OUTER HOUSE, COURT OF SESSION

[2018] CSOH 90

CA116/17

OPINION OF LORD DOHERTY

in the cause

THOMAS FOX, as trustee on the sequestrated estate of John O'Boyle

Pursuer

against

KAREN BRENNAN

Defender

Pursuer: MacDougall; Halliday Campbell WS
Defender: J Gardiner; TC Young LLP

4 September 2018

Introduction

[1] The pursuer is the trustee on the sequestrated estate of John O'Boyle ("the debtor"). The debtor was sequestrated on 11 February 2015 on his own debtor application. In this action the pursuer seeks declarator that the debtor made two gratuitous alienations to the defender. The alienations - of £190,960 ("the first alienation") and £67,837.97 ("the second alienation") - are said to have been made in August and September 2014. The pursuer also seeks payment of those sums by the defender.

[2] The case came before me for a debate on the commercial roll. Counsel for the pursuer accepted that the defender's averments anent the second alienation are suitable for

inquiry. Accordingly it is only necessary to consider the arguments which were advanced in relation to the first alienation.

The pleadings

The summons

[3] The pursuer's averments may be summarised as follows. At all material times the defender has been the debtor's partner. On 28 August 2014 the debtor transferred £190,960 to an account created to finance the acquisition of a house at 16 Attlee Road, East Kilbride. Title to 16 Attlee Road was taken in the defender's sole name on 4 September 2014 and the debtor and the defender lived together there. The defender sold the house for £200,000 in January 2017 and on 17 January 2017 she paid £197,462.20 to the debtor. The transfer of £190,960 and putting title in the defender's name was a gratuitous alienation in terms of s 34 of the Bankruptcy (Scotland) Act 1985. It was granted for no adequate consideration. Following the sale of 16 Attlee Road the debtor and the defender have lived together at a flat owned by the defender. The defender acted in bad faith by facilitating the putting of funds out of the reach of the debtor's creditors.

The defences

[4] The defender admits that £190,960 was transferred to an account created to finance the acquisition of 16 Attlee Road and that title to that house was taken in her sole name. She admits that she was the debtor's partner at the time but she denies that they lived together at Attlee Road or that they now live together at the flat owned by her. She denies that she knew or ought to have known about the debtor's sequestration or his financial affairs at the relevant times, or that she acted in bad faith with a view to putting funds out of the reach of

his creditors. She claims to have had a very limited understanding of the debtor's financial affairs and a very poor understanding of financial affairs generally. She avers that she trusted the debtor, and in so far as he discussed his financial affairs with her prior to his sequestration he assured her that he had sufficient funds to pay his creditors. She accepted the transfer of 16 Attlee Road into her name. She avers that there was "a loose understanding" between the debtor and her "that she would look after him if his health deteriorated" (but she does not aver that was adequate consideration for the first alienation). When the debtor's "financial situation deteriorated" he asked her to sell 16 Attlee Road. She complied. Net sale proceeds of £197,462.20 were paid to her and she paid them to him. She avers (answer 5) that that payment "constituted adequate consideration" and that she "restored the relevant property to the debtor's estate" (ans 10). Her second and third pleas-in-law are:

> "2. The transfers by Mr O'Boyle being for adequate consideration, decree should be refused with expenses to the defender.
> 3. Esto all or parts of the transfers were for inadequate consideration, the alienation having been restored decree should be refused with expenses to the defender."

The relevant statutory provisions

[5] The date of sequestration precedes the coming into force of the Bankruptcy (Scotland) Act 2016. The issues in the present case are governed by the Bankruptcy (Scotland) Act 1985 (as amended by other enactments prior to the date of sequestration (the principal such enactment being the Bankruptcy and Diligence etc. (Scotland) Act 2007)) ("the 1985 Act"). The relevant provisions of the 1985 Act provide:

> "**31.— Vesting of estate at date of sequestration.**
> (1) Subject to section 33 of this Act... the whole estate of the debtor shall by virtue of the trustee's appointment, vest in the trustee as at the date of sequestration for the benefit of the creditors.
> **...**

