

# RESEARCH PAPER ON ENFORCEMENT OF STANDARD SECURITIES

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## A. INTRODUCTION

### (1) General

1.01 This paper seeks to provide an analysis of approaches taken to heritable security (i.e. security over land) in a representative sample of jurisdictions in order to assist the Scottish Law Commission in its consideration of the proper approach to enforcement as part of its broader project on reform of heritable securities in Scotland.<sup>1</sup>

1.02 Heritable security in general and enforcement in particular, have not received a great deal of attention from comparative scholars.<sup>2</sup> As a result, there is as yet no generally accepted framework for categorising and analysing approaches to enforcement and how they relate to the underlying structure of the security device. The discussion below will show that approaches and basic expectations vary widely.

1.03 The English mortgage is still based on the idea of a 3,000-year lease, something which appears absurd to continental European lawyers. Germany (and a number of other systems) devote a great deal of attention to the precise regulation of sale by public auction. Elsewhere, sale by auction tends to be optional and, even when it is used, very lightly regulated. The picture is varied and, at first glance, somewhat chaotic.

1.04 For that reason, the first part of this paper develops a series of fundamental structural and policy questions which can be used as a framework within which the particular legal systems can be considered. Thereafter, the questions are applied to Scotland and to five comparator jurisdictions: (1) England as Scotland's most significant economic partner; (2) New Zealand as a Common Law jurisdiction which has made significant strides forward in simplifying and codifying the somewhat complex and occasionally obscure Common Law rules in this area; (3) France; and (4) Germany both as representatives of the two main branches of the Civilian tradition; and (5) South Africa as a mixed system with which Scots

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<sup>1</sup> While working on it, I met with Ken Swinton (University of Abertay), Mark Higgins (Irwin Mitchell LLP and author of *The Enforcement of Heritable Securities* (2<sup>nd</sup> edn, 2016)) and Tom McEntegart and Zibya Bashir (then both of TLT LLP) who outlined the main challenges which those in practice meet when dealing with the current system. I gratefully acknowledge their help (and that of the participants in the Solicitors Group Law 2017 Conference at which I gave a paper on this topic) in building a picture of the issues which are of particular concern in practice.

<sup>2</sup> The main recent treatment is K Bartels and M-L Noll *Rechtsvergleichende Forschung zur Reform des Gesetzes über die Zwangsversteigerung und die Zwangsverwaltung: Eine Studie im Auftrag des Bundesministeriums der Justiz und für Verbraucherschutz* (2017). It is restricted to Civilian systems. There is some discussion, albeit combined with discussion of security over moveables, in C von Bar *Gemeineuropäisches Sachenrecht* Bd I (2015) 722–59. Exercise and enforcement are treated very briefly in C von Bar and U Drobnič *The Interaction of Contract Law and Tort and Property in Europe: A Comparative Study* (2004) 358. There are some brief summaries of the law in comparator jurisdictions at a number of points in chapter 2 of R Brits *Real Security Law* (2016). More substantial analysis, framed in terms of South African law, can be found in S Scott and E Dirix “Calling up a mortgage bond of immovable property” (2009) 72 THRHR 575. There has also been some comparative discussion which focussed specifically on constitutional or human rights-based protections for residential property: R Brits “Protection for homes during mortgage enforcement: Human-rights approaches in South African and English Law” (2015) 132 SALJ 566.

law has had much fruitful comparative engagement in private law in general and in property law in particular. Of course, the framework which has been developed could be applied to other systems in the future.

## **(2) Two points on expression**

1.05 Before that, however, two brief points regarding expression need to be addressed.

### *(a) Creditors and debtors, security providers and security holders*

1.06 First, it is well established in Scotland, as elsewhere, that rights in security can be granted by persons other than the debtor and can be held by persons other than the creditor.<sup>3</sup> Strictly speaking, it might be preferable to think in terms of “security providers” and “security holders”.<sup>4</sup> Such language, however, is not particularly elegant and does not achieve complete precision since “security provider” does not capture someone to whom burdened property has been transferred.

1.07 Furthermore, in the typical case, the security giver is the debtor and the security holder is the creditor and using these terms draws attention to the basic debtor-creditor relationship which gives the security its purpose and shapes much of its operation. This is also the approach taken by the Conveyancing and Feudal Reform (Scotland) Act 1970.<sup>5</sup> For these reasons, the terms “debtor” and “creditor” will be used and should be taken to include third-party security holders and the owners of burdened property who are not debtors unless the context indicates otherwise.

### *(b) Women and men, creditors and debtors*

1.08 Secondly, English lacks a gender-neutral personal pronoun other than “it”. The choice between male and female pronouns for abstract figures such as the creditor and the debtor can be somewhat distracting and perhaps invidious. However, in the present context, the absence of a gender-neutral option presents an opportunity. It is easy to get mixed up between creditors and debtors in the course of discussion where pronouns are used. To avoid this and to give a role to both the male and female pronouns, in this paper creditors are female and debtors are male (unless a case is being discussed).

## **B. BASIC STRUCTURAL QUESTIONS**

2.01 At the risk of stating the obvious, the purpose of a security device is to improve the creditor’s chance of being paid.<sup>6</sup> The fundamental question is therefore how it does this. That question can be answered in terms of formal legal concepts: the creditor has a subordinate real right, ownership or some other entitlement. The fact that all these answers

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<sup>3</sup> See *Smith v Bank of Scotland* 1997 SC (HL) 111; *UK Acorn Finance v Smith* [2014] SC BAN 25, 2014 Hous LR 50 and *3D Garages Ltd v Prolatis Co Ltd* [2016] SC EDIN 70, 2017 SLT (Sh Ct) 9.

<sup>4</sup> Some may even be tempted by the siren terms “mortgagor” and “mortgagee”.

<sup>5</sup> 1970 Act, ss 9(8) and 30(1).

<sup>6</sup> W M Gloag and J M Irvine *The Law of Rights in Security, Heritable and Moveable, including Cautionary Obligations* (1897) 2; GL Gretton “The Concept of Security” in D J Cusine (ed) *A Scots Conveyancing Miscellany: Essays in Honour of Professor J M Halliday* (1987) 126, J MacLeod “Thirty Years After: The Concept of Security Revisited” in A J M Steven et al (eds) *Nothing So Practical as a Good Theory: Festschrift for George L Gretton* (2017) 177 and L Smith “Powership and its Objects” in *ibid* 223 at 227–234.

can be given shows that security is formally protean.<sup>7</sup> It is also true that the creditor is not ultimately interested in the formal character of these rights but in how they help her to obtain satisfaction. It is therefore helpful to establish some basic functional questions which can be asked of any security device in order to support the analysis.

## (1) Functional questions

(a) *How does the security help the creditor?*

2.02 Where, as in the case of heritable security, the security is proprietary<sup>8</sup> it amounts to “some additional prerogative over the collateral”<sup>9</sup> over and above the personal right which entitles the creditor to pursue payment and do diligence (the Scottish term for judicial execution).

2.03 When reduced to the essentials, two kinds of prerogative over the collateral can help the creditor to obtain her money. She can be entitled:

- (a) to possession or (negative)<sup>10</sup> control of the asset until the debt is paid, and
- (b) to extract value from the asset.

The latter prerogative may be sub-divided into rights to:

- (b)(1) use (directly or by letting out or licensing),
  - (b)(2) acquire, or
  - (b)(3) sell
- the asset.

2.04 When it stands alone, the right to possession or control is basically a bargaining chip. It allows the creditor to deny the debtor (or his successor, unsecured creditors or insolvency official) access to a useful asset and thus to motivate payment. The help that the second class of prerogative gives is more obvious, conferring a patrimonial benefit on the creditor. Of course, the two prerogatives often work together: for example, possession will generally be needed in order to use the asset.

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<sup>7</sup> See further MacLeod “The Concept of Security Revisited” (n 6) at 178–9 and 184–7. In this respect security contrasts pleasingly with trust, which is formally stable but functionally protean: GL Gretton “Trusts without Equity” (2000) 49 ICLQ 599 at 599; M J de Waal and R R M Paisley “Trusts” in R Zimmermann et al (eds) *Mixed Legal Systems in Comparative Perspective: Property and Obligations in Scotland and South Africa* (2005) 819 at 825.

<sup>8</sup> Perhaps we can be forgiven, in the present context, for disregarding the question of whether real or proprietary rights can exist in incorporeals (and whether there is a difference between real and proprietary rights). On this, see G L Gretton “Ownership and its Objects” (2007) 71 *RebelsZ* 802 at 838–844 and MacLeod “The Concept of Security Revisited” (n 6) at 181–182.

