

Business and Regulatory Impact Assessment

TITLE OF PROPOSAL

Draft Moveable Transactions (Scotland) Bill 2017 (“**the Bill**”)

PURPOSE AND INTENDED EFFECT

BACKGROUND

General

Moveable transactions law is of vital importance to the Scottish economy. It impacts on day to day economic life in relation to transactions concerning all property other than land and buildings,¹ that is to say “moveable property”.

This includes both corporeal (tangible) property and incorporeal (intangible) property. The vehicles on the road, the innovative software used by a high-tech start-up, a song on the radio, the whisky in a distiller’s warehouse, the livestock in an agricultural business, or the plant and machinery used in the oil and gas sector are just a few examples.

Moveable transactions law regulates the ability of businesses and individuals to use moveable property to raise finance. Thus a small business may wish to acquire funding by using vehicles or machinery as collateral to obtain loan finance. Alternatively, it might sell invoices due to it² - an otherwise “idle” resource - to invoice financing houses to secure crucial cash flow.

For many businesses, the ability to raise finance using their moveable assets can make the difference between success and failure; between “just about surviving” and thriving. It is particularly important for small and medium-sized enterprises (SMEs),³ which are more likely to suffer cash flow problems. If SMEs cannot fully exploit their assets to raise finance, they might otherwise have to resort to riskier and therefore more expensive types of lending, such as unsecured overdraft facilities or loans (assuming they can access such facilities at all). It is therefore economically and socially important for these transactions to be regulated by a legal regime that is fit for the 21st century.

¹ These types of property fall into the category of “heritable” (immoveable) property.

² According to the Scottish economist Henry Dunning Macleod (1821-1902): “If we were asked – who made the discovery which has most deeply affected the fortunes of the human race? We think, after full consideration, we might safely answer – the man who first discovered that Debt is a Saleable Commodity.” See H D Macleod, *The Principles of Economic Philosophy* (2nd edn, 1872) 481.

³ SMEs can be broadly defined as businesses with fewer than 250 employees and between £25m-£500m turnover per year. See <https://www.gov.uk/government/collections/mid-sized-businesses>. See also the Companies Act 2006 ss 382 and 465.

Scottish law in this area is badly outdated. It is unclear, and unduly restrictive in effect. It has been described as “desperately in need of reform to bring Scottish law into line with other developed countries”.⁴ Indeed, the last twenty years have seen major reforms to moveable transactions laws in other jurisdictions including Australia, Belgium, France, Jersey, Malawi, New Zealand and Nigeria.⁵ The law in Scotland today stands in greater need of improvement than was the case in many of those jurisdictions when their reforms were effected. Scotland is falling behind and reform is long overdue.

The impact of reform in these countries has been very positive. The Australian Government, for example, attributes its improved position in the World Bank’s Report on ‘Ease of Doing Business’ to the implementation of their 2009 reforms.⁶

There is considerable support for reform in Scotland. In December 2017, the Committee of Scottish Bankers (CSCB) stated to the Commission:

“The CSCB welcomes law reform in this area. It has been long needed.

It is hoped that reform in this area will:

- Augment the current legal structures (which were framed for the needs of the day when drafted) giving new options that are relevant for the modern Scottish economy;
- Empower Scottish businesses to grow by offering wider options to access capital; and
- Give funders new options to support Scottish customers better.”

Writing in the Corporate Briefing in the September 2017 edition of the Journal of the Law Society of Scotland, Emma Arcari, an associate at CCW Business Lawyers, notes:

“Moveable property more often than not constitutes a significant part of the lifeblood of a business, and difficulties with the current law in using moveables to obtain funding can often prove a disincentive for businesses to use Scots law, or lead to complex contractual arrangements. With this in mind, the Scottish Law Commission (SLC) has been working to provide much sought-after reform. [...] Hopefully Scots law will be on its way to a long-awaited reform in this area.”⁷

⁴ *The Scotsman*, 28 August 2011, “It’s an area of Scots law desperately in need of reform”, available at <http://www.scotsman.com/news/it-s-an-area-of-scots-law-desperately-in-need-of-reform-1-1816927>.

⁵ For an overview of reform in other jurisdictions, see L Gullifer and O Akseli (eds), *Secured Transactions Law Reform: Principles, Policies and Practice* (2016).

⁶ See B Whittaker, *Review of the Personal Property Securities Act 2009* (2015) 32, available at <https://www.ag.gov.au/Consultations/Documents/PPSReview/ReviewofthePersonalPropertySecuritiesAct2009FinalReport.pdf>.

⁷ E Arcari, “Briefings: Corporate” 2017 Journal of the Law Society of Scotland (September) 29-30. And see also <https://shepwedd.com/knowledge/consultation-finance-law-reform-scotland>.

If implemented, the recommendations in the Report, as provided for in the Bill, would modernise and expand the existing rules and procedures of Scottish moveable transactions law. This would open up greater access to finance for businesses and individuals in Scotland, and would contribute to ensuring the Scottish legal system serves the needs of the Scottish economy and the Scottish people.

Assignment of, and security over, moveable property

This section outlines the background to this area, and the problems with the current law which the Report on Moveable Transactions and the accompanying draft Moveable Transactions (Scotland) Bill seek to remedy. The area can be divided into two broad parts.

- 1) Assignment (transfer) of claims (rights to performance of an obligation), and
- 2) Security over:
 - a. Incorporeal (intangible) moveable property, and
 - b. Corporeal (tangible) moveable property.

This project does not cover the transfer of corporeal moveable property, nor does it extend to the assignment of incorporeal property other than claims, where there is relevant UK-wide law.⁸

(1) Assignment of claims

General

“Claim” is a shorthand expression used to refer to a right to have an obligation performed, such as a right to be paid money. (In everyday language the word “claim” is typically used with reference to compensation and insurance claims, but its legal meaning is much broader). A claim is a form of incorporeal (intangible) property. “Assignment” is the transfer of incorporeal property from an “assignor” to an “assignee”. The assignment of a claim, then, is the transfer of a right to require the performance of an obligation.

The assignment of claims is used in a variety of commercial transactions. A typical example is invoice financing. Here, the assignor (eg a business) assigns to an assignee (eg a bank or financier) unpaid invoices owed by customers in exchange for a discounted lump sum payment. Invoice financing is just one example, but this important facility is becoming an

⁸ See eg Sale of Goods Act 1979; Bills of Exchange Act 1882; and Copyright, Designs and Patents Act 1988.

increasingly used means of obtaining finance as an alternative to bank loans; global factoring⁹ volume reached an all-time high in 2015, with annual turnover reaching €2,373 billion.¹⁰

Utilising these finance facilities can be particularly valuable for SMEs. The Scottish Government's Small Business Survey published in 2017 found that the main reason small firms sought external finance was to secure working capital and cash flow. 41% of SMEs stated their reason for seeking working capital was to cover a short-term gap until funds were received from customers, whilst 15% said they sought working capital to cover unexpected late payments.¹¹ SMEs rely heavily on steady cash flow, but are often burdened by the late payments of debts owed to them. A House of Commons briefing paper published in 2017 shows that the average late payment SMEs face is around £32,000, a figure which puts many businesses at risk of insolvency.¹² The paper also showed that 12% of the SMEs which experience late payments say it impacts on their ability to pay their own staff on time, while 20% have difficulty paying business bills like energy, rates and rent. "Some 29% rely on costly overdrafts to make up for cash flow shortfalls due to being paid late".¹³ Whilst the Late Payment of Commercial Debts (Interest) Act 1998 was introduced to give SMEs the right to claim interest on late payments,¹⁴ 80% of small businesses do not do so, for fear of jeopardising business relationships with customers who often have greater bargaining power.¹⁵

Late payment is therefore a significant concern to the business community. The Federation of Small Businesses (FSB) has told the Commission that approximately 3,500 small Scottish businesses are forced to close down every year whilst waiting to be paid for work they have already undertaken.

The ability to assign unpaid debts to secure working capital and cash flow is therefore very valuable, but the law governing these transactions in Scotland is unnecessarily restrictive, hampering access to finance.¹⁶ That the law makes it more difficult to sell unpaid debts in

⁹ "Factoring" is a form of invoice finance facility whereby the financier takes responsibility for processing payments from the debtors on behalf of the assignor.

¹⁰ See <https://fci.nl/en/news/global-factoring-volume-reaches-all-time-high-2015/3677>. See also ABFA 2017 statistics, available at <http://www.abfa.org.uk/statistics/2017/Q1%202017/ABFA%20Statistics%20Q1%202017.pdf>.

¹¹ See Scottish Government Small Business Survey Scotland 2016 p 26. Available at <http://www.gov.scot/Resource/0052/00523509.pdf>.

¹² T Edmonds, "Late Payment of Debts" (House of Commons Library Briefing Paper No 6640, July 2017) p 18 available at <http://researchbriefings.files.parliament.uk/documents/SN06640/SN06640.pdf>.

¹³ Edmonds, "Late Payments of Debts" (n 12) at 19.

¹⁴ At a statutory rate of 8% plus the Bank of England's base rate. See Late Payment of Commercial Debts (Rate of Interest) (Scotland) Order SSI 2002/336 art 4.

¹⁵ See Federation of Small Businesses, *Time to Act: The Economic Impact of Poor Payment Practice* (2016) 12. Available at [http://www.fsb.org.uk/docs/default-source/fsb-org-uk/fsb-report---late-payments-2016-\(final\).pdf?sfvrsn=0](http://www.fsb.org.uk/docs/default-source/fsb-org-uk/fsb-report---late-payments-2016-(final).pdf?sfvrsn=0).

¹⁶ Some financiers do not engage with businesses in Scotland due to difficulties with the law. Difficulties accessing finance are a prevailing concern. The Scottish Government's SME Report of 2015 shows that many viable Scottish small and medium-sized enterprises in all sectors face

order to raise finance may mean that the impact of late payment is even more severe for Scottish businesses than elsewhere in the UK.

In order to transfer a claim under Scottish law, intimation (notification) must be made to the person bound to perform the obligation which is the subject of the claim (also known as the 'account debtor'). Intimation is the means by which the party in debt to the assignor is told that the claim has been assigned. It is often accompanied with an instruction to perform to the assignee. The mid-Victorian Transmission of Moveable Property (Scotland) Act 1862 provides for two methods of intimation: one involves the use of a notary public and the other requires a certified copy of the assignation document to be sent to the debtor. It is uncertain whether less formal methods of intimation will be regarded as valid, particularly in an insolvency.

This requirement to intimate for a claim to be transferred is not found in many other legal systems. That claims can only be transferred by intimation is very cumbersome and can increase costs. Furthermore, exactly what is required for an effective intimation is uncertain,¹⁷ and legal uncertainty deters financiers from engaging in the Scottish market. This is exemplified by one member of the Asset Based Finance Association ("ABFA"),¹⁸ who told the Commission:

"The law related to the assignation of receivables is complex [...] we have funded Scottish businesses in the past but had withdrawn from the market because of legal complications. We would consider doing so again if the law were less complicated."

ABFA itself has stated that:

"Invoice finance is becoming one of the most necessary routes to finance for businesses in the UK, whether Scottish or anything else. We feel that the capacity of the Scottish legal system to deal with what is required to enable the offering of invoice finance to Scottish businesses has not kept pace with the developments in other western European legal systems, far less than with English law."

Describing moveable transactions law more broadly, CBI Scotland has commented:

"We consider that Scots law at present puts difficulties in the path of banks and finance companies offering credit facilities to businesses based in Scotland and, while ways round that have been devised over the years - usually involving the use of English law and the submission to the jurisdiction of the English courts - this has

significant challenges raising the funding they need. See Scottish Government, *The Market for SME Finance in Scotland* (2015), available at <http://www.gov.scot/Resource/0048/00484379.pdf>.

¹⁷ S Mills, N Ruddy and N Davidson (eds), *Salinger on Factoring* (5th edn, 2017) paras 7-53 to 7-57 (R B Wood).

¹⁸ On 1 July 2017 ABFA was integrated into UK Finance, which represents around 300 firms in the UK providing credit, banking and payment-related services.

not been a panacea and difficulties remain. This can be more challenging for SMEs than for major corporates, the latter having greater ease of organising their credit lines furth of Scotland than SMEs may do. To put it another way ... it is detrimental to Scottish SMEs competing in what is now a UK-wide market, if not a wider one, to find that their ease of accessing credit is constrained in a way which would not be the case if they were English based.”

Considering that SMEs account for 99.3% of all private sector enterprises and 54.6% of private sector employment in Scotland,¹⁹ deficiencies in the law which make it harder for smaller businesses to access finance may be having serious knock-on effects in relation to the wider Scottish economy. If the law properly facilitated the assignation of claims, businesses would be better placed to utilise an often untapped resource to secure capital and cash flow.

Commercial transactions

The requirement for intimation causes problems in numerous commercial contexts. In 2017 a major Scottish law firm told the Commission that in one particular transaction the requirement to intimate cost nearly £4,000 and required approximately 17.5 hours of fee-earner and trainee time.

The following are a number of examples in which the current law makes it more difficult and expensive to transact in Scotland than in other jurisdictions.