34.— Gratuitous alienations.
(1) Where this subsection applies, an alienation by a debtor shall be challengeable by—
(a) any creditor who is a creditor by virtue of a debt incurred on or before the date of sequestration, or before the granting of the trust deed or the debtor's death, as the case may be; or
(b) the trustee, the trustee acting under the trust deed or the judicial factor, as the case may be.
(2) Subsection (1) above applies where—
(a) by the alienation, whether before or after the coming into force of this section, any of the debtor's property has been transferred or any claim or right of the debtor has been discharged or renounced; and
(b) any of the following has occurred—
(i) his estate has been sequestrated...
...
(c) the alienation took place on a relevant day.
(3) For the purposes of paragraph (c) of subsection (2) above, the day on which an alienation took place shall be the day on which the alienation became completely effectual; and in that paragraph *"relevant day"* means, if the alienation has the effect of favouring—
(a) a person who is an associate of the debtor, a day not earlier than 5 years before the date of sequestration, the granting of the trust deed or the debtor's death, as the case may be; or
(b) any other person, a day not earlier than 2 years before the said date.
(4) On a challenge being brought under subsection (1) above, the court shall grant decree of reduction or for such restoration of property to the debtor's estate or other redress as may be appropriate, but the court shall not grant such a decree if the person seeking to uphold the alienation establishes—
...
(b) that the alienation was made for adequate consideration;
...
(8) A permanent trustee ... shall have the same right as a creditor has under any rule of law to challenge an alienation of a debtor made for no consideration or for no adequate consideration.
..."

Counsel for the pursuer's submissions

[6] Counsel submitted that the defences disclose no relevant defence in respect of the first alienation. All the requirements of s 34(2) are satisfied. The defender's averments that the alienation was made for adequate consideration are irrelevant. It is clear from those averments that nothing had been granted in exchange for the alienation. Reference was

made to *Grampian Maclennan's Distribution Services Limited* v *Carnbroe Estates Limited* 2018 SLT 205, at paras 14, 15 and 18. The transfer of funds to the debtor in January 2017 had not been consideration for the alienation. Even if it was correct that it could be a relevant defence to a s 34(1) challenge that the alienation had been restored to the debtor prior to sequestration (cf *Blackburn* v *Alexander* [2015] CSOH 179), or that there had been restoration of the alienation to the sequestrated estate, there had been no such restoration here. There had merely been a payment of funds to the debtor for his benefit after the date of his discharge. Since all of the conditions for the application of s 34(1) were met, and neither of the suggested defences was relevant, the court was bound to order restoration of the cash equivalent of the alienation to the sequestrated estate (s 34(4)). The sequestrated estate was what was meant by the words "the debtor's estate" in s 34(4). The subsection did not confer an equitable discretion on the court to decline to order restoration of the alienation or its equivalent (*Short's Trustee* v *Chung* 1991 SLT 472, per the Opinion of the Court delivered by Lord Sutherland at p 476L). Decree *de plano* should be pronounced in terms of the first and third conclusions.

Counsel for the defender's submissions

[7] Counsel for the defender submitted that the defender's averments set out a relevant defence to the pursuer's challenge of the first alienation. It could not be said that even if the defender proves all that she avers the defence was bound to fail (*Jamieson* v *Jamieson* 1952 SC (HL) 44). A proof before answer should be allowed in relation to the challenges to both alienations.

[8] The payment made to the debtor after his discharge had been "restoration of property to the debtor's estate" in terms of s 34(4). On a proper construction of s 34(4) "the

debtor's estate" and the debtor are inseparable. On sequestration the contents of the debtor's estate vested in the trustee but the debtor's estate did not. If repayment to a debtor is not a relevant defence the recipients of alienations may be discouraged from making voluntary restoration. Moreover, it would be unfair to the recipient of an alienation if, in effect, it has to be restored twice. Counsel relied upon *Blackburn* v *Alexander, supra,* and on a passage in McKenzie Skene, *Bankruptcy,* para 14.31 which cited that case as authority, in support of the proposition that repayment of a gratuitous alienation may be a relevant defence. He ventured that the word "alienation" in s 34(1) might be construed as meaning an alienation which had not subsequently been repaid. A less likely possibility was that such repayment was a common law defence which supplemented the statutory defences in s 34(4). While *Blackburn* v *Alexander* had concerned a corporate insolvency, the approach to s 34 of the 1985 Act ought to be essentially the same as the approach to s 242 of the Insolvency Act 1986 ("the 1986 Act"). The fact that the repayment in *Blackburn* v *Alexander* was said to have been made before the liquidation date ought not to be seen as a material ground of distinction from the circumstances of the present case.