<sup>9</sup> Smith “Powership and its Objects” (n 6) at 228.

<sup>10</sup> Negative control is the ability to prevent the debtor from dealing with the collateral: H Beale et al, *The Law of Security and Title-Based Financing* (3<sup>rd</sup> edn, 2018) para 3.49.

2.05 Thus, to understand how a security device helps the creditor obtain satisfaction, it is necessary to ask which of these prerogatives the creditor has and how they are exercised. These questions can be further developed as follows:

1. Are all four prerogatives available to the creditor and what is the relationship between them?
2. How (if at all) is the creditor required to establish that the debt is due in order to exercise the prerogatives?
3. Is some notification to the debtor (and anyone else) necessary in order to exercise the prerogatives?
4. Is sale carried out privately or done by a public official?
5. How is adequate value ensured?
6. How is the value of the property established in cases of creditor acquisition?
7. Are there constraints on the use that may be made of the property?
8. What additional protections for residential property and/or consumer debtors?

*(b) Enforcement and exercise*

2.06 It is conventional to refer to action by the creditor in reliance on heritable security as enforcement. (Thus the name of this paper.) The term, however, is a little misleading at least in cases where, for instance, the debtor co-operates in allowing the sale of the property.

2.07 “Enforcement” generally refers to the means by which some recalcitrant party is compelled to submit to a right rather than to the mere use of the right. Mere use of the right might better be termed “exercise”. Consideration of the example of a servitude elucidates the distinction. The holder of a right of way who takes access across the burdened property can be said to exercise it but can hardly be said to enforce it. She would enforce it were she to obtain a court decree requiring the owner of the burdened property to permit her to take access. This would only be relevant were the exercise of the servitude to be resisted. Put shortly, enforcement is the means by which the law ensures that a right can be exercised. Exercise is simply doing the thing that the right entitles the right-holder to do.

2.08 Using one of the prerogatives discussed above would be exercise of the right in security: using it for the purpose for which it was created. But it is not necessarily enforcement. This seems natural when we think of a possessory security like pledge or lien: the creditor who holds onto possession is exercising her right but it seems unnatural to say that she is enforcing it. We might be tempted to use the term “enforcement” in the case of sale by a standard security holder but, fundamentally, the same thing is going on: the right in security is being used, being exercised. Where the debtor resists the sale, it might be appropriate to say that the right in security is enforced. Otherwise, the only right that is enforced when the security is exercised is the right to payment which is correlative to the secured obligation.

*(c) How is the value of the security protected?*

2.09 It is clear that the usefulness of a security device depends on the value of the asset. That means that, even before the creditor is in a position to exercise the security, she has an

interest in preserving the value of the asset. This raises the question of how the law protects this interest.

2.10 When the creditor is permitted to act herself or to require action by the debtor in order to protect the value of the asset, she may be said to act on the basis of the security. Were it not for the security right in the asset, the action to preserve the asset's value would not be legitimate. It is tempting to consider this as exercising the security right. Such a temptation should be resisted, however, because the entitlement to take such action is merely ancillary to the purpose of the security right.

2.11 The distinction is perhaps illuminated by returning to the example of a servitude. The holder of a right of way can obtain interdict against actions which would obstruct proper exercise of the servitude and require removal of obstructions which prevent such exercise.<sup>11</sup> These rights clearly derive from the servitude but their assertion can hardly be said to be exercise of the right of way in the same sense as walking across the burdened property is.

2.12 The distinction between the two may be understood in terms of the obligation which is being enforced: where the security is exercised, the secured obligation is enforced by means of the security; where the value of the collateral is being protected, it is an obligation arising from the security which is enforced rather than the secured obligation. This distinction was drawn by Lord Hope in *RBS v Wilson*<sup>12</sup> but, as discussed below, it is not always clearly applied in the 1970 Act.

2.13 Conflating exercise with protection in the context of security is dangerous: a remedy (such as sale) which is perfectly reasonable in the context of exercise may well be grossly disproportionate as a response to risk to the value of the collateral.

2.14 Therefore, the question of how the value of the collateral is protected may be regarded as a question of enforcement but it is one which is distinct from the question of exercise. It is also a question which has raised much fewer questions in practice than the question of exercise in pursuit of payment. For that reason, the remainder of this paper will focus on exercise of the security rather than on remedies which protect the value of the secured asset.

## **(2) Formal questions**

2.15 The answers to the questions discussed above can give a reasonably clear account of the policy choices which a particular system has made in relation to enforcement of security over land. However, it is also important to have some sensitivity to the legal institutions<sup>13</sup> through which these policy choices are delivered. In particular, a sensitivity to such questions can help policies to be delivered in a manner which coheres properly with the rest of the legal system. Further, as the discussion below seeks to show, the form that is deployed can tilt the scales by making one policy outcome seem more natural than another.

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<sup>11</sup> D J Cusine and R R M Paisley *Servitudes and Rights of Way* (1998) paras 12.92–12.93.

<sup>12</sup> *Royal Bank of Scotland plc v Wilson* [2010] UKSC 50, 2011 SC (UKSC) 66 at paras 73–75.

<sup>13</sup> In other words, packages of legal rules which work together, such as ownership, a right in security or the trust.

(a) *What kind of right is the creditor given?*

2.16 Land has a long history of being used as collateral for lending.<sup>14</sup> Significant development took place in Roman law.<sup>15</sup> One thing that is clear from this history is that use as collateral does not necessarily mean subjecting the land to a subordinate real right which entitles the creditor to sell in the event of default.

2.17 Lee identifies three basic structures for security in Roman law:<sup>16</sup> transfer subject to an obligation to reconvey (*mancipatio cum fiducia* or *in iure cessio cum fiducia*, often referred to as *fiducia cum creditore*); transfer of possession but not ownership (*pignus* or pledge) and burdening the property without transferring either (*hypotheca*).<sup>17</sup>

2.18 Goebel, in contrast, suggests a fourfold classification, distinguishing between fiduciary transfer where the creditor has possession and fiduciary transfer where the debtor has possession.<sup>18</sup> The difference is, of course, meaningful but the conceptual motor in both cases is the transfer of ownership. Ownership is what operates to secure the creditor's interest. Furthermore, the same legal institution (*fiducia cum creditore*) was used whether the debtor or creditor had possession.<sup>19</sup> Goebel's classification also characterises the *hypotheca* as giving the creditor a possessory interest. Such a characterisation may make sense in the context of a largely Common Law audience in the rest of the United States of America, but in the present context it is somewhat distracting.

2.19 Thus, it seems preferable to maintain Lee's classification. In principle, the creditor may receive a security transfer (with or without possession), possession (often grounded in a real right to possess) or a non-possessory real right over the collateral. The structure which is used has implications for where the law needs to step in with special rules.

(i) *Security transfer*

2.20 In the case of security transfer, the starting point is that the creditor has all the rights of an owner, albeit subject to an obligation to reconvey the property on satisfaction of the secured claim. In terms of Scottish terminology, this is improper rather than proper right in

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<sup>14</sup> For an early example (and an early articulation of concern about the social consequences of lending against essential assets), see Nehemiah 5:1–13. On this passage, see C D Gross "Is there any interest in Nehemiah 5?" (1997) 11 *Scandinavian Journal of the Old Testament* 270. It is, however, striking that the passages in the Pentateuch which regulate secured lending appear not to allude to the use of land as collateral: Exodus 22:26–7; Deuteronomy 24:10–13, 17.

<sup>15</sup> For a recent account, see H L E Verhagen "The evolution of *pignus* in classical Roman law[,] *Ius honorarium* and '*ius novum*'" (2013) 81 *Tijdschrift voor Rechtsgeschiedenis* 51. For recent overviews of mediaeval and Common Law developments see D J Seipp "A Very Brief Legal and Social History of Mortgage" in D Rodima-Taylor and P Shipton (eds) *Mortgage Across Cultures: Land, Finance, and Epistemology* (2017) 19 and C Briggs and J Zuijderdijjn (eds) *Land and Credit: Mortgage in the Medieval and Early Modern European Countryside* (2018).

<sup>16</sup> R W Lee *The Elements of Roman Law* (4<sup>th</sup> edn, 1956) § 258. For a similar analysis, see W W Buckland, *A Textbook of Roman Law* (3<sup>rd</sup> edn, 1963) 473–481.

<sup>17</sup> The term *pignus* was also sometimes used for non-possessory security in Roman law and indeed for some even more adventurous constructions (see Verhagen "The evolution of *pignus*" (n 15) at 58–66) but the *pignus*–*hypotheca* division is a useful marker for possessory–non-possessory divide.

