



Economy, Energy and Fair Work Committee

Ash Denham MSP
Minister for Community Safety

The Scottish Parliament
Edinburgh
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Sent by email only

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29 July 2020

Dear Ash,

Moveable Transactions findings

Please find attached a summary of evidence received in response to our call for views on Moveable Transactions. This summary has been produced by SPICe to inform the Committee's work in this area.

The Committee's call for views closed on 17 April and we received 12 responses. Our aim was to explore the need for legislation to be updated in line with the [Scottish Law Commission's report on Moveable Transactions](#). We had previously taken evidence on [26 November 2019](#) and were told that businesses were suffering due to the need for legislative change.

On 1 April, before the completion of the Committee's call for views, the Minister for Parliamentary Business announced that the planned Scottish Government bill would not be taken forward this session. The Committee was unaware that this bill was planned when it launched its own inquiry.

In light of COVID-19 and the Minister's announcement on the Scottish Government's legislative priorities, the Committee has agreed to write to you to highlight the evidence received. The attached summary of evidence demonstrates that there is strong support amongst respondents for legislation. However, a number of issues relating to consumers were also highlighted.

Given the current circumstances, the Committee does not intend to carry out any further work on these matters during this session. However, we will highlight the issues in our legacy paper for our successor Committee to pursue.

I hope that you will find the attached summary of views helpful when developing a future bill in this area.

Kind regards

A handwritten signature in black ink, appearing to read "Michelle". The signature is fluid and cursive, with a long horizontal stroke at the end.

Michelle Ballantyne MSP

Convener



ECONOMY, JOBS AND FAIR WORK COMMITTEE

MOVEABLE TRANSACTIONS SUMMARY OF EVIDENCE

PURPOSE OF THIS PAPER

This paper provides a summary of the responses to the Committee's [call for views](#) on proposals from the Scottish Law Commission to reform the law around moveable transactions.

BACKGROUND

Problems with the current law

The Scottish Law Commission has been looking at the ability of those who wish to raise money to use moveable property as security for the debt. Moveable property covers things like cars, machinery and plant (corporeal moveable property) as well as things like legal claims and intellectual property rights (incorporeal moveable property). It published its final [Report on Moveable Transactions](#) (including a [draft bill in volume 3](#)) in 2017.

Scots law in this area is antiquated – making it more difficult to use moveable property for security than in many other countries. The two main problems are:

- Where moveable property is used for security, it must be placed in the custody of the creditor. This puts it out of use for the debtor, making it an unattractive proposition for business finance. It may also put obligations on the creditor which they are not willing to accept.
- Incorporeal moveable property is transferred by a process called assignation. It is a legal requirement that the person who owes the obligation (often the debtor in a debtor-creditor relationship) is notified of the assignation. This makes some forms of financing – such as invoice financing – very difficult in Scotland.

Reform proposals

The proposals in the Moveable Transactions (Scotland) Bill are intended to modernise and clarify the law. Importantly, the main changes build on, rather than replace, the current law. So people will be able to transfer interests in the traditional manner if they prefer.

The key proposal is the creation of two new official registers:

- The **Register of Statutory Pledges** would provide details of corporeal moveable property which had been used as security to raise finance. It would also be available for some incorporeal moveable property – specifically intellectual property and financial instruments.
- Assignations could be registered in the **Register of Assignations** as an alternative to intimation to the debtor.

The Bill would create “statutory pledge” as a new type of security over moveable goods. The purpose of the Register of Statutory Pledges would be to serve as a proxy for actual delivery of the goods to the creditor.

The Register of Assignations would remove the need for intimation to the debtor when their obligation is transferred to someone else. It would also facilitate the assignation of future claims.

Glossary

Asset-based finance – finance secured on a business’s moveable property, such as a car fleet, plant or intellectual property rights.

Assignee – the person to whom ownership of incorporeal moveable property is transferred through the process of assignation.

Assignor – the original owner of incorporeal moveable property who, by assignation, transfers ownership to the assignee.

Floating charge - a form of security available to companies and related entities (such as limited liability partnerships), but not to partnerships or sole traders. It allows finance to be secured on a changing selection of assets which are in the possession of the company at the time.

Invoice financing – a way for businesses to raise money using its invoice book (the obligations of customers to pay for goods and services). The invoice book can be used as security for a loan - which can be tailored to grow with the business (as the amount of invoices issued grows, so does the finance available).

Invoice factoring is a sub-category of invoice financing. It improves cashflow. Factors may be used by a business to collect money owed by customers (but the business still owns the debt). Customer debts may also be sold at a discount to a factor.

Limited liability partnership – a partnership created under the Limited Liability Partnerships Act 2000. As with the members of a company, partners in such an arrangement have limited liability for the debts of the business. In a standard partnership arrangement, all partners are jointly and personally liable for business debts.