(i) Notification invoice finance

As detailed above, invoice finance is a form of asset-based finance whereby businesses effectively sell their unpaid invoices to a financier, in exchange for a discounted sum. We understand from ABFA that in 2015 the value of invoices assigned by UK businesses was £276 billion.²⁰ Approximate figures specific to Scotland can be obtained from the data through basic calculations, as follows.

There are approximately 335,015 private sector enterprises in Scotland²¹ and approximately 5,243,100 private sector enterprises in the UK overall.²² This means that 6.4% of UK private sector businesses are based in Scotland. 6.4% of £276 billion is £17,664,000,000. Therefore assuming that, proportionally, Scottish businesses utilised invoice financing to the same extent as in the UK as a whole, in 2015 Scottish businesses assigned invoices worth

¹⁹ Scottish Corporate Sector Statistics 2016: Key Facts available at <http://bit.ly/2dgXJgN>.

²⁰ For the latest general UK figures for 2017 see <http://www.abfa.org.uk/news/statistics.asp>.

²¹ See Scottish Government Statistics, *Businesses in Scotland: Scotland Tables* at Table B. Available at: <http://www.gov.scot/Topics/Statistics/Browse/Business/Corporate/Tables>.

²² See UK Government Department for Business Innovation & Skills, *Statistical Release: Business Population Estimates for the UK and Regions* 2014. Available at: http://static.guim.co.uk/ni/1416995961456/bpe_2014_statistical_releas.pdf.

approximately £18 billion. Due to difficulties with the law, however, it cannot be said with any certainty that Scottish businesses do make use of invoice financing to the same extent as businesses elsewhere in the UK. The Scottish Government's Small Business Survey showed that only 2% of businesses surveyed applied for an invoice discounting or factoring facility, with most (34%) applying for bank overdrafts, followed by loans (32%).²³

With "notification" invoice finance, the assignee notifies the debtors that they are now to make payment to the assignee instead of the assignor. If compliant with the current law, this will effect transfer. The need to intimate to effect transfer can be extremely impractical for the assignee financier, who may need to give notice to each individual debtor, in a pool of potentially thousands. This leads to increased costs which may be passed on to the assignor.

As noted above, there is also uncertainty as to what the legal rules for notification actually are and what is required to intimate effectively. In factoring, the assignee factor will always notify regardless of whether this is actually required by law to effect the transfer because part of the service a factor provides is to process and manage payment on behalf of the assignor. However, a practice has developed in factoring whereby financiers notify debtors by stamping (or 'stickering') the relevant invoices to show that the debts have been assigned and to give the financier's details. The stamped invoices are then sent to the debtors.

Whilst stickering means that the debtors are *de facto* notified that they are now to pay the factor, the statutory procedure for intimation in the 1862 Act is not being followed in practice. In a recent Outer House decision of the Court of Session, Lord Bannatyne stated that the 1862 Act is "permissive not prescriptive" but stopped there, without further discussion.²⁴ The Inner House decision in *Christie, Owen and Davies Plc v Campbell*²⁵ also suggests that it is not essential to comply with the 1862 Act in order to effect transfer, but most of what was said was not necessary to decide the case and there was no competing claimant. Thus what is required to achieve a valid intimation is uncertain. The common law position prior to the 1862 Act was very cumbersome, requiring the involvement of five people.²⁶ Some finance providers will be prepared to rely on the more recent decisions mentioned, but others are not, particularly due to the risk that an ineffective assignation carries if an assignor becomes insolvent.²⁷

Uncertainties with the law increases costs for the parties. We understand from our advisory group that financiers can charge more for their invoice finance services to businesses in Scotland as a result. This is usually in the form of the "discount charge".

²³ Small Business Survey Scotland (n 11) at 28.

²⁴ *Promontoria (Ram) Ltd v Moore* [2017] CSOH 88 at para 96.

²⁵ *Christie, Owen and Davies Plc v Campbell* [2009] CSIH 26; 2009 SC 436.

²⁶ A procurator (lawyer) acting on behalf of the assignee, a notary public, two witnesses and the debtor. See R G Anderson, *Assignation* (2008) para 6-23.

²⁷ Having likely paid for the claims, an ineffective transfer would mean a putative assignee would lose priority in a question with prior third party creditors seeking to execute diligence.

A further difficulty is that the 1862 Act unsurprisingly does not provide for electronic intimation. Having to intimate by post increases costs.

A broader problem with the current law relates to the assignment of “future claims”. Future claims are typically claims which are not yet in existence at the time they are transferred, for example a business’s invoices for certain types of job it will carry out over a future period. The ability to assign these types of claims is an important feature of invoice financing and, in a modern legal framework, it should be possible to do so. However, as the individual debtor is not known at the time of the assignment and therefore cannot be intimated to, assignment of “future claims” is impossible in Scottish law.

(ii) *Non-notification invoice finance*

In non-notification finance (largely “invoice discounting”), a business assigns outstanding invoices to a finance company *without* the customers being notified. This would include the assignment of claims that do not exist at the time of assignment, as there is no account debtor to whom intimation can be made. The requirement to intimate to effect a transfer leads to invoice financing taking place in Scotland with the support of complicated trust arrangements, whereby the assignor holds the claim against the debtor as a trustee, with the assignee being the beneficiary.

Trust law is another area of Scottish law in need of reform.²⁸ Not only is the law here underdeveloped - resting mainly on the one reported case of *Tay Valley Joinery Ltd v CF Financial Services Ltd*²⁹ - the need to resort to trust structures adds a layer of complexity and expense for financiers (in the form of legal advice and assistance), which can have repercussions for those seeking to use this facility.

One invoice finance provider and member of the Finance Leasing Association (FLA) has told the Commission that having to use a trust structure for these transactions in Scotland is very cumbersome. In its response to the Commission’s draft Bill consultation in 2017, the Scottish law firm Shepherd and Wedderburn explained that requiring to adopt trust structures makes it difficult to set up efficient, fully electronic financing mechanisms, which has led to some international banks taking the view that Scottish debts should not be eligible for their funding facilities.

The Commission also understands from members of ABFA that financiers often ask their Scottish clients to enter into invoice finance agreements with their debtors under English law

²⁸ See Scottish Law Commission, Report on Trust Law (Scot Law Com No 239, 2014).

²⁹ *Tay Valley Joinery Ltd v CF Financial Services Ltd* 1987 SLT 207.

in order to take advantage of the comparatively straightforward law of equitable assignment, which does not require intimation to complete transfer.³⁰ It is not clear, however, following the *Ticketus* decision,³¹ whether the use of English law in such circumstances is always effective.³² Nevertheless, due to deficiencies in Scottish law many parties have no better option.

Having to resort to complicated workarounds or the laws of another jurisdiction can be inconvenient and costly for parties based in Scotland. It also casts an unfavourable light on the ability of Scottish law to meet the needs of modern commerce.

(iii) *Block discounting*

Block discounting involves a business assembling and assigning a “block” of its customer claims (usually hire-purchase or lease agreements) to a funder. Typically, the funder makes an advance payment to the business based on the discounted value of the block of agreements. The advance payment is repaid by the business over an agreed period and the block of agreements are later released back to the business.

Again, the current requirement to intimate to each customer in the underlying hire-purchase or lease agreements hinders the ability of Scottish businesses to fully utilise this finance facility. A block discounting provider and FLA member has responded to the Commission: “[f]or my part I have deliberately not block discounted in Scotland because of the need to advise each underlying customer.”

(iv) *Finance transactions where debtor is instructed to continue to perform to assignor*

The Commission has been informed that some law firms are of the opinion that an instruction to the debtor, to continue to perform to the assignor until notified to perform to the assignee, impacts on the effectiveness of the assignation. This would arise, for example, in a finance transaction involving an assignation of book debts where the assignor continues to “control the book”. Another area where this would occur in practice is in project finance transactions where an assignation in security provides that the debtor is to continue to pay the assignor unless there is default on the secured obligation. This affects multi-million pound transactions.

(v) *Assignation of rents*

It is common in practice for commercial landlords to assign to lenders the rents due to them under leases in security of a loan. Currently the assignation of rents requires intimation to

³⁰ See Regulation (EC) No 593/2008 of the European Parliament and of the Council of 17 June 2008 on the law applicable to contractual obligations (Rome I).

³¹ *Joint Administrators of Rangers Football Club Plc, Noters* 2012 SLT 599.

³² It was held in the *Ticketus* case that where Scottish debtors are concerned, the currently restrictive Scottish law will apply, irrespective of the chosen law of the parties.

the relevant occupational tenants. There is therefore no effective security until intimation of assignation is given. This is onerous especially where, for example, rents are assigned in a shopping centre with dozens of units which requires intimation to each individual tenant.

(vi) *Securitisations*

Securitisations are another type of transaction which is currently difficult under Scottish law due to the requirement for intimation in assignations. Securitisation is a complex financial practice where various types of assets are pooled and sold as securities. Dr Hamish Patrick of Shepherd and Wedderburn has informed the Commission that it is too burdensome to perform intimation in these types of transaction meaning that resort is made to trusts. The difficulties involving trust structures have already been alluded to above.

Conclusion

Scottish law in this area is not fit for purpose. Lagging behind other jurisdictions including England and Wales, the law requires to be updated to ensure that those conducting business in Scotland are not placed at a commercial disadvantage. Some financiers do not provide facilities in Scotland due to difficulties with the law and this may ultimately be hampering access to finance for Scottish businesses. There is consensus that reform is long overdue.

(2) Security over moveable property

General

Secured lending is of the greatest commercial importance. In a working legal framework, individuals or businesses can grant a lender security against an item of property (collateral) in exchange for a loan or credit arrangement. If the debt is unpaid, the lender can enforce the security by realising the encumbered property, with any surplus returning to the debtor. This is essentially a means by which creditors can mitigate risk, which in turn lowers the cost of borrowing.

It is well established, through empirical studies conducted by organisations such as the World Bank, the International Monetary Fund (IMF), the Asian Development Bank and the European Bank for Reconstruction and Development (EBRD), that one of the most effective means of accessing working capital is through secured lending.³³ Studies also show that granting security reduces the cost of borrowing.³⁴ Whilst the broader economic benefits of

³³ G Affaki, "Increasing Access to Credit: Reforming Secured Transactions Laws" in B Foëx, *The Draft UNCITRAL Model on Secured Transactions: Why and how?* (2016) 157.

³⁴ Affaki, "Increasing Access to Credit" (n 33). See also G Castellano, "Reforming Non-Possessory Secured Transactions Laws: A New Strategy?" 2015 *Modern Law Review* 611; R Haselmann et al, "How Law Affects Lending" (2010) 23 *Review of Financial Studies* 549; E Benmelech and N K

secured lending have long been debated on a theoretical level,³⁵ there is “growing international consensus that secured credit is a general social and economic good”.³⁶

Security over moveable property - like the standard security (in layperson’s terms, “mortgage”) over land - is utilised for a variety of reasons and in different contexts. It can be used in order to acquire the property over which security is being granted, as is commonly the case with motor vehicles. Alternatively, security can be granted over property already owned by the debtor, such as machinery or intellectual property, in order to secure working capital and cash flow. This is particularly important for SMEs, which typically own more moveable property than land.

In any given legal jurisdiction, access to finance is closely linked to the strength of the security rights regime.³⁷ In Scotland, this regime as regards moveable property is woefully outdated, unclear and unduly restrictive. Other than the possessory pledge (pawn) and the floating charge (which ranks relatively low in insolvency and may only be granted by companies, LLPs and some other corporations), Scottish law does not provide for a “true”³⁸ security over moveable property which is widely available.³⁹ This compares poorly with the law in England and Wales which, although in need of reform, is in a much better state than in Scotland.⁴⁰ Scotland is also falling behind other jurisdictions such as Australia, Belgium, France, Jersey, Malawi, New Zealand and Nigeria, which have reformed their security rights laws in recent years.

In lieu of true security, a patchwork of “functional” securities has emerged. These are intended to act in practice like true securities. But they require ownership of the encumbered property to be transferred to the creditor. These can be unduly costly and are legally uncertain. Being a full transfer of title from the debtor to the creditor, they clearly go beyond their intended purpose, taking away too much from the debtor and giving too much to the creditor. Requiring a transfer to the creditor also means that a particular asset can only be used as collateral once at any given time, which may significantly diminish the asset’s economic potential for the borrower. For example, if an IP asset, valued at £1 million, is transferred to a creditor to collateralise a loan of £500,000, the borrower effectively loses the ability to exploit the full value of the asset. If a true security could be granted, the provider could grant multiple securities over the same asset in order to collateralise up to a

Bergman, “Collateral Pricing” (2009) 91 *Journal of Financial Economics* 339 and J R Booth and L C Booth, “Loan Collateral Decisions and Corporate Borrowing Costs” (2006) 38 *Journal of Money, Credit and Banking* 67.

³⁵ See Scottish Law Commission, *Discussion Paper on Moveable Transactions* (2011) chapter 12.

³⁶ G McCormack, *Secured Credit under English and American Law* (2004) 18.

³⁷ R Haslemann et al, “How Law Affects Lending” (2010) (n 34). See also C Calomiris et al, “How Collateral Laws Shape Lending and Sectoral Activity” (2016); World Bank, “Getting Credit: The Importance of Registries” (2014) in *Doing Business 2015: Going Beyond Efficiency*. Available at <http://www.doingbusiness.org/reports/global-reports/doing-business-2015>.