[9] Counsel also maintained that the repayment to the debtor in 2017 constituted "adequate consideration" for the first alienation. The word "consideration" is to be given its ordinary meaning of something which is given or surrendered in return for something else (*MacFadyen's Trustee* v *MacFadyen* 1994 SC 416, per the Opinion of the Court delivered by Lord McCluskey at p 421E-F; *Grampian Maclennan's Distribution Services Limited* v *Carnbroe Estates Limited*, *supra,* at para 18). The making of an alienation and the giving of consideration need not be contemporaneous. Whether something is indeed consideration for an alienation falls to be determined at the time the supposed consideration is given, not

at the time of the alienation. The defender's averments set out a relevant s 34(4)(b) defence that the alienation "was made for adequate consideration".

[10] Counsel was critical of the trustee's predecessor in office. If she had challenged the alienation "during the sequestration" (by which I understood counsel to mean before the debtor's discharge, whether that was the date it in fact occurred (11 May 2016) or a later date to which his discharge could have been deferred on application by the trustee), counsel asserted that the defender would have repaid the alienation to the trustee when the challenge was made. It would be inequitable if the defender had to repay the first alienation not only to the debtor but also to the trustee. If creditors were prejudiced by the alienation not being repaid to the trustee they may have a remedy in damages against his predecessor if they are able to establish professional negligence on her part.

Decision and reasons

[11] Since the challenge is to the relevancy of the defender's averments I require to take them *pro veritate*. Where matters are disputed the defender's version of events must be assumed is true at this stage (*Jamieson* v *Jamieson*, *supra*).

[12] In my opinion it is clear that the combined effect of (i) the transfer by the debtor of £190,960 to an account created to finance the acquisition of 16 Attlee Road, and (ii) the taking of title in the defender's name, was that there was an alienation by the debtor to the defender which is challengeable in terms of s 34(1). The alienation involved a transfer of part of the debtor's property (s 34(2)(a)). The debtor's estate has been sequestrated (s 34(2)(b)(i)). The alienation took place on a "relevant day" in terms of s 34(2)(c) and s 34(3).

[13] It is important to have in mind the objects of the 1985 Act and of s 34 in particular. In *MacFadyen's Trustee* v *Macfadyen, supra,* the Extra Division observed at p 421H:

> "A principal purpose of the Bankruptcy (Scotland) Act 1985 is to regulate intromissions by a debtor with his material assets in order to safeguard the interests of his creditors: *cf.* the headnote to secs 34 and 35."

In *Short's Trustee* v *Chung*, *supra*, the Second Division noted at p 476K:

> "It is in our opinion clear from a reading of s.34(4) that the general purpose is to provide that as far as possible any property which has been improperly alienated should be restored to the debtor's estate."

In *Joint Administrators of Oceancrown Limited* v *Stonegate Limited* 2015 SCLR 619, [2015] CSIH 12 (a company insolvency involving the equivalent provision of the 1986 Act, *viz* s 242) an Extra Division put the matter thus (in the Opinion of the Court delivered by Lord Brodie):

> "26... It is unnecessary to observe that the avoidance of the diversion of a company's assets away from its creditors is exactly what section 242 of the 1986 Act is intended to prevent."

[14] Counsel for the defender suggests that although the first alienation was gratuitous at the time it was made, it lost that character when, more than two years later (and almost two years after the sequestration), payment of an equivalent sum was made to the debtor for his own benefit. That is a startling proposition. It would mean that the object of s 34 could be circumvented with impunity. Where a debtor transferred funds to a third party on a relevant date (to the prejudice of his creditors), but after his discharge requested and obtained their return, the alienation would not be challengeable and the debtor would be entitled to the benefit of the returned funds.