<sup>18</sup> R J Goebel "Reconstructing the Roman Law of Real Security" (1961–2) 36 *Tul L Rev* 29 at 29.

<sup>19</sup> Contrast C Briggs and J Zuijderdijjn "Introduction: Mortgages and Annuities in Historical Perspective" in Briggs and Zuijderdijjn *Land and Credit* (n 15) 1 at 4–5, who suggest (apparently on the basis of Goebel) that *in iure cessio cum fiducia* permitted the debtor to retain possession while *mancipatio cum fiducia* did not. I have not been able to detect this argument in Goebel's piece.

security.<sup>20</sup> Special rules are needed to ground the debtor's right to possess (when necessary) and his right of redemption. The debtor's recovery of ownership of the property depends on exercising the right of redemption. Such a right, of course, may be lost, typically by failure to redeem within a specified period.

2.21 In principle, there is little need for particular mechanisms which confer rights on the creditor: the creditor's prerogatives to extract value and to preserve the value of the property can be explained by her status as owner. The key question is when and how the debtor's right to recover ownership of the property and (if relevant) right to possession of the property are lost.

2.22 This security transfer model is the basic idea underlying the traditional Common Law mortgage<sup>21</sup> and the later form of the wadset<sup>22</sup> and the *ex facie* absolute disposition in security in Scots law.<sup>23</sup> In both cases, the fundamental remedy was foreclosure in the strict sense of the term: the debtor's ability to recover the property was cut off by failure to repay and the creditor was left with ownership untrammelled by the right to redemption.<sup>24</sup> Both mortgage and wadset, but not the *ex facie* absolute disposition, are distinguishable from a classical *fiducia cum creditore* in that the right to redeem was proprietary rather than merely personal.<sup>25</sup> As will be seen in the discussion below, this is part of a general trend evident in heritable security,<sup>26</sup> to assimilate to security transfers with what might be called the hypothecary model, where the creditor has a subordinate right in the asset.

2.23 In Scots law, the security transfer approach has been excluded from voluntary heritable security by subsections 9(3)–(4) of the Conveyancing and Feudal Reform (Scotland) Act 1970, which prevents grants of real rights in land for the purpose of security

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<sup>20</sup> A proper security is a distinct type of subordinate right whose purpose is to secure a claim. This term appears to be distinctively Scottish, at least in the anglophone world: Smith "Powership and its Objects" (n 6) at 227.

<sup>21</sup> Working Paper on *Land Mortgages* (Law Com WP 99, 1986) paras 2.1–2.2; C Harpum (et al) *Megarry & Wade: The Law of Real Property* (8<sup>th</sup> edn, 2012) para 24-001. The position is, of course, complicated somewhat by the absence of a clear concept of ownership in (early) English law. Strictly, a proprietary title was granted which was subject to a resolutive condition of payment, the right to exercise such payment being protected by the equity of redemption, on which see D P Waddilove "Why the Equity of Redemption" in Briggs and Zuijderdijn *Land and Credit* (n 15) 117 (with further references).

<sup>22</sup> See Erskine *Inst* 2.8.4; W Ross *Lectures on the History and Practice of the Law of Scotland: Relative to Diligence and Conveyancing* (2<sup>nd</sup> edn, 1822) Vol II, 330–91; D Hume *Baron David Hume's Lectures 1786–22* (ed G C H Paton) Vol IV (St Soc 17, 1955) ch VII; G Watson *Bell's Dictionary and Digest of the Law of Scotland* (7<sup>th</sup> edn, 1890 repr 2012) "wadset"; A J M Steven *Pledge and Lien* (2008) paras 2-12–2-13 and 3-62–3-65 and "Accessoriness and security over land" (2009) 13 *EdinLR* 387 at 395–6.

<sup>23</sup> Bell *Comm* I, 714; Steven "Accessoriness and security over land" (n 22) at 398.

<sup>24</sup> This structure might be considered to bear close functional similarities to systems where sale of land was subject to a right of redemption and was assumed to have arisen from financial hardship: Leviticus 25:25–34; R Abrahams "Retrait Lignager – Some Thoughts on an Old European Family Institution" (2011) 29 *Cambridge Journal of Anthropology* 16 (giving a wide survey of similar institutions from sociological perspective)

<sup>25</sup> Reversion Act 1469; Erskine *Inst* 2.8.10–2; *Pawlett v The Attorney General* (1678) *Hadres* 465, 145 *ER* 550.

<sup>26</sup> The position with moveable property is more complex. On the one hand, there is the growth of functional systems based on Article 9 of the US Uniform Commercial Code which might be regarded as part of the same trend but on the other there are the rules of the Financial Collateral Directive which seek to preserve rights of appropriation in the event of default: Council Directive 2002/47 (OJ 2002 L168/43) Art 4, as amended by Council Directive 2009/44 (OJ 2009 L146/37) Art 2(7).

other than in the form of the standard security.<sup>27</sup> It does live on, however, in adjudication, which started life as a judicial wadset.<sup>28</sup> Seen in this context, the idea of the “legal”, the ten-year period during which the debtor could recover the property, makes sense. Adjudication viewed as judicial wadset also explains why the second court order, which marks the end of the redemption period, is termed a declarator: a remedy which recognises rather than constitutes a state of legal affairs.

2.24 The requirement of declarator of expiry of the legal also draws attention to the fact that, while it is perfectly plausible to have a security transfer without the requirement for a formal procedure for exercise, it is equally possible to impose one. The imposition of such a procedure may be regarded as a further example of the tendency for security transfer to be brought into line with the characteristics which would be expected of a subordinate right in security.

2.25 Over time the understanding of adjudication slipped from transfer of ownership subject to a right of redemption, to the idea that adjudication gave the creditor a right in security, which was converted to ownership by declarator of expiry of the legal.<sup>29</sup>

2.26 The decision in *Hull v Campell*<sup>30</sup> is another example of the tendency to assimilate institutions which start out as security transfer with the hypothecary model. In *Hull*, an adjudging creditor sought declarator of expiry of the legal. Significant judicial ingenuity was deployed in order to impose an obligation on the creditor to pay compensation to the debtor to cover the gap between the value of the property and the debt which was due. Without such an obligation, the enforcement would have been inconsistent with article 1 of the First Protocol to the European Convention on Human Rights. Of course, such assimilation is aided by the procedural step of requiring declarator of expiry of the legal.

2.27 *Hull* matters in the present context because it suggests that simple forfeiture of the collateral to the creditor (without the need to account for the surplus) is likely not to be an acceptable mechanism for exercise in the context of heritable property. That conclusion removes one of the more obvious advantages of the security transfer method for the creditor: simplicity and directness of exercise. Once an accounting needs to be made for the surplus, some means of establishing the value needs to be found and applied.

2.28 Of course, it might be argued that the position in *Hull* is significantly different from cases where the creditor’s right was granted voluntarily by the debtor. In the latter case, he may be said to have walked into the situation with his eyes open. That argument has some merit but a significant aspect of the concern in *Hull* was focussed on the simple disproportion between the debt due and what the creditor would end up with.<sup>31</sup> Security, be it voluntary or judicial, is not a speculative arrangement. It is designed to give the creditor protection rather than the hope of a windfall.<sup>32</sup>

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<sup>27</sup> Sale in security of goods is also excluded from the scope of the Sale of Goods Act 1979 by section 64(2).

<sup>28</sup> J MacLeod *Fraud and Voidable Transfer: Scots Law in European Context* (PhD Thesis, University of Edinburgh, 2013) 137–138.

<sup>29</sup> GL Gretton “Diligence” in *The Laws of Scotland: Stair Memorial Encyclopaedia* Vol 8 (1991) para 189.

<sup>30</sup> [2011] CSOH 24, 2011 SLT 881.

<sup>31</sup> [2011] CSOH 24 at paras 25 and 26 per Lord Turnbull.

<sup>32</sup> One might further consider the position of financial collateral, where a much more relaxed attitude is taken to forfeiture. It is perhaps worth bearing in mind, however, that dealings with financial collateral may be considered to be inherently speculative, whereas this is not the case with land. Even there,



2.29 As noted above, the basic approach in a security transfer does not dictate that either the creditor or debtor should have possession of the property. Where the creditor is in possession, no steps are needed once the debtor's rights have fallen away. In principle, no steps should be needed in the case of debtors in possession either, since owners generally have a right to eject those who are in possession of their property without a right to do so. That procedure will, however, generally be judicial and, like declarator of expiry of the legal, it provides the opportunity to restrict and control the creditor's access to the collateral.

