assets in a way which would prejudice MRK 1's claim.

The Defenders' Counsel advised the court that the total indebtedness of the firm was £720,000. Much of this debt was secured against heritable properties. The Defenders indicated that they owned property with a total value of around £900,000. Accordingly, the Defenders had demonstrated that there was "free equity" in the properties of around £180,000. However, Lord Pentland indicated that the proper test to consider was what the Defenders' financial position would be in the event that the Pursuers were successful in their claim. The Pursuers and Defenders had agreed that, if the Pursuers were successful in the action, the Defenders would be liable to them in the sum of £1,550,000.

Lord Pentland indicated that he had heard nothing from Sara Properties to suggest that, in the event they were indeed liable to pay these sums, they would be in a position to do so. He was accordingly satisfied that there was a real and substantial risk that Sara Properties would be unable to satisfy the Pursuers' claim, if that claim was upheld. Accordingly, he allowed the warrants to remain in place.

It's worth noting that the court seems to have placed much of the burden on Sara Properties Limited to prove their solvency, rather than on MRK 1 to demonstrate otherwise.

A LESSON IN DEBT RECOVERY

The current economic climate is resulting in an increase in debtors who appear unable to pay debts. Accordingly, businesses are placing more emphasis on debt recovery as they battle the recession.

However, the recent English case of *Ferguson v British Gas Trading Limited* [2009] EWCA Civ 46 provides a warning to those involved in debt collection. Ms Ferguson was previously a British Gas customer but switched suppliers. However, British Gas continued to send her bills for 8 months for sums already paid or covering the period following the termination of her contract with British Gas. British Gas threatened to cut off her gas supply, commence legal proceedings and report her to credit rating agencies if payment was not made. Ms Ferguson sent British Gas confirmation of her new supplier. However, despite numerous letters and telephone calls, British Gas continued to send the unjustified bills and threats.

Ms Ferguson raised an action against British Gas for £10,000 arguing that its conduct amounted to unlawful harassment in contravention of the Protection from Harassment Act 1997, having caused her stress, anxiety and financial loss through lost time and expenses. British Gas sought to have the claim struck out because Ms

Ferguson's pleadings did not disclose reasonable grounds for a claim in terms of the 1997 Act. The High Court refused its application and British Gas appealed this decision. British Gas argued that its conduct was not serious enough to constitute harassment under the 1997 Act. It contended that because the letters were computer generated, they ought not to have been taken as seriously as if they had come directly from an individual. In addition, it argued that even if its conduct did amount to harassment, it could not possibly be guilty as a large corporation. They claimed that Ms Ferguson had to demonstrate that British Gas knew, or ought to have known that the conduct amounted to harassment.

In the Court of Appeal, Lord Justice Jacobs was not impressed with these arguments. He advised that the threats issued were read by a real person who was likely to suffer real anxiety and distress, despite the fact that they had been computer generated. Further, he advised that at the very least, British Gas ought to have known about the conduct and could not rely on a "defence of incompetence".

The appeal was refused and the case remitted to trial, however, subsequently settled out of court.

This case is obviously an extreme example, however, it has highlighted valuable lessons for those involved in debt recovery:

- If you pursue the wrong person or pursue *after* a bill has been settled, you may risk both civil and criminal liability. This could result in you being liable to pay damages and/or a court order for interdict, interim interdict or non-harassment being granted against you, breach of which could result in imprisonment of up to five years;
- You may not be able to avoid taking responsibility for correspondence sent with the argument that it was merely computer generated;
- Ensure your computer systems which hold customer data are up-to-date and accurate. This is of particular importance for those businesses dealing with debt factoring arrangements; and
- Appreciate the importance of good customer relations. Ensure your customer complaints procedures are accessible and efficient, with particular reference to debt collection procedures.

(SOME) BREATHING SPACE FOR BORROWERS

The 'credit crunch' has left few sectors unscathed. One particular area which has given the government great cause for concern is the housing sector and, more particularly, the issue of families finding themselves homeless resulting from an inability to manage mortgage payments. In order to help address this issue of homelessness, the government has introduced in England a new civil procedure protocol, the Pre-Action Protocol for Possession Claims based on Mortgage or Home Purchase Plan Arrears in Respect of Residential Property (the "Protocol"). This Protocol seeks to promote negotiation between lenders and borrowers, avoiding court actions unless absolutely necessary and, ultimately reducing the number of people becoming homeless.

Application and Aims

Application of the Protocol extends to monetary and possession claims by lenders on mortgages over residential property. It does not alter the parties' existing rights and obligations. The Protocol aims to ensure that parties act in a fair and reasonable manner in attempting to resolve these matters without resorting to court proceedings where possible. Communication between the parties is considered crucial.