[15] Section 34(4) directs that where there has been an alienation to which s 34(1) applies the court is required to grant redress by taking one or other of the three courses specified unless the person seeking to uphold the alienation establishes one or other of the circumstances thereafter described. It is important to emphasise that what the court has to

do (unless a defence is established) is grant redress which, so far as possible, puts the creditors in the position they would have been in had the gratuitous alienation not occurred. The reference to "other redress as may be appropriate" does not give the court a general discretion to decide on equitable principles to order something less than full return of the alienated property. It is designed to enable the court to make an appropriate order in a case where reduction or restoration of the property is not a remedy which is available (*Short's Trustee* v *Chung, supra,* p 476L; *Cay's Trustee* v *Kay* 1998 SC 780, Opinion of the Second Division delivered by Lord McCluskey at p 788G). It follows that counsel for the defender's resort to equitable considerations (much of which was not the subject of averment) does not provide a relevant ground for resisting decree. Similar arguments were advanced and rejected in *Cay's Trustee* v *Kay, supra* (see p 787G and p 788E-G).

[16] In my opinion, on a proper construction of s 34(4) the words "debtor's estate" mean the estate vested in the trustee to be administered for the benefit of creditors. That is the natural reading of those words. It is a construction which sits comfortably with the other provisions of the Act. It is the only reading which gives effect to the clear purpose of the provision.

[17] The alienation here became challengeable (by the trustee or by a creditor) by virtue of s 34(1) as soon as the requirements of s 34(2) were satisfied. All relevant s 34(2) requirements were met at the time the debtor was sequestrated. Those requirements continued to be met when the trustee brought the s 34(1) challenge. But for the alienation the funds concerned would have vested in the trustee at the date of sequestration. As a result of the alienation they did not so vest. The alienation was to the clear prejudice of the debtor's creditors.

[18] In my opinion the character of an alienation generally falls to be determined at the time it is made. Where after the date of alienation but before the date of sequestration an alienation has been restored to the debtor's estate or adequate consideration for it has been granted, there might be scope for arguing that it is the position as at the date of sequestration which is important. On each of those scenarios it might be possible to show that in the result the purported alienation had not prejudiced creditors. However, it is unnecessary, and probably undesirable, to reach a concluded view on those questions because it is clear that they do not arise in the present case.

[19] Similar questions did arise in *Blackburn* v *Alexander*. A company, E, carried on the business of trading in contracts for differences. It had four accounts with a broker company (IG), a head account and three individual trading accounts. Two of those trading accounts were the accounts of D and S, who were directors, shareholders and clients of E. In terms of E's agreement with IG the four accounts were pooled and E was liable to IG for any deficit. In May 2008 E paid £200,000 into D's self-invested personal pension fund ("SIPP"). On 8 October 2008 D tried to withdraw £250,000 from the credit balance in his trading account. He was unable to do so because there was a large overall deficit on the four pooled accounts (on 10 October 2008 the deficit was £3.9 million). On 9 October 2008 D arranged for £250,000 to be transferred from his trading account to the head account (via S's trading account). The funds were credited to the head account the next day. D intended that £200,000 of that sum should be used to repay E's payment to D's SIPP. E went into liquidation on 17 October 2008. Counsel for D argued (para 31) that where an alienation is repaid prior to the date of liquidation the alienation is, in effect, "undone" before that date. She submitted (para 32) that D had voluntarily supplied the remedy which would otherwise have been appropriate in terms of s 242(4) of the 1986 Act. Alternatively, she maintained (paras 32 and 33) that

since the transfer from D's trading account to the head account had reduced E's indebtedness to D by £200,000, the extinguishing of that liability had been the provision of adequate consideration for the alienation to the SIPP. The Lord Ordinary gave short shrift to the submission that the alienation was made for adequate consideration (para 34). I will return to that later. Nor was he satisfied that there had been repayment of the SIPP payment (para 37). Although the book entry value of the October transfer was £200,000, and the effect of the transfer was that it discharged E of nominal debt of £200,000 due to D in respect of the sum at credit in his trading account, in reality, because of E's insolvency, the transfer had not had a material or patrimonial value anything like £200,000.

[20] *Blackburn* v *Alexander* was an unusual case. It is very clear that an important premise of the repayment argument was that the transfer had been made before the liquidation date. The facts and the "repayment" argument which was advanced there are both clearly distinguishable from the facts and the "repayment" argument advanced in the present case. Whatever else might be derived from *Blackburn*, in my opinion it provides no support for the proposition that "repayment" to a discharged bankrupt of an alienation is a relevant defence to a s 34(1) challenge.