2.30 With regard to preservation of the value of the collateral, owners can be expected to have the relevant rights.<sup>33</sup> In the case of creditor possession, there is really no issue (although there is the converse question of the protection of the debtor's interest in the value of the property). Where the debtor is in possession, some special rules may be necessary as is the case with lease and liferent.

2.31 In principle, a security transfer model requires little in the way of enforcement. However, it is necessary to be aware of rules which assimilate the functional operation of security transfer with the hypothecary model and the likelihood that simple forfeiture is no longer acceptable as a mode of enforcement. The extent to which specific rules are needed for the preservation of the collateral's value depends largely on who is in possession.

(ii) *Pledge or pignus of the land*

2.32 Where the creditor has possession, neither preservation of the asset's value nor access to it are live issues for the creditor. These interests are adequately secured by her control of the property.

2.33 However, possession of the asset does not necessarily imply the right to extract value from it and certainly does not imply the right to sell it or appropriate it. Special rules were therefore required to secure the creditor's interest in this respect.<sup>34</sup> Pledge in early systems does seem to have been attended by forfeiture in the case of non-payment.<sup>35</sup> The trend of legal development was away from forfeiture towards remedies which restricted the creditor to what was required to satisfy her interest as creditor.<sup>36</sup> This reflects the tendency discussed above.

2.34 Further, unlike the retention of possession, the creditor's prerogatives to extract value do not arise from the moment when the pledge is granted. A trigger (and often a procedure) is necessary before they can be exercised. In many cases, this will be a default under the principal obligation. This has a tendency to render enforcement of a pledge a little more

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however, there is a duty on the collateral taker to account for the surplus value on appropriation under a security financial collateral arrangement: Financial Collateral Arrangements (No 2) Regulations 2003, reg 18. There is no equivalent provision for title transfer collateral arrangements.

<sup>33</sup> The law of liferent might be considered a partial exception, since the fiar's remedies are restricted over the course of the liferent. See P Hellwege "Enforcing the Liferenter's Obligation to Repair" (2014) 18 EdinLR 1.

<sup>34</sup> See generally, Steven *Pledge and Lien* (n 22) para 7-03-7-10, 8-04-8-10 and 8-14-8-18. Verhagen "The evolution of *pignus*" (n 15) at 69-72. During the period when wadset was a proper pledge, it included the right to value produced by the property: see "wadset" in *Bell's Dictionary* (n 22) with further references.

<sup>35</sup> Steven *Pledge and Lien* (n 22) paras 2-03 and Verhagen "The evolution of *pignus*" (n 15) at 69.

<sup>36</sup> Steven *Pledge and Lien* (n 22) paras 8-14-8-17 and Verhagen "The evolution of *pignus*" (n 15) at 70-2.

complex from the creditor's point of view but it also provides opportunities to insert conditions for debtor protection.

2.35 Pledge of land is not possible in Scotland in light of section 9(3) of the 1970 Act (though there is nothing in principle to prevent the parties from agreeing that the creditor under a standard security should have possession) and there is no evidence of it as a significant security device in the comparator systems considered below.

*(iii) Hypothecation*

2.36 The dominant modern approach, and the one which other institutions have tended to assimilate with, is the grant of a non-possessory subordinate real right in the collateral. This approach is the most demanding in terms of enforcement rules. Unlike cases where the creditor has ownership, possession or both, there is no general regime such as possession or ownership from which the creditor's prerogatives may flow. Rather, they require to be established as part of the design of the security interest.

2.37 Their design can therefore be expected to be shaped more directly by the security purpose of the institution. Like pledge, a trigger rule (and associated procedure) will be required for the exercise of the prerogatives which allow the extraction of value. In contrast to pledge, however, the creditor is not in possession so there is greater need for rules which allow the creditor to intervene to protect the value of the collateral and to take possession (or at least eject the debtor) in order to exercise the extractive prerogatives.

*(iv) Dominance of non-possessory models*

2.38 All three devices were, at one period or another of Roman law, applicable to land. In the later western tradition, the first and third types have tended to dominate as is evidenced by the systems considered in this paper. Their common feature is that they allow the debtor to retain possession.

2.39 We might speculate about the reasons for the dominance of debtor-possession in relation to land: its importance as a productive asset or place of habitation; the fact that those with the capital to lend money are not necessarily in a position to make productive use of land; the fact that non-possessory securities tend to make it easier to grant further lower ranking securities; the relative ease (in comparison to moveables) of finding the land should enforcement be necessary and, in later periods, the greater availability of non-possessory methods for publicising transactions affecting land. Whatever the reasons, the relative insignificance of possessory security over land leaves two basic categories for consideration: transfer of ownership and creation of a distinct right in security.

*(b) The relationship of debt and security*

2.40 The fact that heritable security exists for the purpose of improving the creditor's hope of satisfaction of a debt raises the question of how the debt and the security device relate to one another. This is the question of accessoriness: that is the extent to which the security depends on and serves the debt which is secured.<sup>37</sup> A strongly non-accessory (or abstract) security may allow enforcement without any reference to any underlying debt and can thus

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<sup>37</sup> See generally, Steven "Accessoriness and security over land" (n 22) and Bartels and Noll *Rechtsvergleichende Forschung zur Reform des Gesetzes über die Zwangsversteigerung und die Zwangsverwaltung* (n 2) 13–20.

be transferred independently of it and used to secure further debts once the first one had been paid off.

2.41 The question of accessoriness is broader than exercise: it bears on transfer, discharge and ranking of heritable securities.<sup>38</sup> However, it does have consequences for exercise. In particular, a strongly non-accessory security need not restrict the value that the creditor extracts to the amount due under the debt which is secured nor require that the indebtedness be established for exercise. The converse can be expected of an accessory security.

2.42 The question of accessoriness relates to the nature of the creditor's right. Security transfer can be said to be naturally non-accessory. The creditor has ownership which can subsist without any debt (or other rights for that matter). Thus, if accessoriness is to be achieved, fairly extensive special rules will be needed to constrain the creditor's rights.

2.43 Specific security rights can (in principle) be either accessory or not, although it might be suggested that a right which is so non-accessory as to be enforceable even in the absence of an enforceable debt cannot really be called a right in security.<sup>39</sup> Where, however, a right is non-accessory in the sense of being capable of securing multiple debts in sequence but where indebtedness is required for enforcement, some procedural step will be needed in order to establish which debt is being satisfied through exercise of the security.

2.44 As Steven has established, accessoriness is a matter of degree but it remains a major structural question in discussions of rights in security within the Civilian tradition (in particular, within the Germanic tradition).

*(c) The form of exercise*

2.45 The final general structural question which requires consideration is the means by which the creditor's right is asserted. As discussed above, as a matter of general principle, where the creditor has received a security transfer, little is needed in the way of direct provision for exercise. However, as noted above, a procedural step may be introduced to establish that the debtor's right of redemption has fallen away.

2.46 More extensive rules are needed where the creditor's right is limited, particularly where the debtor remains in possession. In terms of the broad approaches there are two main distinctions to be drawn.

*(i) Bespoke exercise or exercise through another process?*

2.47 A right in security may have its own process for exercise, typically based on the right to take possession and to sell the asset. That is the procedure with which we are familiar in Scotland. However, in many systems, the creditor's right is not asserted in this way. Rather, it is asserted either through the system's equivalent of diligence or recognised in the context of insolvency processes.<sup>40</sup>

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<sup>38</sup> Discussed at length in Steven "Accessoriness and security over land" (n 22).

<sup>39</sup> See MacLeod "The Concept of Security Revisited" (n 6) at 189.

<sup>40</sup> The landlord's hypothec might be considered a domestic example of this approach since the abolition of sequestration for rent: Bankruptcy and Diligence etc. (Scotland) Act 2007, s 208.

2.48 These are fairly broad categories which permit a significant degree of internal variation. It is, however, the case that where a right is enforced through a process which is also available to creditors to whom no security right has been granted a greater level of procedural protection is likely to be built into the system. Such systems, after all, need to establish that there is a right to enforce in the first place.

*(ii) Private or public sale?*

2.49 The second major categorical question relating to the manner of enforcement concerns the manner in which any right of sale is asserted: by private sale or public auction. Within the second category, there is the subsidiary issue of who organises the auction: the creditor or a public official.

2.50 This choice has significant implications for the kind of protections that are necessary to ensure best value is obtained for the asset. It can also affect the circumstances in which the creditor can acquire the asset. As a matter of general principle, if an auction administered by a public official is used, there is nothing to stop the creditor bidding in the auction. In contrast a separate process will be necessary where the creditor proceeds by means of private sale since she cannot sell to herself.