³⁸ A “true” security is a right in the property itself, subordinate to the debtor’s right of ownership.

³⁹ While aircraft mortgages and ship mortgages are possible they are obviously asset-specific.

⁴⁰ In England and Wales there is to be reform by means of a Goods Mortgages Bill, which was announced in the 2017 Queen’s Speech. See <https://www.lawcom.gov.uk/project/bills-of-sale/>.

further £500,000 of finance.

The restrictive legal backdrop in Scotland may be having a serious impact on access to finance. Scottish Government evidence from *The Market for SME Finance in Scotland Report 2015*,⁴¹ published after consultation with the lending sector and business representative bodies, cited security shortfalls as one contributing factor to an estimated funding gap for Scottish SMEs of up to £0.75 billion per annum.⁴²

The FSB has described the law here as being “rooted in the past”.⁴³ It has been described elsewhere as “desperately in need of reform”.⁴⁴ In many ways, the current position has parallels with the legal regimes of less-advanced economies. In a study published by the US National Bureau of Economic Research on how moveable security laws shape lending activity in *developing* countries, three features were identified as characterising a “weak” security rights regime:

- limited types of moveable assets which may be encumbered;
- the lack of a centralised registration system to monitor the security interest; and,
- the requirement that enforcement in the event of default must be through the courts.⁴⁵

These weaknesses, common in developing countries, are similar to the rules currently in place in Scotland. The following sets out the legal position and difficulties relating to specific types of moveable property.

a) Incorporeal (intangible) moveable property

The rules on security over incorporeal moveable property are quite unsuited to modern commerce. They largely pre-date the industrial revolution. The floating charge aside, which can only be granted by companies, limited liability partnerships and a few other corporations, there exists no “true” security which can be granted over incorporeal moveable property in Scotland. Resort must be made to functional security, whereby the property is transferred through assignation to the lender for the duration of the loan, otherwise known as an “assignation in security”.

Shares are becoming an increasingly common part of security packages required by lenders in Scotland,⁴⁶ because these constitute a valuable proportion of a business’s assets and

⁴¹ *The Market for SME Finance in Scotland* (2015) (n 16).

⁴² *The Market for SME Finance in Scotland* (2015) (n 16) at 9.

⁴³ Comment made to the Commission by Colin Borland, Senior Head of External Affairs, Devolved Nations, FSB.

⁴⁴ B Wood, “It’s an area of Scots law desperately in need of reform”, *The Scotsman*, 28 August 2011 (n 4).

⁴⁵ Calomiris et al, “How Collateral Laws Shape Lending and Sectoral Activity” (n 37) at 2.

⁴⁶ See eg <https://www.turcanconnell.com/legal/family-businesses/share-pledges/>.

allow the sale of the company on enforcement. However, if a bank seeks to take security over a company's shares in return for a loan, the shares must be transferred to the lender.⁴⁷ This is referred to as a Scottish "shares pledge". The lender is accordingly registered as a shareholder. Expensive contractual arrangements are then agreed to avoid the consequences of transfer such as, using the example of shares again, giving the debtor the right to vote at shareholder meetings or the right to dividends. As noted above, requiring transfer of the collateral to the creditor means security can only be granted once, potentially restricting access to finance as there is no possibility of a second-ranking share pledge as such. The Commission understands that many UK and foreign lenders are deterred from taking security over shares in Scottish companies for these reasons.

Jonathan Hardman, an associate at Dickson Minto WS, in an article published in 2017, notes:

"an informal conversation with a London counterparty on a debt finance transaction in which the counterparty indicated that certain of his international bank clients were unwilling to allow their corporate borrowers a blanket permission to incorporate new Scottish subsidiaries on the grounds that taking fixed securities over their shares was too difficult – but that blanket permissions for the incorporation of English companies and Channel Island companies would pose no issue."⁴⁸

The requirement since 1 April 2016 for certain businesses to maintain a "Person of Significant Control (PSC) Register"⁴⁹ and for registration of any individual or "relevant registrable legal entity"⁵⁰ which exercises specified methods of significant control of the businesses, for example, holding (directly or indirectly) 25% or more of the shares in the company⁵¹ has raised questions in relation to how the holder of a Scottish share pledge should be treated. Failure to comply with these requirements can be a criminal offence.⁵²

If a lender were to be treated as a relevant registrable legal entity, it would result in a requirement for entire syndicates (which change over time) to be registered. This would be likely to deter banks from lending where security over shares in a Scottish company would form part of the usual security package. A consensus has now been reached among major law firms, having received an Opinion from Senior Counsel, that the grantor of a shares pledge retains control and the holder does not require to be registered. But a new security which avoids these issues (and other issues on which Scottish practitioners are frequently asked to advise upon, such as consolidation) would clearly have significant benefits.

⁴⁷ See the Supreme Court decision in *Farstad Supply A/S v Enviroco Ltd* [2011] UKSC 16.

⁴⁸ J Hardman, "Some Legal Determinants of External Finance in Scotland: A Response to Lord Hodge" (2017) 21 EdinLR 30 at 31.

⁴⁹ Companies Act 2006 Part 21A and Sch 1A, inserted by the Small Business, Enterprise and Employment Act 2015 s 81 and Sch 3.

⁵⁰ Companies Act 2006 s 790C(8).

⁵¹ Companies Act 2006 Sch 1A Pt 1 para 2.

⁵² Companies Act 2006 ss 790F, 790Q and 790R.

Difficulties also arise in relation to intellectual property, another form of incorporeal moveable property of significant importance to Scottish businesses and the Scottish economy. Scotland is home to many IP-rich sectors such as food and drink, oil and gas and renewable technologies, IT, life sciences and the creative industries. The UK Intellectual Property Office “Fast Facts 2017” publication indicates that the global trade in IP licences was worth over £220 billion and rising.⁵³ The Scottish Enterprise Intellectual Assets Service estimates that IP assets form around 80% of a Scottish business’s value,⁵⁴ and it is predicted that the value of IP to business will continue to increase in the future.⁵⁵ Indeed, UK investment in incorporeal assets protected by intellectual property rights has risen from £23.8 billion in 1990 to £63.5 billion in 2011; a 167% increase.⁵⁶

One commentator has noted in 2017:

As knowledge increasingly becomes the key factor of production in developed economies, IPRs are emerging as some of the most valuable property owned by businesses. Against this landscape, there is a burgeoning interest in deploying these assets as collateral to reduce the cost of credit.⁵⁷

It is therefore crucial that businesses in Scotland are able to fully exploit their IP assets. Granting security over these is one way they can do this, but again, deficiencies in the law require recourse to expensive functional security arrangements which limit the benefits of using IP as security. A leading Scottish law firm, Brodies, has described the law here as being “stuck in the 19th century.”⁵⁸ As a result, taking security over IP is difficult in Scotland, despite what is often the high value of the IP assets owned by many Scottish businesses. This exacerbates an already difficult lending environment for businesses which have a preponderance of their assets tied up in IP and other incorporeal property (intangibles), such as high-tech start-ups and certain service providers.

While floating charges can encumber incorporeal moveable property, as noted above, these have a relatively low ranking in insolvency and are thus less attractive to lenders. It is widely thought therefore that Scottish businesses are placed at a commercial disadvantage which

⁵³ Available at https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/581279/Fast-Facts-2017.pdf.

⁵⁴ See <http://www.scottish-enterprise.com/services/develop-new-products-and-services/manage-your-ia/overview>.

⁵⁵ See <http://www.brodies.com/news/independence-constitutional-considerations/intellectual-property-and-scotlands-constititional-fu>.

⁵⁶ See https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/467634/Fast_facts_2015.pdf.

⁵⁷ A Tosato, “Security Interests over Intellectual Property Rights in Italy” in S V Bazinas and N O Akseli (eds), *International and Comparative Secured Transactions Law: Essays in Honour of Roderick A Macdonald* (2017) 259 at 260.

⁵⁸ See <http://www.brodies.com/blog/technology/intellectual-property/security-over-ip-scots-law-stuck-in-the-19th-century/>.

is not offset by the availability of the floating charge. For non-corporate borrowers who cannot grant a floating charge, these difficulties are not even partially alleviated by the availability of this security.

In England, security can be taken over incorporeal property by means of a “fixed charge”, which ranks highly in insolvency and allows the provider to retain title. As such, the Commission understands that Scottish solicitors make use of the English law by, for example, siting IP rights in England rather than Scotland. This incurs more legal costs for Scottish businesses, gives a potentially misleading impression of the scale of the Scottish economy, and reflects badly on Scottish law generally.

b) Corporeal (tangible) moveable property

In 1897, the law regarding security over corporeal moveable property in Scotland was described as being “beset with difficulties”.⁵⁹ Nevertheless, other than the introduction of floating charges in 1961, no major reform has taken place.

Besides the floating charge, the only security which can be taken over corporeal moveable property in Scottish law is the ancient security of “pledge”.⁶⁰ Pledge requires delivery of the property to the secured creditor.

Physical delivery is unsuited to modern commerce for obvious reasons: the need to part with the property means that debtors then cannot use their assets for business operations. Consider a local business which sells farm produce to the public on a door-to-door delivery basis. If the only significant asset is a single delivery van, the business cannot part with it. Additionally, with pledge the lender bears the responsibility of holding potentially large items of encumbered property for the duration of the loan. This increases costs for the lender, which is often ultimately borne by the borrower.

In commercial practice, pledge is typically used over property which is held by an independent third party custodian, for example whisky held in a commercial warehouse. In this scenario, there is no physical delivery. Instead the third party custodian is notified of the pledge and instructed to hold the property for the secured creditor. This is described as “constructive” rather than “actual” (physical) delivery of the encumbered property to the creditor. The efficacy of constructive delivery for pledge is uncertain, as the mid-nineteenth century case of *Hamilton v Western Bank*⁶¹ seems to require actual delivery to the creditor. The Commission understands that, in practice, *Hamilton* is largely ignored. Constructive delivery is often performed by incorporating a subsidiary (or using an existing subsidiary) referred to as a “captive warehouse company”. Ownership of the warehouse in which the encumbered property is held is then transferred to the subsidiary, which is then instructed to

⁵⁹ W M Gloag and J M Irvine, *Law of Rights in Security* (1897) 187.

⁶⁰ See Genesis 38:18.

⁶¹ *Hamilton v Western Bank* (1856) 19 D 152.

hold the property on behalf of the secured creditor. This is a very unwieldy practice, increasing costs and legal complexity, particularly for small businesses such as whisky distillery start-ups. In order to take security over further assets, supplementary possessory pledges must be made to the secured party in the same way.

The impracticality of pledge has led to the use of complex functional security arrangements. Again, ownership of the property acts as a security. Borrowers “sell” their asset to the lender and have it subsequently returned on a leaseback agreement. However, this transaction structure may be unenforceable because of section 62(4) of the Sale of Goods Act 1979. It bans “sham” sales for the purposes of security. The transaction then falls to be governed by the general law, which seems to require delivery.

Various creative, yet cumbersome, workarounds are therefore required. In one Scottish transaction, a bus company sought to raise finance through a sale and leaseback of some of its buses. In order to give effect to the delivery requirement, the creditor had to lease a warehouse for just one night in order for the buses to be driven in (ie “delivered”) and immediately driven out again.⁶² The bus company borrower incurred unnecessary time and expense. Another example concerned a boat. The agent of the creditor had to wait at a pier for the boat to arrive and step on to it in order to pin a note to the mast to “take delivery” of it.⁶³ These artificial procedures are clearly not a sensible use of business resources.

While there is no delivery requirement with floating charges, as mentioned above only certain corporate bodies such as companies and LLPs can grant these and they have a relatively low ranking in insolvency.

The rigidity of the current law does not meet the commercial needs of modern-day Scotland. Our law contrasts unfavourably with the law in several other jurisdictions, including England and Wales. There, chattel mortgages/bills of sale and fixed charges may be used over corporeal moveable property without the need for delivery of the property to the creditor.⁶⁴ Again, Scottish businesses are being advised to make use of English law.⁶⁵

Conclusion

The law relating to security over moveable property in Scotland is inadequate and unduly restrictive. Functional securities are utilised, but these are often uncertain in effect, complicated and economically inefficient because of associated transaction costs. The result is that individuals and businesses are prevented from fully utilising their assets to raise finance.

⁶² J Hamilton, A Coulson, S Wortley, D Ingram, *Business Finance and Security over Moveable Property* (Scottish Executive Central Research Unit, 2002) 66.

⁶³ Hamilton et al, *Business Finance* (n 62) at 66.

⁶⁴ See eg D Sheehan, *The Principles of Personal Property Law* (2nd edn, 2017) chaps 13 and 14.

⁶⁵ Hamilton et al, *Business Finance* (n 62) at 67.