Pledge – Currently, pledge means a security over corporeal moveable property created when possession is transferred to the creditor. The Bill would create a new type of pledge – the statutory pledge – which would be created by registration.

SUMMARY OF RESPONSES

The Committee received 12 submissions: eight from the legal sector, three from the business sector and one from a consumer organisation.

There was almost unanimous agreement that the law in this area needed to be reformed, and that it would make a practical difference to the ability of businesses to access finance if it was. Citizens Advice Scotland was concerned that the proposals did not adequately protect the interests of consumers.

The impact on businesses

Although most respondents were not businesses, almost everyone agreed that there was an ongoing impact on business. Broadly, some forms of finance were not available to certain types of business in Scotland, and what was available was likely to cost more.

Respondents highlighted the importance of the floating charge in Scotland. Because most types of financing based on moveable property was subject to uncertainty, creditors would commonly expect a floating charge to be granted in their favour as additional security.

Only companies (and limited liability partnerships) can grant floating charges. Thus, sole traders and partnerships would often be excluded from raising finance on moveable property.

In addition, a floating charge was considered a riskier form of security than security fixed on moveable property (as is available in England)¹. This was likely to be priced into the finance deal, meaning Scottish businesses, including companies, paid more.

The additional cost of legal advice to set up work-arounds was also highlighted. Brodies LLP noted that different firms of solicitors had different views on the law – which could lead to protracted and expensive negotiations.

Some respondents commented on the growing importance of incorporeal moveable property (such as intellectual property rights), particularly to new businesses e.g. in technology and science. If businesses rented their accommodation and equipment, this might be the only asset they had. The current state of the law made Scotland a less attractive place for such businesses to operate.

Academics from Aberdeen University also noted that, even employing all the current workarounds, it was not possible to create multiple security rights over the same property. This is not the case in many other countries. This meant that Scottish businesses were not able to use their moveable property to release finance to the fullest extent.

Several respondents gave real world examples of the impact on business:

¹ This is primarily because, in insolvency a “fixed charge” (lending secured on specific assets) rates above a floating charge. Therefore, the creditor with a fixed charge is more likely to get paid.

- Mr Wood was a director with an asset finance company. He noted that, despite doing all their business in Scotland, the company had to incorporate in England in order to access the finance they needed.
- Brodies LLP and the Law Society of Scotland highlighted situations where Scottish assets of UK businesses were not used as security in finance deals because of the problems with the law here.
- UK Finance noted that banks had experienced difficulties in rolling out the UK Government's Coronavirus Business Interruption Loan Scheme to businesses in Scotland because of the need for workarounds to standard financing arrangements.

How the current workarounds operate

The Faculty of Advocates was clear that the use of workarounds was always undesirable. Its view was that the law should reflect reality as much as possible and the use of workarounds was a clear indication that this was not the case. Workarounds inevitably made the law less transparent and accessible – especially to those who could not afford legal advice.

Many other respondents emphasised the lack of certainty and additional costs associated with workarounds.

Academics from Aberdeen University referred to the “publicity principle”. This “requires publicity of a party’s right in property so that others who may be affected by it have the ability to discover the existence of the right.” It is the reason why property being used as security must be in the possession of the creditor – or that assignments must be intimated to the debtor.

The academics noted that the registers which would be created by the Bill fit better with the publicity principle than the current workarounds. The workarounds make it more difficult to have an accurate view of the interests involved.

Several respondents described in detail the current issues with the law and how they were dealt with:

Security over tangible moveable property

It is not currently possible, in Scotland, to use things like cars, stock or plant for security unless the security is held by the creditor. There is no workaround for this.

In other countries, businesses could secure finance on these assets while continuing to use them. Scottish businesses were disadvantaged by this. The only situation where such items could practically be used as security was where the business did not need to use them for a period – e.g. spirits in bonded warehouses.

Mr Wood noted that the technicalities of Scots law meant that it was not even possible to transfer ownership of tangible moveable property to a creditor and lease it back via a hire purchase-type arrangement.

Invoice financing

UK Finance noted that invoice financing was currently the most important way for businesses to raise working capital.

However, it appears likely that loans secured on invoice books are only available to companies in Scotland, not to partnerships or sole traders.

The problem with invoice financing is that Scots law requires that the assignation of the debt must be intimated to the debtor – in this case, every customer of the business. This is often not practical. It would also breach many businesses' desire for confidentiality in relation to their financial arrangements.

Because of the need for intimation, it is not clear whether future debts can be assigned in Scotland. Invoice financing can be based on an ongoing relationship between income stream (in the form of invoices) and borrowing, so future invoices are part of the security.