2.51 Having considered the basic framework of characteristics for which systems may be examined, some attention should be given to the current position in Scotland, with a view to identifying areas where particular concern has been expressed and to develop a clear sense of where Scottish experience accords with that in the systems which are being considered.

## C. BASIC STRUCTURE

### (1) Scotland

*(a) The 1970 Act and the need for an enforcement regime*

3.01 The law of heritable securities was last subject to comprehensive reform in the Conveyancing and Feudal Reform (Scotland) Act 1970. That legislation represented a major step forward, replacing a security transfer, the *ex facie* absolute disposition in security, with a proper right in security.<sup>41</sup>

3.02 Under the *ex facie* absolute disposition, ownership was held by the creditor until the debt was paid. In contrast to the position with the earlier security transfer known to Scots law (the wadset) the creditor's right was merely personal.<sup>42</sup> The 1970 Act rebalanced the position between the creditor and debtor: giving the creditor a proper right in security (i.e. a subordinate real right) and leaving ownership with the debtor. This reflected the interests of the debtor more accurately and protected debtors, avoiding giving the creditors more than was necessary.

3.03 This shift also created the need for a system of exercise which, for the reasons discussed above, had been a less significant concern with the *ex facie* absolute disposition. This aspect of the 1970 Act has proved to be one of the most challenging.

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<sup>41</sup> It also replaced the heritable bond but it was much less widely used by the time that the 1970 Act was passed.

<sup>42</sup> Bell *Comm* I, 714; Steven "Accessoriness and Security over Land" (n 22).

*(b) Legislative design: statutory provisions and standard conditions*

3.04 Before exploring the 1970 Act's approach to these basic aspects of exercise, it is necessary to note one peculiarity of the design of the standard security. As might be expected, some of the rights and obligations of the secured creditor are mandatory, while others are subject to variation by the parties. The 1970 Act acknowledges this by dividing the rules between the main body of the legislation and the so-called "standard conditions" which are set out in Schedule 3 to the 1970 Act, and most of which are subject to variation.<sup>43</sup>

3.05 This might lead to the assumption that the mandatory rules are in the body of the legislation and that default ones are in standard conditions. The position is, however, not quite that simple. Some of the most important standard conditions (such as those concerning the creditor's power of sale) are mandatory.<sup>44</sup> Furthermore, some of these rules are logically prior to and arguably more important than those in the body of the Act. Thus, section 25 contains rules about how the power of sale may be exercised but it is standard condition 10 that confers this power.

3.06 Further, the rules for ejection in cases where the creditor requires possession of the property (or requires to give vacant possession to the property) are not found in the 1970 Act but in section 5 of the Heritable Securities (Scotland) Act 1894.<sup>45</sup>

## **(2) Comparator systems**

### *(a) England and New Zealand*

#### *(i) Nature of the creditor's right*

3.07 The basic security device for land in Common Law systems is the mortgage. As noted above, this started life as grant of title to possess in fee simple subject to a resolutive condition. This is as close as a system which is reluctant to acknowledge ownership can get to security transfer and was reflected in the exercise regime at common law: the possessory title formed the basis of the creditor's prerogatives to extract value. This explains the use of the term "repossession" (despite the fact that the creditor will typically never have had natural possession of the property). Again, on this model, final exercise naturally takes the form of cutting off the debtor's equity of redemption (foreclosure), leaving the creditor's possessory title unencumbered.

3.08 Mortgage developed through case law but, in both England and New Zealand, there has been significant legislative reform. This reform, however, did not take the form of building a fresh institution as was the case with the standard security in Scotland. Rather, particular aspects and rules have been tweaked, particularly in the course of general legislation on the law of property in the twentieth century.

3.09 In particular, this legislative intervention rebalanced the interests between the creditor and debtor, moving the mortgage away from the security transfer model.<sup>46</sup> In England,

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<sup>43</sup> 1970 Act, s 11(2) and (3).

<sup>44</sup> 1970 Act, s 11(3).

<sup>45</sup> It is not clear why ejection was left to be regulated by the 1894 Act rather than provision on this being made in the 1970 Act.

<sup>46</sup> 1925 Act, ss 85–86.

under section 85 of the Law of Property Act, “[a]ny purported conveyance of an estate in fee simple by way of mortgage” is read down to a “demise of land to a term of years absolute” for 3000 years (plus one day for second-ranking mortgages, two days for third-ranking and so forth).<sup>47</sup> Section 86 makes similar provision where the collateral is a time-limited interest. Under it, “[a]ny purported assignment of a term of years absolute”<sup>48</sup> is read down as a subdemise which is shorter than the collateral.

3.10 The 1925 Act also makes it possible to create a legal mortgage “by a charge by deed expressed to be by way of legal mortgage.”<sup>49</sup> This appears to raise the possibility of a hypothecary security right but section 87 defines the “protection, powers and remedies” in terms of the demise or subdemise mentioned above. The fundamental nature of a legal mortgage, in English law, therefore, is a time-limited possessory interest. It is worth bearing in mind that this statutory intervention is restricted to legal mortgages. An equitable mortgage remains possible and governed by the old rules.<sup>50</sup> The absence of equitable interests in Scots law and the dominance of the legal mortgage as a security device in English law means that attention should focus on the legal mortgage.

3.11 Thus, its inherent complexity<sup>51</sup> and the initial and the underlying role of the possessory title makes adoption of the English model difficult in the Scottish context.

3.12 The basic structural position in New Zealand is also somewhat confusing. The New Zealand Property Acts of 1905 and 1952 appear to preserve the security transfer model, providing that a mortgage made in the statutory form “shall be deemed to be a conveyance of land by way of mortgage, and may be registered accordingly.”<sup>52</sup> However, these provisions require to be read alongside the provisions of the Land Transfer Acts. As far back as 1870, these provided that a “[m]ortgage and encumbrance under this Act shall have effect as security but shall not operate as a transfer of the land thereby charged.”<sup>53</sup> Pleasingly, the Property Law Act 2007 moves some way towards resolving the difficulty, providing in section 79 that:

- (1) A mortgage over land, whatever its form,—
  - (a) takes effect as a charge; and
  - (b) does not operate as a transfer of the estate or interest charged.
- (2) Subsection (1) does not apply if the mortgage is created by a registered transfer instrument.

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<sup>47</sup> 1925 Act, s 85(2).

<sup>48</sup> 1925 Act, s 86(2).

<sup>49</sup> 1925 Act, ss 85(1) and 86(1).

<sup>50</sup> Harpum et al, *Megarry & Wade* (n 21), para 24-040. The fact that equitable mortgages are created without registration makes it difficult to know how commonly these are used. However, their equitable nature makes them less secure than legal mortgages. The Council of Mortgage Lenders (now part of UK Finance) requires a legal mortgage: see Council of Mortgage Lenders, *UK Finance Mortgage Lenders' Handbook* (2017) Part 1, para 5.12.

<sup>51</sup> “[N]o one, I am sure, by the light of nature ever understood an English mortgage of real estate.” *Samuel v Jarrah Timber and Wood Paving Corporation Ltd* [1904] AC 323 at 326 per Lord MacNaghten.

<sup>52</sup> 1905 Act, s 62(2); 1952 Act, s 76.

<sup>53</sup> 1915 Act, s 59. See similar provision in the later Land Transfer Acts: 1915 Act, s 102; 1952 Act, s 100 and 2017 Act, s 99.

3.13 This does leave the issue of resolving the tension in relation to a mortgage which falls under subsection (2) with section 99 of the Land Transfer Act 2017, which provides that: “A mortgage under this Act takes effect only as security and not as a transfer of the estate or interest charged.”

3.14 The resolution comes from the words “under this Act” in section 99 of the Land Transfer Act. Section 5 of the Land Transfer Act defines mortgage as “a charge over an estate or interest in land created by a mortgagor under this Act a purpose of which is to secure the performance of an obligation to pay money.” Therefore, a transfer by “registered transfer instrument” would not be a mortgage in terms of section 99 because it does not involve the creation of a charge. Thus, the transaction referred to by section 79(2) of the Property Law Act 2007 would not fall within the scope of section 99 of the Land Transfer Act 2017. This means two things: first, there is no conflict between the provisions and secondly, that security transfer therefore remains possible, albeit in a narrow case: where the parties choose to transfer in security and there is nothing in the documentation to disclose this intention.<sup>54</sup>

3.15 This is understandable from a land registration point of view. Any recharacterisation rule creates inaccuracies on the register and this is particularly problematic in a Torrens system such as New Zealand, which uses a system of title by registration.<sup>55</sup> In contrast to England, however, the idea of mortgage being a charge which can be understood as a distinct (and hypothecary) right, is more firmly established.