That Scottish law remains unreformed in this area may affect the reputation of the Scottish legal system more generally. In a report on security over moveable property commissioned by the then Scottish Executive, two respondent solicitors admitted they were “embarrassed” to explain the Scottish rules in cross-border or international transactions.⁶⁶ Whilst anecdotal, this is important: there is evidence to suggest that *perceptions* of governing legal regimes, as well as the actual underlying rules, influence the availability of finance in any given jurisdiction.⁶⁷

Andrew Kinnes of Shepherd and Wedderburn has emphasised to the Commission that “commercial businesses will operate in a jurisdiction with a governing law which facilitates the most straightforward way for them to achieve their goals and that currently with regard to taking security, is not Scotland.” The need for reform is manifest.

Objectives

The Bill, if taken forward, would implement the recommendations contained in the Scottish Law Commission’s Report on Moveable Transactions (Scot Law Com No 249, 2017).

The main policy objectives are as follows:

- Rules surrounding intimation of assignation of claims would be simplified and modernised. Registration would be an alternative to intimation in order to effect transfer of a claim.
- A new type of security to be known as a “statutory pledge” would be introduced in respect of both corporeal moveable property and limited categories of incorporeal moveable property: intellectual property and financial instruments. It would be created by registration.
- Two new registers would be established; the Register of Assignations (“RoA”) and the Register of Statutory Pledges (“RSP”). These would be administered by the Keeper of the Registers of Scotland and would be publicly searchable in exchange for a modest fee. The registers would be self-financing.
- The use of Scottish law to govern moveable transactions would be encouraged.
- Reform would improve access to finance in Scotland for individuals and businesses and would be particularly beneficial for SMEs.

⁶⁶ Hamilton et al, *Business Finance* (n 62) at 70.

⁶⁷ R Haselmann and P Wachtel, “Institutions and bank behaviour: legal environment, legal perception and the composition of bank lending” (2010) 42 *Journal of Money, Credit and Banking* 966.

RATIONALE FOR GOVERNMENT INTERVENTION

The recommendations reflected in the Bill and Report advance three of the Scottish Government's National Outcomes which form part of the Government's National Performance Framework.⁶⁸ These are:

- “We live in a Scotland that is the most attractive place for doing business in Europe”.
- “We realise our full economic potential with more and better employment opportunities for our people”.
- “We are [...] renowned for our research and innovation”.

The Bill meets various Scottish policy objectives:

The Bill contributes to one of the two “pillars” of the Scottish Government's Economic Strategy, namely “increasing competitiveness”.

The Bill also engages two of the four “key priorities” in the Scottish Government's Economic Strategy: increasing investment and encouraging innovation.⁶⁹

- Reform would contribute significantly to providing “Innovative Financing Mechanisms”, with the aim of “maximising opportunities to secure new funds and additionality” and encouraging business investment as set out in the Scottish Government's Economic Strategy.⁷⁰
- Reform would encourage business innovation by improving the ability of businesses to ‘scale up’, an ambition set out in the Scottish Government's “Innovation Action Plan”.⁷¹
- The Bill is in line with the Scottish Government's digital strategy as set out in “Realising Scotland's Full Potential in a Digital World: A Digital Strategy for Scotland”.⁷²

The following section details the recommendations provided in the Report on Moveable Transactions and accompanying Bill, and sets out in further detail the economic and legal justifications for reform.

⁶⁸ See <http://www.gov.scot/About/Performance/scotPerforms>.

⁶⁹ See <https://beta.gov.scot/publications/scotlands-economic-strategy/> at 6-11.

⁷⁰ See <https://beta.gov.scot/publications/scotlands-economic-strategy/> (n 69) at 41-42.

⁷¹ See Point 1 of the Action Plan at p 4: <https://beta.gov.scot/publications/scotland-innovation-action-plan-scotland/>.

⁷² See <https://beta.gov.scot/publications/realising-scotlands-full-potential-digital-world-digital-strategy-scotland/>.

(1) Assignment of claims

Modernising the law of intimation

The Commission's recommendation is that intimation would continue to be an effective way to complete the transfer of a claim, but a simple electronic communication to the debtor would suffice. This is to provide flexibility for parties, and was endorsed by consultees. The Transmission of Moveable Property (Scotland) Act 1862 would be repealed and its impractical dated requirements abolished. Electronic intimation would be given a statutory basis. As an alternative to intimation, an assignment could be registered in the Register of Assignations.

Clarification of the legal rules of intimation would be a major improvement to Scottish law. Legal certainty here would have an economic benefit. It would be made clear what is required from the outset of a transaction, potentially reducing cost and minimising recourse to the courts.

The Scottish law firm Burness Paull LLP has commented:

“We support the proposals to reform and modernise the law so that electronic intimation is facilitated. The commercial approach taken towards intimation in this Bill will be of great assistance in streamlining the intimation process on large transactions and reducing costs for clients. Electronic delivery of notices is something we are often asked for and so will be a very welcome change.”

Clarifying the law as to assignments where the debtor is instructed to continue to perform to the assignor

The reform recommendations would clarify the law in relation to assignments where the debtor is instructed to continue to perform to the assignor. Again, legal certainty here would save time and expense and ultimately provide clarity for all parties in large scale projects in Scotland. The Commission thinks that this would support the Scottish Government's Infrastructure Investment Plan.⁷³

Registration as an alternative to intimation

As an alternative to intimation, assignees could register assignments in the Register of Assignations (RoA) in exchange for a small fee. It is likely that most large scale assignments would be registered in practice. Removing the requirement to intimate is firmly endorsed by stakeholders such as the Federation of Small Businesses, the Asset Based

⁷³ See Scottish Government, *Infrastructure Investment Plan* (2015). Available at: <http://www.gov.scot/Publications/2015/12/5962>.

Finance Association and members of the Finance and Leasing Association, who have all commented on the current impractical nature of Scottish law in this area.

On the ability to register as an alternative to intimation, Shepherd and Wedderburn have commented:

“Although it is difficult for us to quantify the benefit, and some change costs are likely to arise, the increased efficiencies of the new regime seem bound to decrease transaction costs and likely to increase availability of funding from those slightly deterred by the current Scottish legal uncertainties and inefficiencies.”

(i) *Assignment of claims not yet held by the assignor*

The ability to register an assignment would facilitate the assignment of claims not yet held by the assignor, including those not yet in existence (so called “future claims”). The fact that a debtor does not yet exist would not prevent transfer. This has various benefits, not least to those seeking to raise finance by assigning claims, or indeed to anyone who seeks to transfer a right to payment for any reason.

(ii) *Invoice finance would be facilitated*

The ability to assign “future” claims would encourage a larger cash advance from financiers. The Commission believes that this development supports the Scottish Government’s aim to “increase the level of funding available to SMEs and making it easier for SMEs to access this funding.”⁷⁴

Moreover, non-notification invoice finance by means of assignment would become possible under Scottish law. It would no longer be required to use complex trust arrangements, nor would there be a need to resort to English law.

Additionally, notification invoice finance transactions would be less cumbersome than is currently the case, as intimation could be performed to numerous debtors by a simple email.

(iii) *Block discounting in Scotland would be facilitated*

Block discounters would not need to intimate to customers under hire-purchase or lease agreements. Instead, a block discounter could simply register the assignment. A block discounting provider and member of the FLA explained to the Commission that the ability to register block discounting transactions would mean that they would not have to manage different Scottish and English versions of the block discounting agreement. This removes cost and inconvenience for the block discounter and enables better rates for the consumer.

⁷⁴ *The Market for SME Finance in Scotland* (2015) (n 16).

(iv) *Assignations of rents would be made easier*

Currently where rents are assigned in a shopping centre with dozens of units, there must be intimation to each individual tenant. This could be replaced by a single electronic registration.

(v) *Facilitating securitisations*

Securitisation transactions could be registered rather than completed on the basis of a trust structure. This would provide better protection for the arrangement (as the uncertainties surrounding trusts would be avoided) and generate practical advantages for parties involved in this financial practice. As Dr Hamish Patrick of Shepherd and Wedderburn has informed the Commission, where future assets are involved trusts must be set up periodically, which is burdensome and time consuming. Under the Commission's recommended reforms, a single registered assignment could be used instead.

Dr Patrick has said:

"The proposed new assignment regime will make securitisation more straightforward. While the new regime won't help with securitisation of residential mortgages or most other land-related rights, replacing periodic trusts and assignments in security when securitising batches of unsecured loans, trade debts or similar assets with an up-front registered outright assignment and assignment in security will provide a stronger and simpler mechanism for securitising those classes of assets."

(vi) *Increased certainty*

Currently, financiers face uncertainty about if and when intimation has been carried out correctly. The risks of uncertainty are particularly acute in the insolvency context, since upon discovering an assignment has been ineffective, the prospective assignee's right to be transferred the claims would likely be frustrated due to the rights of the assignor's creditors.

Under the Commission's proposals, the law of intimation would be placed on a clear statutory footing. Alternatively, a financier could register an assignment, view the entry on the RoA and therefore be satisfied that it has been properly completed, removing uncertainty and associated risks.

(vii) *Lower administrative and legal costs*

The Commission predicts that registration would reduce the administrative and legal costs incurred by financiers in setting up complex workarounds. Instead of using trust structures, or requiring to intimate to multiple debtors, a single set registration fee would be required, with the potential for the cost benefits to be passed on to clients.

Simplifying intimation by, for example, allowing electronic intimation would also bring cost-benefits.

Conclusion

Put simply, modernising the law would make various forms of financial transactions easier than they currently are in Scotland today. This should encourage increased finance provision to Scottish businesses. This point is emphasised by Jeff Longhurst, Head of Commercial and Asset Based Finance at UK Finance, who has told the Commission that a modern statutory framework would promote more invoice financing in Scotland and potentially encourage new finance companies to enter the Scottish market.

A number of ABFA members have stated that the availability of electronic registration would encourage them to support more Scottish client businesses than they currently do. Several members have also told the Commission that the availability of an electronic registration facility would influence them to increase the amount of invoice finance that they make available to existing Scottish client businesses.

One ABFA member stated that, because registration would provide a similar level of title protection in Scotland to that which is currently obtained under English law from an equitable assignment, it would influence it to lower discount charges and remove other restrictions it imposes in relation to Scottish debts (which are not currently imposed in relation to English debts).

The Commission believes that all the effects outlined above support two of the Scottish Government's National Indicators: '[i]mprove Scotland's Reputation', and '[w]e realise our full economic potential'. The Commission believes that these developments are also important to ensure that '[w]e live in a Scotland that is the most attractive place for doing business in Europe' as embodied in the Scottish Government's National Performance Framework.

Reform would also contribute to the Government's aim to increase access to finance for businesses in Scotland as emphasised in their SME Report.⁷⁵ It is also concordant with broader European ambitions, such as the European Commission's objective to improve the financing environment for SME businesses across Europe.⁷⁶

Furthermore by facilitating growth through greater access to finance, reform may encourage businesses to take on more employees, thus presenting the opportunity to meet the Scottish Government's National Outcome, in the Government's National Performance Framework that: "[w]e realise our full economic potential with more and better employment opportunities for our people".

⁷⁵ *The Market for SME Finance in Scotland* (n 16).

⁷⁶ See https://ec.europa.eu/growth/access-to-finance_en.

(2) Security over moveable property

A new security

The Commission recommends that the new “statutory pledge” could be used in relation to all forms of corporeal moveable property and limited categories of incorporeal moveable property, namely intellectual property and financial instruments. The security would be a “fixed” security and thus have a higher ranking in insolvency than a floating charge. It would be completed by a simple electronic registration in the Register of Statutory Pledges.

With the statutory pledge, there would be no requirement for the encumbered property to be delivered to the creditor. Expense and time would be saved. It would also mean that the provider of the security could continue to utilise their assets irrespective of the security. As no legal transfer to the lender occurs, a single asset could be collateralised multiple times, unlocking its economic potential for the borrower.

The Commission believes that the statutory pledge would be particularly beneficial to non-corporate entities such as sole traders and partnerships which cannot grant a floating charge over their assets.

Responding to the Commission’s reform proposals, the FSB has commented that:

“Today’s small businesses need a commercial environment that lets them raise finance against business assets quickly and easily. The current law is rooted in the past and doesn’t reflect how business is now done. It therefore makes perfect sense to introduce a simple, cost effective method of raising finance against your tangible moveable assets and intellectual property, while allowing you to keep using them.”

Whilst the statutory pledge would be a fixed security, the Bill provides a mechanism by which the grantor can obtain consent from the creditor to release the asset. For example, where a statutory pledge encumbers “all single malt whisky present and future held in X warehouse”, the grantor could obtain consent to release a certain quantity for bottling or blending. By granting the security over present *and future* whisky, the statutory pledge would catch any future stock without the need for further supplementary pledges, as is currently the case with possessory pledge.

Using the statutory pledge rather than a sale and leaseback arrangement (or indeed a hire-purchase arrangement in the case of consumers) could also be preferable to a lender for accounting purposes. With a functional security, the asset would appear on the lender’s books. With the statutory pledge, the lender would not have to remain owner of the asset in order to achieve appropriate security and thus the asset could be removed from their books, reducing administrative burdens.

The use of Scottish law would be promoted because it would no longer be more restrictive in Scotland than in neighbouring jurisdictions to take security over moveable assets.

Facilitating access to finance

The Commission believes that by making it easier and more cost effective to take security over moveable property, access to finance would be facilitated.