The workaround is to create a trust² to take ownership of the invoices. A trust is a device which allows someone (the trustor) to pass ownership of property to trustees who manage it for the benefit of a third party (the beneficiary/ies).

However, the law in this area is far from certain, so it is not clear that this workaround does adequately deal with the legal problems. It is based on legal opinion only and has not been tested in court. This makes it risky.

Security over intangible moveable property

- Shares

Shares can be used as security for loans. However, in Scotland, this requires that the creditor appears in the company's register of members. This can bring with it liabilities, so it is usually not something creditors are prepared to do.

- Intellectual property

Where intellectual property rights (things like trade marks and patents) are used as security in Scotland, the creditor must appear as the owner in the relevant national register. In order for the business to continue to use their rights, they must be licensed back by the creditor.

Demand for the new registers proposed in the Bill

A number of respondents noted that countries which had introduced similar registers had experienced high demand. Australia and New Zealand had recently set up registers – their running costs were low and demand was high. It was argued that there was no reason to think that it would not be the same in Scotland.

² A trust is a legal mechanism whereby property is owned by one party but used for the benefit of another. This way, ownership and management of assets can be separated.

Respondents also noted that the Scottish Law Commission had consulted with interested parties during the development of the proposals. These conversations suggested that demand existed.

UK Finance backed up this view. It stated that its discussions with members suggested that there would be demand. It also expected an initial spike in registrations as businesses moved to register existing agreements.

Broadly, the view was that it was likely that an electronic register could be set up cheaply, easily and in an accessible manner. Fees for registration and searches could be kept low and would cover the costs.

Brodies LLP noted that its solicitors often advised on commercial transactions of this nature. In its view, lots of transactions would be made easier by the use of the registers because they would reduce cost and increase certainty. So, there was every reason to expect demand.

Brodies expected the efficiencies created by the registers to reduce the cost of credit, to the general advantage of Scottish businesses. The Law Society of Scotland suggested that increased efficiency would result in more finance options being available.

Citizens Advice Scotland (CAS) raised a number of concerns about how the registers would operate in practice. It is common practice for creditors in consumer debt agreements to sell (i.e. assign) bad debt on to businesses that specialised in debt collection. As consumers are not excluded from the proposals in the Bill, there was ample opportunity for their interests to be adversely affected.

In summary, CAS's concerns were:

- that registering a debt should not give creditors any greater enforcement rights that they would have had without registration

Section 14 of the Bill restates the current law to provide that a debtor can assert any right against the assignor that they could against the original creditor. However, it would be possible for a debtor to agree with an assignor to waive any defence they might have. This may create a risk that consumers could inadvertently sign away their rights.

Chapter 2 sets out provisions in relation to the Register of Assignations. These provide that a "seriously misleading" entry will be ineffective. It also requires the keeper of the Register to flag any manifest inaccuracies. Anyone who suffers loss as a result of an entry can claim compensation where the person responsible failed to take "reasonable care".

CAS highlighted a particular issue with "prescribed" debts. The law in Scotland gives creditors a set time in which to make good a claim. If this period expired without any action on their part, or acknowledgement by the debtor, the legal obligation ceases to exist. For consumer debts, a creditor will usually have five years to take action to enforce a debt.

CAS suggests that there is a risk that prescribed debts could be registered, creating the impression that the debt was still enforceable, to the disadvantage of the debtor.

It is not uncommon for debt collectors to try to pursue prescribed debts, especially because the law in England does not operate to extinguish an obligation in this way.

The Bill makes no provision for prescription. And it is not clear that such a problem would always be obvious when an assignment was registered. Some assignments will cover a large number of debts.

- that, in consumer debt situations, intimation to the debtor should remain as a requirement

Registration will usually remove the requirement to intimate an assignment to the debtor. However, the Scottish Law Commission noted in its report (Vol 1, paragraph 12.19) that there is an EU law requirement³ for intimation to the debtor when a consumer debt obligation is assigned.

This adds nothing to the law of Scotland at the moment. However, if the reforms were introduced, it would operate to continue to require intimation where a consumer debt was assigned using the Register.

- that the Register will not hold definitive information, as it will still be possible to assign an obligation via the traditional method of intimation

CAS noted that the general direction of public policy had previously been that public registers would hold definitive information so that users could rely on them.

Examples would include the Land Register (for sales of land and buildings) and various insolvency registers.

- that access to the Register should be limited to the assignee, assignor and debtor

The Bill's provisions (section 32) would allow anyone to search the Register. It is arguable that this is necessary if the Register is to serve a useful commercial purpose.

CAS also called for a search by the debtor to be free.

The need for additional consumer protections

The general view from legal respondents was that the Bill contained sufficient consumer protections. The Law Society of Scotland noted specific protections, such as excluding moveable property worth less than £1,000 from the new statutory pledge.