*(ii) Source and location of the rules on remedies*

3.16 As discussed above, the creditor’s rights to extract value can be regarded as inherent in the possessory title. The structure, together with the tendency of the Common Law to allow equitable proprietary interests to arise from private agreement meant that the design of the security interest could develop, in the first instance, through a combination of common law development and drafting.<sup>56</sup> However, significant legislative intervention overlays and constrains the basic operation of these rights.

3.17 Thus, in England, enforcement is regulated by the Law of Property Act 1925, the Administration of Justice Act 1970 and the Consumer Credit Act 1974. In New Zealand, it is regulated by the Property Act 2017 and the Land Transfer Act 2017. In both cases, however, the legislation tends to presuppose and constrain the creditor’s powers rather than to confer them.

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<sup>54</sup> If there was, there is a risk that registration would be refused as fraudulent since the true nature of the transaction was concealed.

<sup>55</sup> Land Transfer Act 2017, s 51. See further, B Allan *The Law of Secured Credit* (2016) 253–254. A Torrens system is a system of land registration based on the model introduced to South Australia by Sir Robert Torrens in the nineteenth century. See generally Scottish Law Commission, Discussion Paper on Land Registration: Void and Voidable Titles (Scot Law Com DP No 125, 2004) especially paras 1.13-1.17.

<sup>56</sup> Harpum et al *Megarry & Wade* (n 21) para 25-003.

(c) France, Germany and South Africa

(i) Nature of the right

3.18 In contrast to the Common Law systems, in the Civilian systems considered (and the Mixed System of South Africa), in most cases security is effected by means of hypothecary rights. These are subordinate real rights designed for the purpose of securing obligations. In France, three distinct rights in security are recognised by the *Code civil*:<sup>57</sup> the *privilège immobilier*, the *gage immobilier* and the *hypothèque*.<sup>58</sup> The *privilège immobilier* is a tacit security, for the benefit of sellers, co-owners of certain common assets with respect to costs associated with the assets and professionals who have done certain works on the property.<sup>59</sup> *Privilèges* rank ahead of *hypothèques* and *inter se* according to the class of *privilège*.<sup>60</sup> The *gage immobilier* is a possessory security.<sup>61</sup> The *hypothèque* does not require the debtor to be dispossessed.<sup>62</sup> The *hypothèque* can be tacit, conventional or judicial.<sup>63</sup> Thus, it straddles what Scots lawyers would consider the law of security and the law of diligence. To a large extent, the rules applicable to *hypothèques* are applicable to the *gage immobilier*.<sup>64</sup>

3.19 In addition, since 2007, it has been possible to transfer assets (both moveable and immoveable) to a *fiduciaire* who then holds these in a separate patrimony for the benefit of beneficiaries.<sup>65</sup> In other words, French law now recognises the commercial trust. In 2009, articles 2488-1–6 were inserted into the *Code civil*. They make explicit provision for the transfer of immoveable property to a *fiduciaire* in security of an obligation.<sup>66</sup> The *fiduciaire* can be the creditor<sup>67</sup> but only certain types of person can be *fiduciaires*,<sup>68</sup> essentially they are banks, insurance companies and *avocats*.<sup>69</sup>

3.20 Like France, Germany recognises distinct types of heritable security: the *Hypothek* and *Grundschild*.<sup>70</sup> Both are non-possessory and they are distinguished according to the rights of the holder. The *Hypothek* involves the burdening of the property for the satisfaction of an obligation.<sup>71</sup> The *Grundschild* involves burdening the property up to a certain amount.<sup>72</sup> In other words, the *Grundschild* is non-accessory. The property is burdened but this is not tied to a particular debt. The provisions on the *Hypothek* are considerably more detailed than those on the *Grundschild* and most of the rules drafted for the *Hypothek* are applied to the *Grundschild* by § 1192 BGB. The *Grundschild* is the dominant form of

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<sup>57</sup> In addition to the possibility of *nantissement du fonds du commerce* (a form of global security for business which bears certain parallels with the floating charge), *Code de commerce* arts L142-1–5.

<sup>58</sup> *Code civil*, art 2373.

<sup>59</sup> *Code civil*, art 2374.

<sup>60</sup> *Code civil*, arts 2324–6.

<sup>61</sup> *Code civil*, art 2387.

<sup>62</sup> *Code civil*, art 2393.

<sup>63</sup> *Code civil*, art 2395–6.

<sup>64</sup> *Code civil*, art 2388.

<sup>65</sup> *Code civil*, art 2011.

<sup>66</sup> See, in general, F Barrière “La fiducie-sûreté en droit français” (2013) 58 McGill LJ 869, who suggests (at 872 and 877–879) that there has been some attempt to deploy the trust in practice prior to the introduction of the legislation.

<sup>67</sup> *Code civil*, art 2488-3.

<sup>68</sup> *Code civil*, art 2015.

<sup>69</sup> Barrière “La fiducie-sûreté en droit français” (n 66) at 891.

<sup>70</sup> There is a separate section for the *Rentenschuld* but it is, in fact, a sub-set of the *Grundschild*: § 1199 BGB.

<sup>71</sup> BGB § 1113.

<sup>72</sup> BGB § 1191.



heritable security in Germany.<sup>73</sup> It will be the focus of the rest of the discussion. In fact, this makes little difference since both the *Grundschuld* and the *Hypothek* are enforced in the same way.

3.21 At first sight, South Africa might appear to follow the pattern of the Common Law systems. The relevant security device is called a mortgage (or, more precisely, a mortgage bond) and much of its regulation continues to be left to common law. The term “foreclosure” is used for enforcement. However, such appearances are deceptive.

3.22 Section 50(2) of the Deeds Registries Act 47 of 1937 provides that “A mortgage bond or notarial bond may be registered to secure an existing debt or a future debt or both existing and future debts.” “Mortgage bond” and “notarial bond” are defined in section 102 of the same Act, which defines the two terms in the following terms:

“mortgage bond” means a bond attested by the registrar specially hypothecating immovable property;

“notarial bond” means a bond attested by a notary public hypothecating movable property generally or specially;

3.23 From this definition, two presuppositions may be inferred. First, that a mortgage bond operates to create a subordinate real right by hypothecating it (the term hypothecating being familiar in South Africa from the Roman-Dutch tradition).<sup>74</sup> Second, in contrast to moveable property, land in South Africa cannot be subjected to a global security right. This aspect of the South African mortgage bond is consistent with the devices from other jurisdictions considered in this paper, albeit that land can form part of a *fonds de commerce* or be subject to a (floating) charge. It is clear that a mortgage bond in South Africa is a hypothecary device which requires rules on enforcement in order for the creditor to exercise her prerogatives.

(ii) *Source and location of the rules on remedies*

3.24 In both France and Germany, the relevant security devices are the creation of the civil code and both contain provisions establishing the basic prerogatives which the creditor has by virtue of the security.<sup>75</sup> In both cases, however, the default means of extraction of value by the creditor is judicial execution so the rules in the civil codes need to be read alongside the *Code des procédures civiles d'exécution* and the *Zwangsvollstreckungsgesetz* respectively. There is no real evidence of a direct role of broader constitutional rules in the interpretation of these provisions.

3.25 In France, however, the creditor can apply to the court for transfer of the collateral in lieu of payment, unless the parties have agreed otherwise, or the collateral is the debtor's principal residence.<sup>76</sup> The parties can now also insert a *pactum commissorium* into the *convention d'hypothèque*, again provided that the collateral is not the debtor's principal

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<sup>73</sup> Verband deutscher Pfandbriefbanken, *Runder Tisch-Grundpfandrechte*, Frage 1.1) <<<https://rtmortgage.pfandbrief.de/de/report/country/>>>.

<sup>74</sup> See R Brits *Mortgage Foreclosure under the Constitution: Property, Housing and the National Credit Act* (LLD Thesis, Stellenbosch, 2012) 29–30 with further references.

<sup>75</sup> *Code civil*, arts 2458–2474 and BGB § 1191.

<sup>76</sup> *Code civil*, art 2458.

residence, subject to an obligation to account for surplus value.<sup>77</sup> These rules are to be found in the *Code civil*.