(i) Secured versus unsecured lending.

As discussed above,⁷⁷ there is a well-established link between an efficient security rights regime and the supply of finance. Studies focusing on reform in countries with “weak” security rights regimes also show that introducing a modern and coherent system for taking security is associated with “dramatic differences in the supply of credit and economic growth.”⁷⁸

Listed below are the generally accepted advantages of secured compared to unsecured lending. These are essentially attributable to secured loans minimising risk: if a debt is unpaid, the encumbered property can be sold to satisfy (partially or in full) the outstanding amount. These benefits for the lender translate to benefits for the borrower:

- Borrowing limits are higher for secured loans.⁷⁹
- Secured borrowing involves lower monthly repayments over a longer term.⁸⁰
- Secured lending allows the borrower to be properly financed. Third parties will have confidence about the borrower’s solvency.

The new statutory pledge would add to the security rights already available to lenders in Scotland. Being a fixed security it would be potentially more attractive to lenders than the floating charge, because it would have a higher ranking in insolvency.

Several ABFA members have informed the Commission that the ability to take the statutory pledge would decrease the interest rates and fees charged on loans. This effect is supported by empirical studies.⁸¹ ABFA members also commented that the existence of the statutory pledge would encourage them to provide more finance than they currently do to businesses in Scotland.

⁷⁷ See pp 10 to 11 above.

⁷⁸ Calomiris et al, “How Collateral Laws Shape Lending and Sectoral Activity” (n 37) at 1. See also Haselmann et al, “How Law Affects Lending” (n 34); World Bank, “Getting Credit: The Importance of Registries” (n 37).

⁷⁹ Affaki, “Increasing Access to Credit” (n 33) at 166.

⁸⁰ J Qian and P E Strahan, “How Laws and Institutions Shape Financial Contracts: The Case of Bank Loans” (2007) 62 *Journal of Finance* 2803.

⁸¹ Castellano, “Reforming Non-Possessory Secured Transactions Laws” (n 34); Benmelech and Bergman, “Collateral Pricing” (n 34); Booth and Booth, “Loan Collateral Decisions” (n 34); World Bank, “Getting Credit” (n 37).

A renewed willingness to extend finance would be welcome in light of the Scottish Government's SME Report, which found evidence of viable Scottish SMEs in all sectors facing challenges raising the funding they need.⁸² Considering that moveable property, rather than land or buildings, accounts for most of the capital stock of SMEs,⁸³ the ability to grant security over these assets would be of particular importance to these types of businesses.

(ii) *Capital requirements of banks*

The presence of collateral security in lending increases the amount of money which UK banks are permitted to lend under the Basel II/Basel III rules contained in the Capital Requirements Directives.⁸⁴ The Capital Requirements Directives were introduced to strengthen the resilience of banks so that they could absorb economic shocks and continue to lend in times of financial crisis. Under these rules, banks must retain an amount of capital on their balance sheet in order to cover outstanding loans. The amount of capital which must be retained is dependent on the bank's total credit portfolio.

The portfolio is defined by credit risk, market risk, operational risk and settlement risk.⁸⁵ Credit risk can be expressed as the "Expected Loss" ("EL"). Put simply, EL means the ratio of the amount loaned that the lender predicts to lose in the event of the borrower's default.⁸⁶

The amount of EL for each type of loan can either be (a) directly derived from the Basel rules (the Standardized Approach (SA)) or (b) calculated by lenders on the basis of requirements set out in the Basel rules (the Internal Ratings Based Approach (IRB)).⁸⁷

Essentially under (a), the SA approach, loans are given a risk weight based on the type of loan. For example, loans secured by a mortgage on residential property are assigned a risk weight of 35%.⁸⁸ This percentage determines the amount of regulatory capital the lender must keep.

There is more flexibility under the IRB approach, which appeals to lenders. IRB is a formula-based approach which allows the EL to be calculated by reference to banks' own extensive empirical data, subject to approval from national regulators (such as the Prudential

⁸² *The Market for SME Finance in Scotland* (2015) (n 16).

⁸³ Affaki, "Increasing Access to Credit" (n 33) at 160.

⁸⁴ Rules originally implemented under Directive 2006/48/EC, OJ L 177, better known as "the Banking Directive"; and Directive 2006/49/EC, OJ L 177, better known as "the Capital Adequacy Directive" have been restated and built upon by the most recent Capital Requirements Package, CRD IV. CRD IV refers to Directive 2013/36/EU and Regulation (EU) No 575/2013.

⁸⁵ Regulation (EU) No 575/2013, article 1(a).

⁸⁶ Regulation (EU) No 575/2013, article 5(3).

⁸⁷ Regulation (EU) No 575/2013, article 107(1).

⁸⁸ D Hamwijk, *Publicity in Secured Transactions Law: Towards a European public notice filing system for non-possessory security rights in movable assets?* (2014) p 100. See also Annex VI, Part I, of the Banking Directive, and Regulation (EU) No 575/2013, articles 117, 122 and 125 for more examples.

Regulation Authority at the Bank of England).

To determine the credit risk using the IRB approach, lenders calculate the EL by reference to the following formula in simplified form: Probability of Default (“PD”)⁸⁹ x Loss Given Default (“LGD”)⁹⁰ x Exposure at Default (“EAD”)⁹¹ = EL.⁹² The presence of security impacts on the calculation of the LGD. The better the quality of security, the lower the LGD and therefore the lower the EL. The lower the EL, the smaller the credit risk to the bank. A lower credit risk means less capital is required to be held by the banks in order to comply with the Basel rules. That capital is therefore unlocked and can subsequently be applied to new loan transactions with existing or new borrowers.

As the EL is representative of the amount of capital that banks must retain under the Basel rules, the EL also essentially represents “lost profit” – capital that cannot be loaned to “make money”.⁹³ Banks pass on this “lost profit” to customers in the price of borrowing, in the form of a “solvency surcharge”. However, by reducing the EL, the availability of collateral will free up more capital for lending, which will lead to a lower solvency surcharge, reduced interest rates and by extension, cheaper borrowing.

Thus, by providing for a new security and allowing banks to more effectively collateralise loans, the new statutory pledge would likely result in easier access to bank loans at a more affordable rate for businesses in Scotland.

(iii) *Responsible lending*

The Commission believes that the statutory pledge would promote responsible lending in Scotland.

In other words, if financial institutions are more willing to lend due to having security in the form of the statutory pledge, this would reduce the need for businesses and individuals to resort to parties who do not adhere to responsible lending, such as high-risk lenders, to obtain finance.

This would reduce the risk that the borrower would take out loans which are unaffordable or be exploited more generally. Borrowers can expect from banks, as responsible lenders as required by the Banking Lending Code,⁹⁴ among other things:

⁸⁹ The likelihood that the debtor will be unable to meet its interest and repayment obligations to the lender within one year.

⁹⁰ This is the loss that the bank will incur on the debtor, after liquidation of the security and set-off of the credit balances held at the bank, in the event of definitive default of the debtor.

⁹¹ An estimate of the total amount that the debtor will owe the lender at the time of default.

⁹² Hamwijk, *Publicity in Secured Transactions Law* (n 88) at 100.

⁹³ Hamwijk, *Publicity in Secured Transactions Law* (n 88) at 102.

⁹⁴ See <https://www.bba.org.uk/policy/retail/credit-and-debt/the-lending-code/the-lending-code/> and http://www.rbs.co.uk/content/personal/downloads/personal_banking_code.PDF.

- Clear information on the cost of borrowing, fees and charges.
- A limit on borrowing to ensure finances are not overstretched.
- An assessment of the borrower's ability to make regular payments and repay the loan.
- Reasonable notice of interest rate and payment changes affecting the borrower.

(iv) *Potentially more secure peer-to-peer lending*

The Commission considers that the statutory pledge could also be used to reduce risk in the peer-to-peer lending sector.⁹⁵ Peer-to-peer lending connects lenders and borrowers online and is often sought by SMEs as an alternative to bank funding.

Lord Turner, a former Director-General of the Confederation of British Industry, has predicted big losses for the peer-to-peer industry on the basis that investors are lending (and losing) money to borrowers which had not been properly risk assessed.⁹⁶ There would be potential to minimise these losses if the risk exposure to the lender was reduced by collateralising loans.

Personal finance and protections for individuals

The statutory pledge could be available to individuals, supporting personal finance in Scotland. There is a significant market for such finance. For example, statistics from the FLA show that the number of those engaging in consumer finance in the UK has grown 8% from May 2016 to May 2017.⁹⁷

In order to provide appropriate protection for individuals, the Commission recommends that where the borrower is an individual, the statutory pledge would only be available for assets of a significant value (with the value to be determined by statutory instrument) eg motor vehicles, boats, musical instruments or works of art.

Reform of possessory pledge

The Commission's reforms would clarify the law in relation to common law (possessory) pledge confirming that delivery is not restricted to physical delivery. This would provide

⁹⁵ Peer-to-peer lending, a system whereby individuals lend to other individuals, has increased considerably in recent years.

⁹⁶ *The Telegraph* 10 February 2016, "Lord Turner: peer-to-peer crash will make 'bankers look like lending geniuses'", available at:

<http://www.telegraph.co.uk/finance/newsbysector/banksandfinance/12149997/Lord-Turner-peer-to-peer-crash-will-make-bankers-look-like-lending-geniuses.html>.

⁹⁷ See <http://www.flc.org.uk/index.php/research/consumer/>.

parties currently using constructive delivery with clarity and certainty.

The Bill provides also for clear enforcement rules in relation to pledge. The rules allow, among other things, a lender to sell the encumbered property if the borrower fails to repay the loan without the need to obtain a court order first. This differs from the current law where the default position requires a lender to obtain a court order (unless an express contractual power of sale has been included in the agreement). Therefore the proposals would save time and expense currently incurred by the requirement to contract for the power of sale. The Bill also provides for appropriate protections for the borrower in this context, striking an important fair balance between the lender and borrower.

Secured lending: asset types

By way of example, the following sets out how the new statutory pledge could be used as regards different types of asset, to illustrate how useful it could be in various contexts.

(i) Whisky

The Scotch Whisky industry is the third biggest industry in Scotland, behind only energy and financial services. It is therefore of vital significance. It contributes £5 billion to UK GDP, supports 40,000 UK jobs and accounts for almost a quarter of UK food and drink exports.⁹⁸

At any given time, some 20 million casks lie maturing in warehouses across Scotland. Under the current law, the only way whisky producers can grant security over this valuable, yet “idle”, commodity is with a floating charge or possessory pledge. As explained above, whether a possessory pledge can be effected by constructive delivery is subject to uncertainty,⁹⁹ and the practice of granting a possessory pledge in this way is very cumbersome.

The Bill confirms the validity of constructive delivery, providing lenders with legal certainty as to possessory pledge and by extension their ranking in insolvency.

Alternatively, the new statutory pledge could be used, completed with a straightforward online registration. It could be granted over future stock, negating the need for supplementary possessory pledges. It would also avoid the need for a “captive warehouse company”, resulting in reduced legal expense, which would be particularly beneficial for small or start-up distilleries.

Improving the lending environment for the whisky industry in this way would facilitate business growth in this vital pillar of the Scottish economy.

⁹⁸ See industry facts and figures from 2014: <http://www.scotch-whisky.org.uk/what-we-do/facts-figures/>.

⁹⁹ See pp 15 to 16 above.

In a letter of support, The Scotch Whisky Association has commented:

“The SWA has consulted its members and believes, in principle, that the proposals would be of benefit to the Scotch Whisky industry”.

Whisky is just one example of how high-value food and drink can be used as collateral. A widely-publicised loan transaction in 2016 saw a £20 million wine collection being pledged as collateral in England.¹⁰⁰ Of course such a transaction would have been subject to some legal uncertainty in Scotland under the current law, for reasons set out above.¹⁰¹

(ii) *Plant and machinery*

Sophisticated, high-value plant and machinery is used in various important sectors of the Scottish economy and often makes up the majority of assets owned by businesses involved in the oil and gas, renewables, engineering, manufacturing and construction sectors.

In the oil and gas sector, rather than purchasing machinery for individual projects, oil companies will often lease equipment from oil service providers. The providers therefore retain title, which has significant potential for security purposes. The new statutory pledge would be of significant benefit to these oil service providers, who would be able to raise funds over pre-existing equipment which they are leasing out because they would not have to give possession of the equipment to the lender. At present, only the floating charge could be used, and this is not as attractive to lenders as a fixed security. The statutory pledge could also be used for acquisition finance, so that new or less established oil service companies could acquire a stock of sophisticated equipment and machinery and enter the supply chain market.

Ensuring businesses in these sectors, active throughout supply chains, have adequate access to finance to invest in innovation, diversification and growth is a Scottish Government priority.¹⁰² The ability to grant a statutory pledge over high-value moveable assets would improve access to finance and likely lower the cost of borrowing.

¹⁰⁰ *The Times*, 30th December 2016, “£20m wine collection put on table to clinch loan” available at: <https://www.thetimes.co.uk/edition/business/20m-wine-collection-put-on-table-to-clinch-loan-nz38jltq>.

¹⁰¹ See pp 15 to 16 above.