[21] Whatever the position might be where repayment is made to a debtor before the date of sequestration, in the present case the character of the alienation was not changed by subsequent events. It did not cease to be an alienation by reason of the defender complying with the debtor's request to transfer funds to him. The transfer by the defender was not a "repayment" of the alienation. How could it be - it was not repaid to the trustee for the benefit of the debtor's creditors? It did not in any way redress the gratuitous alienation or the resulting prejudice to those creditors.

[22] I turn now to the submission that if the payment to the debtor did not redress the alienation it was nonetheless adequate consideration for it. In order to make good this defence the defender needs to establish "that the alienation *was* made *for* adequate consideration" (s 34(4)(b)(emphasis added)). She has to show that at the time of the alienation something of more or less equivalent value was obtained in exchange for it. Since it is not suggested that adequate consideration was given between the date of the alienation and the date of sequestration, it is unnecessary to explore whether the provision of consideration at that time could have provided a relevant defence. I note however that in *Blackburn* v *Alexander* the pursuer did not persuade the Lord Ordinary that a "repayment" made after the alienation but before the date of liquidation constituted adequate consideration in terms of s 242(4)(b) of the 1986 Act. The Lord Ordinary concluded that the SIPP payment was given without any return being demanded, expected or obtained (para 34).

[23] In *MacFadyen's Trustee* v *Macfadyen, supra,* immediately after the passage I have already cited, the court stated (at pp 421I - 422A):

> "These interests [of the debtor's creditors] are patrimonial and able to be vindicated by legal process. It would be curious if the very section, sec. 34, which is specifically intended to safeguard these patrimonial interests against gratuitous alienation to associates of the debtor were to allow alienations to be made by him to such associates gratuitously, *i.e.* without some material, patrimonial consideration or return in exchange..."

At p 422F the court went on to find that the defender's averments:

> "are not apt to support any case that a consideration was given in 1990 by the defender to the debtor in return for which he transferred to her his beneficial interest in the subjects. "

[24] In *Cay's Trustee* v *Kay, supra,* the defender maintained that consideration for an alienation had been provided by way of assumption of an obligation to aliment the debtor. The Second Division opined at pp 785H - 786C:

> "In our opinion, all that happened was that resources belonging to the debtor and consisting of the funds in question were transferred from the debtor to the defender. The absence of any change in the character of the legal rights and obligations of the debtor and the defender is critical. By the transfer, in the circumstances averred, the debtor acquired no new legal right which he could vindicate in a legal process. By the transaction itself he acquired nothing of material or patrimonial value that he did not have before; on the contrary he simply alienated funds which he previously enjoyed and could have spent as he chose. In these circumstances, we do not consider that, by transferring the funds to the defender, he achieved any right or entitlement which could properly be described as a 'consideration' within the meaning of sec 34(4)(b)."

[25] In *Liquidator of Letham Grange Development Co Ltd* v *Foxworth Investments Ltd* 2013 SLT 445 (another case involving s 242(4)(b) of the 1986 Act) the Lord Ordinary had found that a sale of property by LGDC to NSL had been for adequate consideration because, although the purchase price was well below the property's market value, at the time of sale NSL had also assumed liability to pay substantial debts owed by LGDC. The reclaiming motion was heard by an Extra Division. Lady Paton reviewed the authorities and concluded:

> "[75] ... [I]t is my opinion that the consideration allegedly given in exchange for the granting of the disposition of Letham Grange to NSL required to be enforceable (i.e. able to vindicated (sic)) at the time when the disposition was granted on 12 February 2001..."

The Extra Division went on to decide that the Lord Ordinary had not been entitled on the evidence to find that NSL's liability to pay LGDC's debts was enforceable at that time. On appeal (*Henderson* v *Foxworth Investments Ltd* 2014 SC (UKSC) 203) the Supreme Court disagreed with that conclusion, but it did not disagree with anything else which the Inner House said about adequate consideration. Lord Reed JSC delivered the only judgment, with which all the other Justices agreed. He noted:

> "25 ... [T]he Lord Ordinary was aware that an obligation on the part of NSL could only constitute part of the consideration for the sale if it was undertaken as the counterpart of the obligations undertaken by LGDC in relation to the sale ..."