3.26 As might be expected from what is effectively a security transfer, the pattern of enforcement for a *fiducie-sûreté* is somewhat different. In the absence of provision to the contrary, a creditor-*fiduciaire* receives the asset into her own patrimony where there is failure to pay.<sup>78</sup> Where there is a third-party *fiduciaire*, the creditor is entitled to have the asset transferred to her or, where the *fiducie* contract provides for it, to have the asset sold and the price remitted.<sup>79</sup> There is, however, provision for payment of a sum reflecting any surplus value over the secured debt to the debtor.<sup>80</sup>

3.27 In South Africa, the basic entitlements are matters of common law and the parties' agreement.<sup>81</sup> However, as in France and Germany, sale of the property is done through the normal processes for diligence.<sup>82</sup> Therefore, the High Court Rules and the Magistrates' Courts Rules play a significant role in enforcement. Where the property in question is residential, there is the further issue of the right to housing in section 26 of the South African Constitution. Section 26 provides that:

1. Everyone has the right to have access to adequate housing.
2. The state must take reasonable legislative and other measures, within its available resources, to achieve the progressive realisation of this right.
3. No one may be evicted from their home, or have their home demolished, without an order of court made after considering all the relevant circumstances. No legislation may permit arbitrary evictions.

3.28 This clearly bears on enforcement against residential property and means that constitutional questions must also be considered when examining exercise of the creditor's prerogatives in the South African context.

3.29 This position stands in contrast to Scots law. The closest analogue to section 26 of the South African Constitution comes from the interaction between article 8 of the European Convention on Human Rights and article 1 of the First Protocol.

Article 8 provides:

1. Everyone has the right to respect for his private and family life, his home and his correspondence.

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<sup>77</sup> A *pactum commissorium* is a term under which the collateral is forfeited to the creditor by reason of default. See *Code civil* art 2459 and *Bulletin officiel des impôts* 10 D-1-08, No 88 du 3 octobre 2008, paras 1–6.

<sup>78</sup> *Code civil*, art 2488-3: "A défaut de paiement de la dette garantie et sauf stipulation contraire du contrat de fiducie, le fiduciaire, lorsqu'il est le créancier, acquiert la libre disposition du bien cédé à titre de garantie."

<sup>79</sup> *Code civil*, art 2488-3.

<sup>80</sup> *Code civil*, art 2488-4.

<sup>81</sup> The most comprehensive modern summary of the authorities is R Brits *Real Security Law* (n 2) ch 2.

<sup>82</sup> Brits *Mortgage Foreclosure* (n 74) 50–51; A J M Steven "Rights in Security" in E Reid and D Visser (eds) *Private Law and Human Rights: Bringing Rights Home in Scotland and South Africa* (2013) 418 at 425.

2. There shall be no interference by a public authority with the exercise of this right except such as is in accordance with the law and is necessary in a democratic society in the interests of national security, public safety or the economic well-being of the country, for the prevention of disorder or crime, for the protection of health or morals, or for the protection of the rights and freedoms of others.

Article 1 of the First Protocol provides:

Every natural or legal person is entitled to the peaceful enjoyment of his possessions. No one shall be deprived of his possessions except in the public interest and subject to the conditions provided for by law and by the general principles of international law.

The preceding provisions shall not, however, in any way impair the right of a State to enforce such laws as it deems necessary to control the use of property in accordance with the general interest or to secure the payment of taxes or other contributions or penalties.

3.30 In contrast to South Africa, there is no direct right to housing. Rather there is a right not to have your home (or other property) interfered with unless there is good reason. Enforcement of a debt is a sufficient reason.<sup>83</sup> Where a home is involved, however, it might be argued that there is a requirement for a court hearing to ensure the proportionality of the interference.<sup>84</sup>

3.31 In the first instance, a failure to make such provision would be a breach of the state's obligations rather than that of the pursuer. However, Scots courts have shown a willingness to anticipate such challenges and to make appropriate procedural provision.<sup>85</sup>

3.32 In the case of standard securities, however, there has been no need to appeal directly to Convention Rights in this way, because the 1970 Act has been amended to give procedural protections analogous to those which have been developed for South Africa on the basis of section 26(3) of the Constitution.<sup>86</sup>

*(d) Conclusions on the form of the security interest and the sources and location of rules*

3.33 Scotland is relatively unusual in seeking to restrict conventional security over land to a single form. However, it appears that there is a tendency, particularly in the context of Civilian systems, for one form to dominate. On the whole, the comparative experience strongly suggests that a hypothecary model is preferred by most systems and that those systems which started with a security transfer model have tended to move away from it, although the comparatively recent introduction of the *fiducie-sûreté* in French law pulls against this trend somewhat. Even in that case, however, the creditor does not receive simple ownership in the first instance. The most that she can have is a combination of ownership qua *fiduciaire* and the position as beneficiary of the *fiducie*.

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<sup>83</sup> *Wood v UK* (1997) 24 EHRR CD 69.

<sup>84</sup> *Zehenter v Austria* (2011) 52 EHRR 22 at paras 58–59.

<sup>85</sup> *Karl Construction (Scotland) Ltd v Palisade Properties plc* 2002 SC 270, 2002 SLT 312.

<sup>86</sup> See further Steven "Rights in Security" (n 82) at 428–33.

3.34 None of the systems considered present their rules on exercise of the creditor's prerogatives in a single set of rules alongside the rest of the provisions on constitution and content of the creditor's right. There are different reasons for this.

3.35 The South African system remains essentially uncodified, with legislative interventions on very particular aspects. The diligence-based approach of France and Germany has the advantage of a single set of rules dealing with sale of land at the behest of creditors, whether they are secured or not. From the point of view of debtors and their advisors (such as Citizens Advice Bureaux) that is an easier approach to understand than one which deploys a separate process for the exercise of secured creditor's rights. This is because arrears on secured loans are often not the only financial problem that a debtor has to face. Multiple sets of rules on debt enforcement mean that multiple procedures have to be understood simultaneously. That may be thought to outweigh the inconvenience to the creditor of having to apply two sets of rules. The fact that both France and Germany have systems of execution against land which are less cumbersome than adjudication renders the use of judicial execution more attractive than it would be in Scotland.

3.36 It should be borne in mind, however, that neither France nor Germany has a single set of rules on judicial execution against land. In France, the rules are divided between the *partie législative* and the *partie réglementaire* of the *Code des procédures civiles d'exécution*. The latter contains the procedural rules. In Germany, it is necessary to read the *Zivilprozessordnung* which contains the general rules on judicial execution, together with the *Gesetz über die Zwangsversteigerung und die Zwangsverwaltung* (abbreviated to ZVG), which contains the specific rules on execution against land.

3.37 The French approach to the *fiducie-sûreté* reflects the fact that it is not a hypothecary right.<sup>87</sup> Rather the asset is transferred. The fact that this institution is new and was introduced as part of the broader move to the recognition of the *fiducie* tends to separate it from the other heritable security devices. Part of the point of its introduction was to free the creditor from restrictions associated with traditional security devices.<sup>88</sup> This move away from the unitary approach to enforcement is understandable in the legislative context but it is nonetheless somewhat regrettable from the debtor's perspective, particularly given the radical lack of debtor-protection rules.<sup>89</sup>

3.38 The New Zealand approach is quite specifically expressed and reflects the particular approach to land registration taken in that jurisdiction where, contrary to the philosophy of the Land Registration etc (Scotland) Act 2012, significant aspects of the substantive law of conveyancing are found in the land registration statute. Even in New Zealand, however, there is a division between implied covenants,<sup>90</sup> which are set out in a Schedule to the Property Law Act 2007 and the main body of rules in the statute.<sup>91</sup> The English rules are perhaps the most disparate and, in this respect at least, cannot be considered to provide a plausible model for reform.

3.39 The overall picture, however, is one of consistent complexity. No system provides clear and comprehensive rules in a single place. To some extent, this can be explained by the interstitial nature of the topic: between debt enforcement, civil procedure and substantive

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<sup>87</sup> It is difficult to say that this is not a proper right in security since the provisions were introduced specifically for the purpose of creating a right in security.

<sup>88</sup> See art 2488-5 *alinéa* 4.

<sup>89</sup> Barrière "La fiducie-sûreté en droit français" (n 66) at 898 fn 95.

<sup>90</sup> Equivalent to standard conditions in Scots law.

<sup>91</sup> Property Law Act 2007, s 95 and Sch 2 Part 1.

law. Seen in that way, it might prove something of a counsel of despair. However, it is also possible to see this complexity and to find an opportunity. The Commission has a real opportunity to come up with a world leading system in this context, just as it did in land registration.

## D. EXERCISING THE STANDARD SECURITY

### **(1) Are all four prerogatives available to the creditor and what is the relationship between them?**

4.01 As noted above, the basic options for any right in security are possession or control of the asset and extraction of value by use, acquisition or sale.