¹⁰² See the Scottish Government’s “Oil and Gas” cabinet: <https://firstminister.gov.scot/oil-and-gas-cabinet/>. See also Scottish Enterprise, “Helping Oil and Gas Firms to Access Finance” at <https://www.scottish-enterprise.com/knowledge-hub/articles/comment/access-to-finance-oil-and-gas>; Scottish Government, ‘Support for Manufacturing’: <https://beta.gov.scot/news/support-for-manufacturing/>.

(iii) *Livestock*

The value of agricultural livestock production on farms was around £1.5 billion in Scotland in 2016 and accounted for almost half of all agricultural output in Scotland (£3.36 billion).¹⁰³

Other than the floating charge and the rarely used “agricultural charge”¹⁰⁴ there is no security that can be granted over livestock without relinquishing possession. The statutory pledge could be granted over livestock, allowing possession to be retained by the grantor.

This could be an effective means of raising funds to grow an agricultural business, or to mitigate cash flow difficulties.

(iv) *Intellectual property*

As set out above,¹⁰⁵ Scotland is home to many IP-rich industries, and IP often makes up a significant portion of a business’s value.

Under the Commission’s recommendations, granting and taking security over IP would be a lot simpler and less expensive. As a “true” security there would be no transfer, thus avoiding complicated licence arrangements and making it possible to grant more than one security over the IP. This has the potential to unlock the true economic value of IP assets for businesses. This is consistent with Scottish and UK policy objectives, which aim to provide support to SMEs in maximizing the value of IP.¹⁰⁶

Moreover, increasing the potential profitability of intellectual property may encourage innovation and creativity in developing sectors. This supports the Scottish Government’s strategic objective in their National Performance Framework that ‘we are [...] renowned for our research and innovation’.¹⁰⁷

(v) *Vehicles*

At present, it is commercially impracticable to raise finance over vehicles already owned by the borrower. The only true security available (possessory pledge) requires the borrower to be dispossessed of the property, whilst a sale and leaseback arrangement requires ownership to be transferred, as well as initial physical delivery to the lender. This is impossible where vehicles are used in day to day business operations. With the statutory

¹⁰³ See <https://beta.gov.scot/publications/agriculture-facts-figures-2017/>.

¹⁰⁴ A type of floating security introduced by the Agricultural Credits (Scotland) Act 1929. The Commission recommends its abolition because it is so rarely used. A floating charge could be used instead.

¹⁰⁵ See p 14 above.

¹⁰⁶ See

https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/321896/business-support.pdf.

¹⁰⁷ See http://www.parliament.scot/ResearchBriefingsAndFactsheets/S4/SB_12-12.pdf at 11.

pledge, a business could grant security over its fleet of vehicles in order to raise finance. This would be completed by simple registration and would allow the business to retain both ownership and possession of the property.

The statutory pledge could also be used in the acquisition finance context, providing an alternative alongside other staged payment arrangements such as hire-purchase. Acquisition finance for motor vehicles is a significant industry in the UK, with members of the FLA providing some £41 billion of new finance to car purchasers in 2016.¹⁰⁸ The financing party could decide which option was most appropriate depending on the particular transaction.

(vi) *Financial instruments*

In Scotland security over shares in a company may be taken currently by means of a share pledge. As explained above,¹⁰⁹ the pledged shares must be legally transferred to the lender to achieve security.¹¹⁰ This then requires expensive contractual arrangements to give the provider of the shares pledge the continued right to take dividends etc.

The statutory pledge would be a mechanism by which to achieve security over shares with lower costs and less practical difficulties than the current law. There would be no requirement for transfer and therefore no requirement for the subsequent contractual arrangements to be made.

The Commission's recommendations comply with Directive 2002/47/EC of 6 June 2002 on financial collateral arrangements, as implemented by the Financial Collateral Arrangements (No 2) Regulations 2003 (SI 2003/3226). There are specific provisions in the Bill to ensure this, in particular the registration requirements are disapplied where necessary.

(vii) *Works of art*

High value artwork can be used to secure lending, but this is rarely done in practice in Scotland due to difficulties with the law. The exhibition of art tends to enhance its value, but other than the floating charge the only security available is a possessory pledge, and it is inconvenient and expensive to remove and transport – particularly large or fragile pieces. Alternatively, the borrower could adopt a sale and leaseback arrangement, allowing the borrower to retain possession, but again, this would probably require physical delivery and limits the asset's economic potential for reasons set out above.¹¹¹

¹⁰⁸ See the Finance and Leasing Association Motor Finance page: <https://fla.org.uk/index.php/motor-finance-2/>.

¹⁰⁹ See p 13 above.

¹¹⁰ See the Supreme Court case of *Farstad Supply A/S v Enviroco Ltd* [2011] UKSC 16.

¹¹¹ See p 11 above.

With a statutory pledge a non-possessory fixed security could be granted, allowing the artwork to remain on exhibition. It could be completed by simple registration and would allow multiple securities to be granted over the work, unlocking its economic potential for the borrower. A 2017 Report by Deloitte estimates that the outstanding value of art-secured loans in the USA to be \$17 - \$20 billion, a 13.3% increase from 2016.¹¹² In its consultation on bills of sale, the Law Commission for England and Wales was informed by respondents that given the UK's substantial art market, making it easier to take security over artwork would lead to a significant increase in art being used to obtain finance.¹¹³ As noted above,¹¹⁴ whilst the law in England requires reform, it is in a much better state than Scottish law here.

(viii) *Small sea vessels*

The Commission considers that the statutory pledge could be used in relation to smaller sea vessels such as yachts where registration of the vessel in the UK Register of Ships is necessary before a ship mortgage can be granted over it. However, registration of small vessels is cumbersome and requires, among other things, the boat to have a name.¹¹⁵ The statutory pledge would remove the time and cost associated with unnecessary ship registration.

Conclusion

At present Scottish law in relation to security over moveable property is outdated, impractical and deficient. Unlike in other jurisdictions, recourse must be made to functional securities and artificial procedures, which increase complexity and cost.

The new statutory pledge would allow individuals and businesses to grant a fixed, "true" security over moveable property. In the view of a member of the FLA:

"I am sure all funders will agree – anything which makes the security position in Scotland more accessible and transparent will be welcomed. The [Commission's proposals] certainly sound like they would achieve this."

Indeed, respondent members of ABFA have also told the Commission that a new statutory pledge would encourage increases in lending for asset-based finance in Scotland at a reduced cost for borrowers.

¹¹² Deloitte, *Art and Finance Report* (5th edn, 2017) p 156 available at <https://www2.deloitte.com/content/dam/Deloitte/lu/Documents/financial-services/artandfinance/lu-art-finance-report.pdf>.

¹¹³ See https://s3-eu-west-2.amazonaws.com/lawcom-prod-storage-11jxou24uy7q/uploads/2016/02/cp225_bills_of_sale_key-points.pdf.

¹¹⁴ See p 11 above.

¹¹⁵ See <https://www.gov.uk/register-a-boat/the-uk-ship-register>.

As with the reform of assignation, the Commission believes that these developments would support the ambitions set out in Scotland's Economic Strategy including the aim to increase the number of medium-sized enterprises and improve Scotland's productivity performance to rival international competitors. By facilitating growth, reform may encourage business to take on more employees, thus presenting the opportunity to meet the Scottish Government's National Outcome that: "[w]e realise our full economic potential with more and better employment opportunities for our people".

The Commission also believes the outlined reforms would support two of the Scottish Government's National Indicators: '[i]mprove Scotland's Reputation', and '[w]e realise our full economic potential'. The Commission believes that these developments are also important to ensure that '[w]e live in a Scotland that is the most attractive place for doing business in Europe' as embodied in the Scottish Government's National Performance Framework.

Reform would also contribute to the Government's aim to increase access to finance for businesses in Scotland as emphasised in their SME Report,¹¹⁶ and would cohere with similar broader European ambitions, namely the European Commission's objective to improve the financing environment for businesses across Europe.¹¹⁷

(3) Registers

In recent years, publicity based on publicly available electronic registries has become a key component in reforming moveable transactions law internationally.¹¹⁸ Under the Commission's recommendations, two new public registers would be created.

The Register of Assignations would provide for an alternative method for completing an assignation and the Register of Statutory Pledges would provide the means of creating a statutory pledge. These registers could be searched by anyone in exchange for a small fee.

The economic benefits of simplicity and transparency

Easy access to information at relatively low cost is the "primary element" through which to establish a transparent and harmonised market for secured credit.¹¹⁹ In the secured lending context, lenders will conduct investigations into a prospective borrower's financial position in order to limit exposure to insolvency. Such investigations usually require gathering information on the extent to which assets are already subject to pre-existing security,¹²⁰ as the risk of hidden and unquantifiable pre-existing securities can be a significant deterrent for lenders.¹²¹ These investigations cause the cost of credit to rise.¹²² With a publicly

¹¹⁶ *The Market for SME Finance in Scotland* (n 16).

¹¹⁷ See https://ec.europa.eu/growth/access-to-finance_en.

¹¹⁸ Castellano, "Reforming Non-Possessory Secured Transactions Laws" (n 34) at 625.

¹¹⁹ Castellano, "Reforming Non-Possessory Secured Transactions Laws" (n 34) at 627.

¹²⁰ Castellano, "Reforming Non-Possessory Secured Transactions Laws" (n 34) at 622.

¹²¹ World Bank, "Getting Credit" (n 37) at 67.

accessible register, financiers can discover the true picture without resorting to in-depth investigation, thus potentially lowering the cost of borrowing.

Both registers would be managed by the Keeper of the Registers of Scotland, who is responsible for a number of existing Scottish registers.¹²³ The Commission has liaised closely with Registers of Scotland (RoS) in relation to the costs of setting up and running these registers.

Electronic registers

As stated, the registers would operate electronically: searching, registering and payment would all be performed online. There are several economic and environmental benefits to electronic registration.

- **Improved efficiency and reduced cost.** Electronic applications are cheaper than paper applications. For example, to register the particulars of a right in security created by a UK registered company at Companies House using an MR01 form costs £26 to file on paper and £15 to file it online.¹²⁴
- **Faster availability and access to information.** Almost all statutory pledges would be registered (except those created under the special rules for financial collateral arrangements) and, it is likely, so too would most large scale assignments. Third parties could then obtain information through a simple online search.
- **Automation.** The lack of human intervention is not only cost effective; it also reduces the risk of error and delay.
- **It is environmentally friendly.** It reduces the amount of paper used. For example, thousands of sheets of paper could be saved in completing an assignment as a copy of the assignment document would not need to be sent to the debtor(s) (as required by the Transmission of Moveable Property (Scotland) Act 1862). This is consistent with the Scottish Government's objective in their National Performance Framework to "reduce the local and global environmental impact of our consumption and production". Reducing paper usage also supports the government's strategic objective to "value and enjoy our natural environment and protect and enhance it for future generations".
- **It reflects the "digital age" in which we live.** The use of digital technology across all sectors is constantly increasing. Scotland must address the implications of digital

¹²² Benmelech and Bergman, "Collateral Pricing"; Booth and Booth, "Loan Collateral Decisions" (n 34).

¹²³ See <https://www.ros.gov.uk/about-us/registers-we-hold>.

¹²⁴ For charges created on or after 6 April 2013.

change by providing for new digital channels in order to remain an attractive place to do business. Providing for the electronic creation of security rights and completion of assignments would therefore meet stakeholders' expectations and would be consistent with the current digital transformation programme at RoS¹²⁵ and the digital transformation strategy at Companies House (CH).¹²⁶ The digital transformation programme at RoS aims to move RoS from a paper-based organisation to one that always does everything digitally as the first option. Similarly at CH, the aim is for CH to become as close as possible to a 100% digital organisation by the end of 2018/19. The strategy plans to develop a new digital service to replace the existing filing and search systems and to provide digital options for transactions currently submitted on paper. CH states that this will enable them to reduce the number and amount of fees which they currently charge. It was reported in the CH 2015/16 Annual Report and Accounts that their digital take-up is 83.7%.

The electronic registers are therefore consistent with the following Scottish Government National Indicators which form part of the Government's National Performance Framework to:

- Improve digital infrastructure.
- Reduce Scotland's carbon footprint.
- Reduce waste generated.

CONSULTATION

WITHIN GOVERNMENT

- The Commission has met with officials of the Family and Property Law division of the Scottish Government as work on the Bill progressed.
- The Commission has worked closely with Registers of Scotland (a non-ministerial Government department). RoS assisted on matters including the liability of the Keeper, searching and the identification of persons on the register.
- The Commission has consulted with the UK Government Department for Business Innovation & Skills (DBIS) (now the Department for Business Energy & Industrial Strategy, or DBEIS), as well as Companies House and the Intellectual Property Office (both of which are executive agencies sponsored by DBEIS).

¹²⁵ See <https://www.ros.gov.uk/about-us/digital-transformation>.

¹²⁶ See https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/446159/Annual_Report_201415.pdf.