Contact and Information

The Protocol prescribes that where a borrower falls into arrears, the lender should provide them with information on regulatory advice, together with specific details of the arrears. Reasonable steps should be taken to discuss with the borrower the cause of the

arrears, the borrower's financial situation and whether the causes of the arrears are temporary or long term, with a view to establishing a reasonable time in which the borrower might be able to pay. In addition, the lender should be open to reasonable requests by the borrower to make changes in order to facilitate agreement, for example, altering the date of payment. Any refusal of these requests must be provided in writing, together with reasons for doing so. In the event the borrower fails to comply with any agreement reached, the lender requires to give the borrower 15 business days notice in writing of its intention to raise a possession claim, unless the breach of the agreement is remedied.

Postponement

A lender should refrain from raising court proceedings where the borrower can demonstrate that he has submitted a claim to an insurer under a mortgage payment protection policy, there is a reasonable expectation that a payment will be made by the insurer and that he is able to pay a mortgage instalment not covered by the insurance. In addition, a claim should be postponed where the borrower can demonstrate that reasonable steps have been or will be taken to market the property at an appropriate price in accordance with professional advice.

Alternative Dispute Resolution

The court considers that a possession claim is a last resort and should not normally be started when settlement is still actively being explored. Discussions between parties are

encouraged with a view to achieving an extra-judicial resolution. Suggestions include extending the mortgage term, changing the type of mortgage, deferring payment of interest or capitalising the arrears.

Scotland

The Protocol applies to England only, however the issue of repossessions and homelessness is also being addressed north of the border. Section 11 of the Homelessness etc (Scotland) Act 2003 came into force on 1 April 2009, requiring all landlords and creditors to notify the relevant local authority before taking action to recover a rented property. The purpose of this "jigsaw piece" of legislation is to ensure that local authorities have early notice of people who are at risk of homelessness and, with the assistance of other agencies, can provide assistance to the tenant and take steps to avoid unnecessary homelessness.

Conclusion

The Protocol, therefore, takes a "prevention is better than cure" approach in an attempt to control the number of people finding themselves homeless in this difficult financial climate. Statistics look promising following the new Protocol – the Ministry of Justice has just released figures showing that the number of initial repossession claims in England and Wales is 32% lower than in the previous three months. At this early stage, however, it is unclear whether the launch of the Protocol has led to a permanent fall in the number of new mortgage possessions, or whether the breathing space provided is merely postponing the inevitable.

AND FINALLY. . . .

IT DOES WHAT IT SAYS ON THE TIN – OR DOES IT? – FM FINNIESTON LIMITED V ROSS

The general approach to interpreting contracts, such as missives, is to give the words used their ordinary meaning and to give effect of the objective intention to the parties. As such, in *FM Finnieston Limited v Ross* (OH 26th March 2009) the seller, a developer, perhaps came in for a nasty surprise.

In short, the missives of sale provided that the date of entry was 14 days after the later of "(a) the date on which the plot has been inspected and passed by the Local Authority as habitable and fit for occupation (whether or not a formal certificate to that effect by the Local Authority is available at that time) and (b) the date on which a cover note has been issued by NHBC." On a literal interpretation therefore, it would appear that as long as the plot is passed by the Local Authority as being habitable and fit for occupation, even if only verbally, that will suffice. To this end the seller contended that upon the building inspector inspecting the properties and confirming that they had been completed to the satisfaction of the local authority and 14 days without payment having elapsed, they were entitled to rescind the missives.

However, the court held that the missives had to be considered against the statutory background, namely the Building (Scotland) Act 1959. The 1959 Act provides that a building cannot be occupied unless a completion certificate or temporary habitation certificate has been issued. There was no provision for verbal authority by the Local Authority. Nor do the provisions of the Act refer to a building as being "habitable and fit for occupation" - the completion certificate certifying that "the building complies with the conditions on which the relative warrant was granted".



As such, the statutory regime made no provision for a Local Authority to pass a property as being "habitable and fit for occupation" as provided in the missives - nor did it make provision for consent by any means other than a formal certificate.

As such, the purchaser argued that the lack of a formal certificate envisaged by the missives referred to a temporary habitation certificate (rather than a formal completion certificate) and not to e.g. a verbal authority that the property is "habitable and fit for occupation".

The court preferred this interpretation, particularly in light of the position of the typical domestic purchaser who would expect to move into the property on the date of entry and not to be prohibited from doing so by the lack of a certificate in terms of the Act (which would, of course, constitute an offence).

The clause in question is by no means unusual and, as such, developers would be well warned to get their completion or temporary habitation certificates as soon as possible and to re-consider rescinding in the absence of the same.

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