CAS took a different view. It argued that the most effective way to prevent the Bill from resulting in consumer detriment was to specifically exclude them from its provisions.

Several respondents noted that consumers could be excluded from the Bill if that was desirable. The main driver for reform was to improve businesses' access to credit. However, several thought that consumers could benefit from reform as well.

³ Directive 2008/48/EC, Art 17(2) – currently implemented into UK law by Consumer Credit Instrument 2014 (FCA 2014/11), rule 6.5

A number of respondents expressed the view that the body of consumer protection law was the appropriate vehicle for additional consumer protections. As this Bill dealt with property law, the Senators of the College of Justice argued that it would make the law more complex and difficult to apply to include consumer protections here rather than refer to existing consumer legislation.

It was noted that consumer protection legislation – including the many protections in the Consumer Credit Act 1974 – would apply to transactions covered by the Bill where a consumer was involved. However, CAS highlighted that the Bill's provisions could undermine these.

CAS noted that, at the moment, cars were purchased under hire purchase or conditional sale agreements. These were specifically regulated by the Consumer Credit Act 1974 and provided a right for consumers to return cars once they had made the majority of payments. A new type of car security created under the Bill would not contain this protection and may therefore be used to undermine consumer rights.

Several respondents addressed the complex issue of how to define consumers. Mr Wood and academics from Aberdeen University noted that, if consumer was defined in a way that covered sole traders, their access to credit would not be benefited by the Bill. The academics noted that even uncertainty in this area may be sufficient for creditors to refuse to lend to sole traders in practice.

CAS took the opposite view. It noted that it was not possible to separate the personal and business finances of a sole trader or independent contractor. It argued that, for their interests to be safeguarded, they should enjoy protection as consumers.

CAS also wanted protections against assigning away essential income streams. It noted that the Bill would prevent assignation of future wage payments. It argued that this protection should be extended to royalties, licences and share income, where these were the sole income stream of an individual.

Other issues

A number of respondents raised additional issues:

UK Government Finance Bill

Legislation progressing at Westminster would re-introduce “Crown preference”. This gives Crown debts (primarily tax debts) preference in insolvency situations. The effect would be that tax debts would be paid before a floating charge – increasing the risk associated with relying on a floating charge as security. UK Finance noted that this was likely to impact on access to credit for those offering a floating charge.

In England, creditors with a fixed security would still be entitled to payment before tax debts were considered. Therefore, without action, Scottish business were likely to be further disadvantaged. However, the introduction of a “statutory pledge” as proposed in the Bill would address this.

Lack of consultation with consumer interests

CAS noted that nowhere in its development of proposals did the Scottish Law Commission appear to have consulted with consumer bodies or regulators. As the proposals had potential to cause consumer detriment, CAS called for more input from these groups.

Assignment of wages

Greensill Pay (an arm of Greensill Capital UK Ltd.) highlighted that the ban on assignment of wages threatened its business model. It was developing a new service which it believed had the potential to tackle poverty and high lending costs. Consumers can currently access “pay day loans” at very high rates of interest and poor terms. Those on low incomes often had no choice but to use these services if they needed access to cash before their wage payment was due.

Greensill’s model would involve working with employers to give employees access to advance wage payments at no cost to them (SPICe presumes there would be a cost to the employer). It was currently working with the NHS to offer this service to staff.

However, staff were required to assign the right to payment of the relevant proportion of their wages to Greensill to access the service. This would not be possible in Scotland if the ban on assignment of wages was enacted.

Companies legislation

Companies are required to register new securities over their assets with Companies House. The Law Society of Scotland thought this provision improved transparency and should continue.

However, there would be duplication between registration at Companies House and registration in the new registers to be created by the Bill. Several respondents thought that it would be good if arrangements could be put in place to allow information to flow between the registers to minimise the work required to register a security.

Section 893 of the Companies Act 2006 creates a power to allow this to happen. However, it is exercisable by the Secretary of State.

Trade marks and patents

The Law Society also thought that it would improve transparency if pledges involving trade marks or patents also appeared in the relevant UK registers of these interests. Again, changes were likely to be within the competence of the UK Parliament.

Insolvency law

The Faculty of Advocates expressed the concern that the proposals did not expressly deal with insolvency law. It was when a business became insolvent that the new arrangements were most likely to be tested. Company insolvency is mainly within the competence of the UK Parliament.

Abigail Bremner, SPICe Research, 16 June 2020

Note: Committee briefing papers are provided by SPICe for the use of Scottish Parliament committees and clerking staff. They provide focused information or respond to specific questions or areas of interest to committees and are not intended to offer comprehensive coverage of a subject area.

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