PUBLIC CONSULTATION

- The Commission received extensive feedback, support and advice from a wide range of stakeholders and experts in the area of moveable transactions.
- The Commission received strong support for reform of the law of assignation and security over incorporeal moveable property in the Commission's Seventh Programme of Law Reform (2005 to 2009).
- There was overwhelming support from consultees to extend the project to include reform of the law of security over corporeal moveable property as part of the Commission's Eighth Programme of Law Reform (2010 to 2014).
- In 2011 the Commission formed a small advisory group of expert practitioners and academics to assist with the project.
- The Discussion Paper on Moveable Transactions (Discussion Paper 151) was published by the Commission in June 2011, followed by a three-month consultation. Over forty responses to the Discussion Paper were received and the project generated support from stakeholders including members of ABFA, FLA, CBI Scotland, the Committee of Scottish Clearing Bankers and the Federation of Small Businesses.
- The Commission held follow-up meetings with consultees to the Discussion Paper and discussed the project with various other stakeholders.
- In October 2011 a symposium was held at the University of Edinburgh on the security aspects of the project. The event attracted over forty individuals. The speakers were Professor George Gretton of the University of Edinburgh; Dr Ross Anderson of the Faculty of Advocates; Dr Hamish Patrick of Shepherd and Wedderburn and Professor Hugh Beale of the University of Warwick. The papers from the symposium were published in the *Edinburgh Law Review*.¹²⁷
- The Commission held two meetings with Colin Borland of the FSB. The first was in March 2013 to discuss policy and the need for reform. The second was in November 2016, prior to which Mr Borland received extracts from the draft Business and Regulatory Impact Assessment. Mr Borland provided helpful examples of instances where the law has created difficulties for small businesses. He later provided a letter of support in favour of the reform proposals in principle.

¹²⁷ (2012) 12 *EdinLR* 261.

- Between 2014 and 2017, the core advisory group was enlarged to nineteen people. This included academics, representatives from various law firms, a bank, an advocate and a Court of Session judge. Numerous meetings have been held throughout the life of the project, including two specialist meetings on intellectual property and financial collateral aspects. Various meetings have also been held with other experts not on the advisory group.
- In September 2015 the Commission held a meeting with a group of insolvency practitioners where there was representation from, among others, members of the Institute of Chartered Accountants of Scotland (ICAS), the Accountant in Bankruptcy and the Association of Business Recovery Professionals (R3).
- In January 2016 the Commission held a meeting with ABFA. ABFA's then Chief Executive, Jeff Longhurst (now Head of Commercial and Asset Based Finance at UK Finance) and Director of Policy and Communications, Matthew Davis attended the meeting. Thereafter the Commission produced and distributed a questionnaire to ABFA members and received completed questionnaires from ten members.
- In March 2016 the Commission held a meeting with the FLA. Simon Goldie, Head of Asset Finance was present at the meeting. The Commission prepared a project statement which FLA distributed to several of its members. The Commission received responses from three members.
- The Commission consulted the Scotch Whisky Association and in November 2016 received a letter of support in principle for the reforms.
- In January 2017 the Commission met with lawyers from Burness Paull's banking and finance team, who were particularly supportive of the reform to assignation.
- In July 2017, the draft Moveable Transactions (Scotland) Bill was placed on the Commission website for public comment. The Commission received responses from various stakeholders, including the Association of Business Recovery Professionals (R3), the Law Society of Scotland, the Faculty of Advocates, the Institute of Chartered Accountants of Scotland (ICAS), Burness Paull, Shepherd and Wedderburn, Professors Hugh Beale and Louise Gullifer of the Secured Transactions Law Reform Project and Richard Calnan of the City of London Law Society's Financial Law Committee.
- In December 2017 the Commission received a statement of support from the Committee of Scottish Bankers.

BUSINESS

The Commission has engaged with a number of businesses through various representative bodies.

Through the Asset Based Finance Association, the Commission received feedback in the form of questionnaire answers from:

1. Santander Corporate & Commercial (Invoice Finance): 2 Triton Square, Regent's Place, London NW1 3AN
2. RBS Invoice Finance: Kirkstane House, 139 St Vincent Street, Glasgow G2 5JF
3. Ultimate Finance Group: 1 West Point Court Great Park Road, Bradely Stoke, Bristol BS32 4PY
4. Hitachi Capital Invoice Finance: 5 Hollinswood Court Stafford Park 1 Telford, Shropshire TF3 3DE
5. IGF Invoice Finance Lloyds Banking Group Commercial Finance 3rd Floor 151 West George Street Glasgow G2 2JJ
6. Lloyds Banking Group Commercial Finance No.1 Brookhill Way Banbury, Oxon OX16 3EL
7. Metro Bank Invoice Finance 35-37 North Street, Guildford GU1 4TE
8. Secure Trust Bank Commercial Finance Team Factors Ltd 1 Arleston Way, Solihull B90 4LH
9. Team Factors Ltd. Unit 21-23 John Dickinson Enterp, Stationers Place, Hemel Hempstead HP3 9QU
10. Working Capital Partners Ltd 45 Vivian Avenue, Hendon NW4 3XA

The Commission also consulted various financing businesses through the Finance and Leasing Association, but responses were anonymised.

The Commission engaged with the Scotch Whisky Association (who in turn consulted their own member businesses), the Federation of Small Businesses, CBI Scotland, Scottish Enterprise and the Consumer Credit Trade Association.

OPTIONS

Option 1: Do nothing

Option 2: Introduce the system in the Bill

Option 3: Introduce a UCC–9/PPSA type system

The Commission recommends Option 2.

Sectors and groups affected

- Anyone who seeks to transfer a right to payment or grant security over moveable property.
- Anyone seeking to purchase assets using acquisition finance, for example motor vehicles.
- Individuals and businesses seeking to raise finance in Scotland using their moveable assets. This includes transferring claims as well as granting security over moveable property. Notable sectors include whisky, oil and gas, renewables, motor vehicles, construction, engineering, manufacturing, financial-technology and the creative industries.
- Legal practitioners who would require training as regards any new registration system.
- Banks, invoice discounting houses, asset financiers, peer to peer lenders would also be affected.
- Anyone administering an insolvent estate.

Benefits

Option 1

No benefits.

The law in relation to moveable transactions would remain outdated, uncertain and inadequate. As a result businesses and consumers in Scotland would continue to be restricted in using their moveable assets and debts to raise finance in contrast to those in many other countries.

Option 2

A new modern statutory regime for moveable transactions would provide legal certainty, increased simplicity and greater access to finance for individuals and businesses in Scotland.

It would benefit from the experience of other jurisdictions which have introduced a UCC–9/PPSA type system (see Option 3). In particular it would, where appropriate, include measures successfully implemented in several such systems.

Aspects of the existing law as regards intimation for assignments, and constructive delivery for pledge would be clarified and modernised.

Various new mechanisms would be introduced to supplement the existing law. Claims could be transferred by registration in a new online register. A new fixed security could be granted over corporeal and some types of incorporeal moveable property making it easier to grant and take security in Scotland.

The reputation of Scottish law would improve internationally and Scotland would be further promoted as a competitive, attractive country in which to do business.

As set out above, there is broad stakeholder support for the Commission’s reform proposals.

In response to the draft Bill consultation, the Law Society of Scotland commented:

“We are aware that there is strong support for these changes across the [legal] profession and would encourage the Scottish Government to bring forward legislation in this area in line with the Commission’s recommendations...”

...[w]e consider that the Bill as a whole presents a modern, balanced and practical set of reforms that should provide benefits to Scottish businesses – including, and perhaps especially, SMEs – while protecting consumers.”

The Scottish law firm Shepherd and Wedderburn said:

“[w]e consider that the regimes set out in the draft Bill provide modern, pragmatic mechanisms for assigning claims and taking fixed security over relevant moveables and that registration mechanisms appear reasonably straightforward for this purpose. We therefore very much support the draft Bill and would see it as very much addressing the issues [with the current law].”

A company member of the Finance and Leasing Association commented:

“I am sure all funders will agree – anything which makes the security position in Scotland more accessible and transparent will be welcomed. The [Commission’s proposals] certainly sound like they would achieve this.”

Crucially, option two, whilst modernising the current law in many ways, has sought to add, rather than take away. Thus intimation, whilst an alternative would be introduced, could still

be used to complete an assignation. Sale and lease-back or hire-purchase, whilst an alternative would be introduced, could still provide parties with a means of structuring secured motor-vehicle finance transactions. It has sought to give those engaging with Scottish law in effect many of the same options in practice that are currently available in England and Wales, with the benefit of placing these options on a clear statutory footing.

Option 3

Scotland could adopt a functional approach to moveable transactions law along the lines of the UCC–9 and the PPSA security regimes.

The Uniform Commercial Code ('UCC') of the USA is divided into parts called articles, and article 9 (UCC–9) deals with security interests in moveable property. The UCC is a model law, which has been enacted in virtually identical form by all fifty states. It is revised from time to time, and in practice the states adopt the revisions promptly.

Statutes in other jurisdictions based on the UCC–9 are often called Personal Property Security Acts ('PPSAs'). In this context the word "personal" is used to mean "moveable". The PPSAs differ to some extent from the UCC and also to some extent vary among themselves, but the similarities outweigh the differences.

Hence the expression "UCC–9 and the PPSAs" does not signify some unique and unchanging system, but rather a broad approach.

The main benefit of introducing a UCC–9/PPSA system would be the clear alignment with a system successfully adopted in a wide range of comparative jurisdictions.

It would for example be easy for inward investors from those jurisdictions to understand the nature and scope of their relevant duties and obligations.

Lessons learned in those jurisdictions, and consequent improvements, could readily be adopted in Scotland.

Costs

Option 1

No immediately foreseeable cost implications, but the law in relation to moveable transactions would remain outdated, inadequate and uncertain. As a result businesses and individuals in Scotland would continue to be restricted in using their moveable assets and debts to raise finance.

This may result in less business growth, and poorer economic performance.

Option 2

The costs of introducing the Commission's Bill would be limited. This is because the Bill is not intended to rewrite fundamentally the existing law in this area. It aims to provide clarity and add more options as regards security rights and assignments of claims, thereby improving the position when contrasted with other jurisdictions such as England and Wales.

There would be initial set-up costs for the new registers, but it is anticipated that registration and search fees would cover initial expenditure.

Registers set-up costs

RoS has estimated costs of between £500,000 and £1,000,000¹²⁸ to set up the two new registers. This is on the assumption that these would not operate until RoS's current programme of digital transformation has been completed. RoS consider that the actual set-up costs would be recovered from registration fees, and would typically expect to recover such costs within three years.

This figure is based on the registers being online and electronic, both in terms of the information submitted in relation to a particular registration and payment of registration fees. The Keeper would not expect to have to validate submitted information. The registers would therefore be similar to electronic systems used in other countries, including New Zealand, Australia, the USA and Canada although in contrast to these jurisdictions a copy of the assignment or security document would be registered in line with the current position at Companies House which many of the Commission's stakeholders supported.

Registration and search fees

The fees for searching and registering would be fixed by the Scottish Ministers after consultation with the Keeper.¹²⁹ Clearly, a large country with a high volume of registrations will need less revenue per registration than a small one with fewer registrations in order to recoup costs. Suggested figures are provided below having regard to fees in comparator systems in other jurisdictions and current UK security registration fees.

Australia. To register a security interest against moveable property under the Personal Property Securities Act 2009 for seven years or less costs \$7 (Australian dollars) (£4). To register for more than seven years but less than 25 years, the fee is \$34 (Australian dollars) (£20). For registration of an interest with no stated end time, the fee is \$119 (Australian Dollars) (£70).¹³⁰

¹²⁸ As at December 2017.

¹²⁹ See Land Registration etc. (Scotland) Act 2012 s 110.

¹³⁰ See <https://www.ppsr.gov.au/fees>.

Belgium. Registration and renewal of a security right in the National Pledge Register (from January 2018) under the Royal Decree Concerning the Use of the National Pledge Register 2017¹³¹ incurs a fee which ranges between €20 and €500 (£18 and £447) depending on the value of the secured obligation.

Jersey. Registration in the Security Interests Register under the Security Interests (Jersey) Law 2012 costs £8 per year of registration for up to 20 years. To register for 20 years or more, the fee is £150.¹³²

New Zealand. Registration of a financing statement in the Personal Property Securities Register under the Personal Property Securities Act 1999 costs \$16 (New Zealand dollars) (£8).¹³³

UK. It costs £15 to register a Scottish floating charge electronically and particulars of a mortgage or a charge created by a UK company at CH.¹³⁴ It costs £50 to register a standard security under the electronic ARTL system in the Land Register.¹³⁵

The Commission therefore thinks that it is reasonable to suggest that the registration fees required to cover set-up and operating costs for the estimated volume of applications¹³⁶ would be in the region of £10 to £60.

In its impact assessment for the RoS Fee Review 2014, RoS set a fee of £10 for electronic registration of an advance notice in the Land Register.¹³⁷ RoS stated there was potential for the Keeper to use her power under section 110 of the 2012 Act to increase or decrease it (by a maximum of £10) based on actual volumes post-designated day.