[26] In *Joint Administrators of Oceancrown Limited* v *Stonegate Limited* 2015 SCLR 619, [2015] CSIH 12 (another company insolvency) an Extra Division put the matter thus (in the Opinion of the Court delivered by Lord Brodie):

> "26. ... [T]he alienation must be *for* adequate consideration. Fundamentally, what is envisaged by section 242(4)(b) is a voluntary transaction for the exchange of, on the one hand, a part of the company's property and, on the other, something else of equivalent patrimonial value...
>
> 27 [Counsel for the defenders] was very much aware that he had to satisfy the court that the relevant alienations were made *for* the relevant consideration. He referred to the causal connection which the section requires as a "*nexus*"...
> ...
> 30 ... [I]t is not disputed that at the date of alienation, the companies as owners of the properties had no obligation, express or implied, to dispose of the subjects in any particular way. They could have continued to hold them. They could have sold them to anyone. In the event they alienated them and got nothing in return.
> ...
> 32 Given that the alienation of the four properties within the relevant period was admitted, it was for the defender to show ... that consideration had been given as a counterpart ..."

On appeal the Supreme Court upheld the Extra Division's decision and reasoning (2016 SC (UKSC) 91). Once again, Lord Reed JSC delivered the only judgment, with which all of the other Justices agreed. At para 17 he observed:

> "17 ... Before the various conveyances, the companies owned five properties. A bargain was in place for the sale of one of those properties, 278 Glasgow Road, for the sum of £2.4 million. After the sale was completed, £2.4 million was transferred to the bank in reduction of borrowings, and the companies retained the other four properties, valued at £1,525,000. Those properties were then conveyed to the appellants. The companies received nothing whatsoever in return. There was no reciprocity between those disposals and the earlier payment made to the bank. The purpose and effect of those transactions was to divert assets away from the companies' creditors: exactly what sec 242 of the 1986 Act is intended to prevent. That they were gratuitous alienations is plain and obvious."

[27] In my opinion it is equally plain and obvious on the defender's averments that the alienation here was not made for adequate consideration. The only suggested consideration which counsel for the defender relied upon was the "repayment". However the alienation was not made in consideration of that payment. The fact of the matter is that the alienation was made for no consideration. Nothing was granted by the defender in exchange for the alienation. The debtor received nothing whatsoever in return for it. The defender undertook no obligation to repay the debtor. There was no relevant nexus between the making of the alienation and the defender's subsequent compliance with the debtor's request that payment be made to him.

[28] The complaint that the trustee should have challenged the alienation before the debtor's discharge is misconceived in my view. There is no such restriction of the s 34(1) rights of trustees and creditors to challenge gratuitous alienations. In my opinion counsel for the defender attached undue significance to the debtor's discharge. That discharge did not end the sequestration. The sequestrated estate remains vested in the trustee, who continues to be obliged to administer it for the benefit of creditors. His title to challenge alienations and preferences subsists. As Lord Justice Clerk Hope observed in *Henderson* v *Bulley* (1849) 11D 1470 at p 1473:

> "The sequestration is not at an end. The process subsists as much as ever. The trustee is not discharged... His title to recover funds, if any can be shown to exist, still subsists; or to reduce any improper preference or security, if such were granted. The title of creditors to make good further funds, or to reduce such securities, is available to them in law, if the trustee and general body of creditors will not institute such actions. That the trustee says there are no further funds, is of no consequence. A statement by him is not a statutory deliverance, to which any particular effect is given...From him there may be funds, not accounted for, yet to be recovered. The discharge of the bankrupt is in many cases almost the first step taken; and many great sequestrations have gone on for many years after his discharge. Hence that circumstance makes no difference as to the subsistence of the sequestration; neither does the belief, probably quite correct, that there are no more funds. That may or may not be the case, but still the process subsists."

See also to similar effect McBryde, *Bankruptcy* (2nd ed.), paras 1-07 and 18-57; and Mackenzie Skene, *Bankruptcy,* para 18-04.

[29] In my opinion there is no relevant defence to the pursuer's challenge to the first alienation. I am satisfied that even if the defender proves all she avers her defence to that challenge is bound to fail.

Disposal

[30] I shall put the case out by order to hear submissions on (i) the terms of an appropriate interlocutor to give effect to my decision; (ii) interest; and (iii) expenses.