On the basis that it is unclear what the exact volume of registrations would be, Scottish Ministers may wish to give the Keeper a similar flexibility for RSP and RoA fees. It is possible that Scottish Ministers may contribute to the set-up costs, which would reduce fees as was the case with the new Crofting Register.¹³⁸

The Commission predicts that searching fees would be inexpensive (£0-£4 per search). It costs £4 to search the Jersey Security Interests Register,¹³⁹ \$3.40 to search the Australian Personal Property Securities Register¹⁴⁰ (£2), \$2.30 to search the New Zealand Personal

¹³¹ See http://www.ejustice.just.fgov.be/cgi_loi/change_lg.pl?language=fr&la=F&cn=2017091405&table_name=loi.

¹³² See https://www.jerseyfsc.org/pdf/SIR_Fees_October_2013.pdf.

¹³³ See <http://www.ppsr.govt.nz/cms/customer-support/fees>.

¹³⁴ See <https://www.gov.uk/government/organisations/companies-house/about/about-our-services>.

¹³⁵ See <https://www.ros.gov.uk/services/registration/registration-fees>.

¹³⁶ See discussion at page 42.

¹³⁷ See https://www.ros.gov.uk/_data/assets/pdf_file/0006/5685/BRIA_Fee_Review_2014.pdf at 7.

¹³⁸ See <http://archive.scottish.parliament.uk/s3/committees/finance/reports-10/fir10-CroftingReformBill.htm>.

¹³⁹ See https://www.jerseyfsc.org/pdf/SIR_Fees_October_2013.pdf.

¹⁴⁰ See <https://www.ppsr.gov.au/fees>.

Property Securities Register¹⁴¹ (£1.20), and €5 to search the Belgian National Pledge Register (£4.40).¹⁴²

RoS has stated to the Commission that a realistic estimate for searching fees is in the region of £0-£4.

Ultimately, it is difficult to predict with certainty what the registration and searching fees would be as they would depend on many variables including the annual volume of registrations, IT costs and staff costs.

Another factor to be considered is the Keeper's liability for compensation. The Commission recommends that the registers should be automated systems meaning that they would not normally require any input from the Keeper's staff. The Keeper would be liable to compensate for errors attributable to the Keeper, for example in the situation where the computerised system made an error. There would be more potential for error in the RSP as, unlike assignments, the statutory pledge would be open to more potential post-registration changes. However there would be limitations on the Keeper's liability for compensation, in particular, the person claiming compensation would have a duty to mitigate their loss.

For example, the Commission recommends that on registration the automated systems would issue a verification statement confirming the data which had been registered. This should be checked by the party registering which would enable any inaccuracy to be corrected swiftly and thus reducing any possible loss caused by such an error.

Volume of registrations

As stated, since most of the costs of operating an online register are fixed, the volume of registrations is an important factor in determining the fee that would require to be charged to permit recovery of operating costs. An estimate is provided below.

Comparison with registrations of floating charges.

Floating charges are currently registered at Companies House. In 2011 the Register of Floating Charges Technical Working Group predicted that if a new Register of Floating Charges was set up under the Bankruptcy and Diligence etc. (Scotland) Act 2007 Part 2 the annual number of registrations would be in the region of 10,000 documents.

3,000 of these documents were attributed to advance notices. Advance notices are not provided for in the Bill.

¹⁴¹ See <http://www.ppsr.govt.nz/cms/customer-support/fees>.

¹⁴² See http://www.ejustice.just.fgov.be/cgi_loi/change_lg.pl?language=fr&la=F&cn=2017091405&table_name=loi.

The floating charge is used regularly in commercial transactions because it can be used over a pool of (rather than specific) assets. But, the Commission also notes that the floating charge cannot be granted by non-corporate entities such as sole traders and partnerships. The statutory pledge would be available to these.

In terms of the RoA, the Commission predicts that given the incentive to register (as discussed above: certainty, convenience and efficiency) registration would be more widely-used than intimation. The Commission also predicts that in the register's early years there would be a larger number of assignation registrations (a single registration which covers current and future transactions).

Taking the above estimations into consideration, the Commission predicts that the likely annual number of registrations across both registers would be in the region of 5,000 to 15,000.

Register familiarisation costs

In relation to solicitor training costs, the Commission expects that solicitors would receive training on the new registers as part of their Continuing Professional Development (CPD). This would mean that there was no additional cost burden placed on solicitors for training on the RoA and RSP. It was estimated by the Law Society of Scotland in the final Business and Regulatory Impact Assessment for the Land Registration etc. (Scotland) Bill that on average a solicitor would commit four hours of annual CPD time to the new legislation.¹⁴³

The Commission does not anticipate that the Moveable Transactions (Scotland) Bill would require as much as four hours of annual solicitor CPD time as the recommended reforms are less extensive than those in the Land Registration legislation. RoS has advised the Commission that the Keeper would make guidance on the new registers available in a form which she considered to be most appropriate.

RoS staff would also have to familiarise themselves with the new registers, but the Commission anticipates that this would not be very costly or time consuming. There would also be initial training costs for others, including accountancy firms, finance companies and advice agencies such as the Citizens Advice Bureau. There may also be costs related to promoting public awareness of changes to the law.

Option 3

The cost of introducing a UCC-9/PPSA type system, whilst difficult to quantify, would be considerable.

¹⁴³ See

[http://www.parliament.scot/S4_Bills/Land%20Registration%20etc.%20\(Scotland\)%20Bill/BBV_174-LandRegistration-Final-rev.pdf](http://www.parliament.scot/S4_Bills/Land%20Registration%20etc.%20(Scotland)%20Bill/BBV_174-LandRegistration-Final-rev.pdf) at 157.

This would be far more radical and comprehensive reform. A substantial amount of governmental and parliamentary time would be spent on the necessary legislation.

It would necessitate the registration of a notice in respect of any transaction which functions as a security over moveable property in order for that transaction to be effective against third parties and in insolvency.

For example, any retention of title clause in a sale contract would be unenforceable against parties other than the buyer unless an appropriate notice was filed. All hire-purchase contracts would need to be similarly registered. So too would finance leases and transactions where trusts are used for security purposes.

It is difficult to see how such a scheme could co-exist with the existing statutory framework for floating charges in Scotland, or how it could be implemented without significant revisions to other areas of law such as intellectual property law, the law in relation to company charges registration and corporate insolvency law. Any such revisions may relate to reserved matters, and if so would be outside the legislative competence of the Scottish Parliament.

The introduction of such a scheme would also lead to greater divergence between moveable transactions laws in Scotland and in the rest of the UK. Businesses often work on a UK-wide basis and a proposal that sales, hire-purchases etc. would require to be registered in Scotland but not south of the border would be likely to attract strong opposition.

The implications of introducing a scheme radically different to that in England and Wales would also potentially increase costs for Scottish borrowers and the users of invoice finance facilities. Financiers would require legal advice regarding an unfamiliar system and may initially be put off engaging in the Scottish market by such divergence.

The consequent desire for the respective moveable transactions laws not to diverge has been demonstrated by the experience in relation to Part 2 of the Bankruptcy and Diligence etc. (Scotland) Act 2007. This legislation would have placed Scottish floating charges on a separate registration footing from those granted elsewhere in the UK, but has never been brought into force following representations from the banking sector.

In the early 2000s the Law Commission for England and Wales proposed that the English law on secured transactions should be reformed along the lines of UCC-9 and the PPSAs.¹⁴⁴ This was rejected by key stakeholders.¹⁴⁵ Although there is a consensus today

¹⁴⁴ See Law Commission, Registration of Security Interests: Company Charges and Property other than Land (Law Com CP No 164, 2002).

¹⁴⁵ See G McCormack, "Pressured by the Paradigm: the Law Commission and Company Security Interests" in J de Lacy (ed), *The Reform of UK Personal Property Security Law: Comparative Perspectives* (2010) 83 at 84.

that reform of English law is required, there remains strong opposition to introducing a functional scheme.¹⁴⁶

A further difficulty is that the UCC–9/PPSA approach has primarily been implemented in common law systems. Its “attachment/perfection” distinction, in terms of which a transaction can be effective between the parties to it by “attachment” but only becomes effective against third parties by “perfection” (typically by registration), is coherent in systems influenced by equity. But in many jurisdictions where property law is strongly influenced by Roman law the idea of relative effectiveness or rights which “limp” is a problematic one. Scotland is such a jurisdiction.

Consultees to the Commission’s Discussion Paper overwhelmingly rejected Option 3.

Scottish Firms Impact Test

In setting out to understand the impact of the proposed changes to the law, it is important to note that the Bill does not take anything away from firms that they can currently do at present. The Bill provides firms with new mechanisms that they can adopt to raise finance. As such, any impact would largely be indirect, unless a firm opts to take advantage of the new regime. Law and accountancy firms would have to provide training to their employees as regards changes to the law.

As set out above, the Commission has consulted closely with business representative bodies. These consultation exercises resulted in positive responses to reform proposals from business. It is anticipated that Scottish firms would benefit from increased access to finance and reduced legal expense owing to clarity in the law. Those engaged in acquisition finance transactions would also have an alternative to current arrangements, which would allow the purchaser to have title to the property throughout the repayment period.

The Commission has also worked extensively with an expert Advisory Group. Discussion with the Advisory Group has helped refine policy. The Group includes lawyers from the following law firms:

- Addleshaw Goddard LLP
- Brodies LLP
- BTO Solicitors LLP
- CMS Cameron McKenna Nabarro Olswang LLP
- Dentons UKMEA LLP

¹⁴⁶ See eg R Calnan, “What does a Good Law of Security Look Like?” in F Dahan (ed), *Research Handbook on Secured Finance in Commercial Transactions* (2015) 453.

- Morton Fraser LLP
- Pinsent Masons LLP
- Shepherd and Wedderburn LLP

These firms regularly advise businesses on moveable transactions law and concur with the need for reform.

The Commission also engaged with:

- Burness Paull LLP
- The Federation of Small Businesses
- ICAS
- The Law Society of Scotland
- R3 (the Association of Business Recovery Professionals).

Competition Assessment

It is not anticipated that the Bill would have an impact on competition within Scotland. The proposals within the Bill do not create a competitive advantage for any particular sector or individual; they simply offer benefits which can be reaped by businesses and individuals alike.

The proposals would not directly or indirectly limit the number or range of suppliers. The Commission thinks that the proposals would encourage asset and invoice financiers to operate in Scotland and would encourage lending institutions to provide secured lending in Scotland.

The proposals would not limit the ability of suppliers to compete; they would not limit suppliers' incentives to compete vigorously nor would they limit the choices and information available to consumers.

Test run of business forms

The Bill does not introduce any forms. However, the Bill empowers Scottish Ministers to do so. This would be consulted on by Government at a later stage.

Legal Aid Impact Test

The effects of the Commission's proposals are unlikely to impact on legal aid, being primarily concerned with business. One issue the Commission thought could involve legal aid is where consumers in vehicle finance might wish to use the proposed new security as an alternative option to hire-purchase.

The Commission approached the Scottish Legal Aid Board for any data on the extent to which legal aid is sought in relation to hire-purchase and similar secured lending transactions entered into by consumers and whether the new proposed security would impact on the fund.

The Legal Aid Board advised the Commission that the current legal aid expenditure in relation to hire-purchase comes under a category known as 'Advice and Assistance' where the current annual amount is in the low £100,000s. The introduction of a new security right available to consumers in limited cases was considered unlikely to have a big impact on this expenditure.

Enforcement, sanctions and monitoring

The Bill does not require public enforcement and imposes no sanctions. The Bill provides consumers and businesses with an additional security option over corporeal moveable property and limited categories of incorporeal property. Similarly, the Bill provides for an optional registration mechanism to complete assignments.

It is anticipated that RoS and the Scottish Government would monitor the uptake of registrations and searches in the RoA and RSP in order to, among other things, inform their policy on fee levels moving forward. RoS would also monitor the workability of the new registers to ensure they are working effectively and efficiently for those searching for securities and assignment entries.

Implementation and delivery plan

The proposals would be implemented by the Scottish Government introducing the Bill following further consultation as appropriate. The timescale for implementation is to be determined by the Scottish Government.

Post-implementation review

In accordance with section 3(1) of the Law Commissions Act 1965, the Scottish Law Commission has a duty to “keep under review” the laws with which it is concerned and would endeavour to stay informed of the Bill’s reception by the legal profession and wider business community.

The Commission expects that the Scottish Ministers would review the legislation within 10 years. It is hoped that, in light of the support generated from various stakeholders for the proposals in the Bill, that the operation of the reformed law would be uncontroversial.

Summary and recommendation

Dismiss Options 1 and 3

Option 1 is maintaining the *status quo*. Although this would have no additional cost, it would bring no improvements. Option 3 would be radical, costly and has little support amongst consultees.

Recommend Option 2

Option 2 is implementing the Bill. This would improve Scottish moveable transactions law by putting it on a modern statutory footing. Cumulatively, the policies in the Bill are expected to bring significant economic benefits to the people of Scotland.

Declaration and publication

I have read the Business and Regulatory Impact Assessment and I am satisfied that (a) it represents a fair and reasonable view of the expected costs, benefits and impact of the policy, and (b) that the benefits justify the costs. I am satisfied that business impact has been assessed with the support of businesses in Scotland.

Signed:

A handwritten signature in blue ink that reads "Paul B Cullen". The signature is written in a cursive style with a large initial 'P'.

Lord Pentland, Chairman, Scottish Law Commission

Date: 18 December, 2017