#### *(a) Scotland*

4.02 Provision is made for each mode of realisation in standard condition 10 to Schedule 3 of the 1970 Act.<sup>92</sup> Therefore, the standard security makes both prerogatives available to the debtor. Since the standard security is non-possessory, provision is necessary to allow the creditor to enter into possession of the security subjects.<sup>93</sup>

4.03 The basic condition for exercise of any of the prerogatives is default and standard condition 10(1) might be taken to give the creditor a free choice:

Where the debtor is in default, the creditor may, without prejudice to his exercising any other remedy arising from the contract to which the standard security relates, exercise, in accordance with the provisions of Part II of this Act and of any other enactment applying to standard securities, such of the remedies specified in the following sub-paragraphs of this standard condition as he may consider appropriate.

4.04 However, “the provisions of Part II” restrict the availability of transfer to the creditor to cases where an attempt to sell the asset has failed.<sup>94</sup> The Act refers to such transfer as “foreclosure” but the term is not used in its traditional sense. Prior to the foreclosure, the debtor rather than the creditor is the owner. “Foreclosure” under the 1970 Act is not the loss of the right to redeem the property but the transfer of the asset to the creditor.<sup>95</sup>

4.05 In the present context, in which the majority of secured creditors are not in a position to make direct use of the collateral, by far the most significant means of extracting value is letting out the property (if it is not already let out) and collection of rents. Express provision on letting and rents is made in standard condition 10:

(3) He may enter into possession of the security subjects and may receive or recover [...] the rents of those subjects or any part thereof.

(4) Where he has entered into possession as aforesaid, he may let the security subjects or any part thereof.

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<sup>92</sup> 1970 Act, Sch 3, para 10.

<sup>93</sup> 1970 Act, Sch 3, para 10(3).

<sup>94</sup> 1970 Act, s 28(1).

<sup>95</sup> 1970 Act, s 28(6)(a).

(5) Where he has entered into possession as aforesaid there shall be transferred to him all the rights of the debtor in relation to the granting of leases or rights of occupancy over the security subjects and to the management and maintenance of those subjects.

4.06 The major question arising from these provisions is the relationship between taking possession and the leasing rights. Condition 10(3) might be taken to present the right to enter possession and the right to rents as separate entitlements. Equally, the right to rents might be read as consequent on the right to enter possession. However, it is clear that 10(4) and 10(5) make the right to let the property conditional on having entered into possession.<sup>96</sup> In light of that, it appears that the right to rents is conditional on having entered into possession.

*(b) England*

4.07 Since mortgage is based on a title to possess, foreclosure and the right to possession are said to “arise from the very nature of the security”.<sup>97</sup> Thus, at a basic level, very little in the way of legal architecture is needed to allow the creditor to take possession. This remains the position with regard to property other than dwelling houses (discussed below), where, absent provision to the contrary, the creditor is entitled to take possession and receive the profits of the property even when there is no default.<sup>98</sup> Of course, provision to the contrary in the deed is very common<sup>99</sup> and such intention may be implied.<sup>100</sup> As in Scotland, receipt of profits such as rents derives from taking possession.<sup>101</sup> In practice, such entry in possession is considerably discouraged by the stringent duties which the creditor then owes to the debtor.<sup>102</sup>

4.08 Since the intervention of Equity in creating a right to redeem even when there was no longer one at Law<sup>103</sup> and the prohibition of mortgage by conveyance of the collateral in the Law of Property Act 1925 the property cannot be acquired by the mere falling away of a right. Therefore, a court action is needed to complete the acquisition by the creditor.<sup>104</sup> This cannot happen until the debtor is in default (for no equity of redemption arises until then).<sup>105</sup> While the right to foreclose may be restricted by contract, there is no general requirement that other remedies be used first.<sup>106</sup> However, the court can order a sale instead of foreclosure on the request of the debtor or any other person with an interest in the debt secured or in the debtor’s interest in the property.<sup>107</sup> Thus, there is a means of protecting the rights of the debtor and other parties in the proper marketing of the property, albeit that, in contrast to Scotland, it requires an application that this be done.

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<sup>96</sup> R Rennie (et al) *Leases* (2015) para 8-17.

<sup>97</sup> Harpum et al *Megarry & Wade* (n 21) para 25-003.

<sup>98</sup> *Four-Maids Ltd v Dudley Marshall (Properties) Ltd* [1957] Ch 317; *Ropaigealach v Barclays Bank plc* [2000] QB 263 esp at 271–2.

<sup>99</sup> [1957] Ch 317 at 321.

<sup>100</sup> *Birmingham Citizens Permanent Building Society v Caunt* [1962] Ch 883 at 891 per Russell J.

<sup>101</sup> Harpum et al *Megarry & Wade* (n 21) para 25-026.

<sup>102</sup> [1962] Ch 883 at 887 per Russell J.

<sup>103</sup> *Williams v Morgan* [1906] 1 Ch 804.

<sup>104</sup> 1925 Act, ss 88(2) and 89(2).

<sup>105</sup> *Williams v Morgan* [1906] 1 Ch 804.

<sup>106</sup> *Ramsbottom v Wallis* (1835) 5 LJ Ch 92.

<sup>107</sup> 1925 Act, s 91(2).

4.09 The Law of Property Act 1925 also confers a power of sale on the creditor, which accrues once the secured debt is due<sup>108</sup> and the debtor is in default either by reason of failure to comply with a notice demanding repayment for three months after its service; by reason of two months of arrears on interest which is due; or by reason of breach of a non-pecuniary obligation under the mortgage.<sup>109</sup>

4.10 As with foreclosure, sale is not limited to cases where another remedy has been used, although it is subject to the terms of the mortgage.<sup>110</sup> Further, in the same circumstances, the creditor will usually appoint a receiver to take possession of the property and act on the creditor's behalf, thus avoiding the disadvantages of being in possession.<sup>111</sup>

4.11 English law, therefore, affords a relatively free choice between the prerogatives which allow the creditor to realise or extract value. One contrast with the approach in Scotland is a slightly more relaxed attitude to foreclosure. The difference is essentially one concerning the burden of initiative. In Scotland, it is up to the creditor seeking foreclosure to demonstrate that sale is not feasible. In England, it is up to another party with an interest to intervene and to insist on a sale. The other is the possibility (depending on the type of property and the terms of the mortgage) of entry into possession and uplift of rents even in the absence of default, albeit that this is rarely exercised in practice.

(c) *New Zealand*

4.12 The departure from the presuppositions inherent in the mortgage in the law of New Zealand is considerably more extensive than in England. Foreclosure has been explicitly abolished.<sup>112</sup> A creditor who wishes to acquire the collateral must do so by buying it at a public auction or in a sale administered by the court.<sup>113</sup>

4.13 The creditor's powers to enter possession, appoint a receiver or to sell the land are all subject to the same initial conditions: requiring notice of default and a notice period.<sup>114</sup> The conditions for exercise of these rights is not made conditional on the exercise of the others, so the creditor has an essentially free choice between them. However, it is open to the debtor to apply to the court for an order directing the sale of the property.<sup>115</sup> Where such an application is made, the court has very wide discretion (and very little statutory guidance) regarding whether, and on what terms, an order for sale is made.<sup>116</sup>

4.14 As with England, receipt of income from the collateral is dependent on being in possession or having a receiver in place.<sup>117</sup>

(d) *France*

4.15 For the *hypothèque* (and the *gage immobilier*<sup>118</sup>), resort to sale by means of judicial execution prevents acquisition of the asset by the creditor, as might be expected.<sup>119</sup> Where

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<sup>108</sup> 1925 Act, s 101(1)(i).

<sup>109</sup> 1925 Act, s 103.

<sup>110</sup> 1925 Act, s 101(4).

<sup>111</sup> 1925 Act, s 101(1)(iii).

<sup>112</sup> Property Law Act 2007, s 117.

<sup>113</sup> Property Law Act 2007, ss 176(2), 196 and 200.

<sup>114</sup> Property Law Act 2007, s 119.

<sup>115</sup> Property Law Act 2007, s 107.

<sup>116</sup> Property Law Act 2007, s 108. See further Allan *Law of Secured Credit* (n 55) 297–8.

<sup>117</sup> Property Law Act 2007, s 169.

acquisition is permitted, however, either by means of a *pactum commissorium* or by resort to the court there is no requirement that sale be pursued first.<sup>120</sup>

4.16 The rules on judicial execution (*saisie immobilière* in this case) are explicitly directed to sale of the property.<sup>121</sup> Given that they are also applicable where there is no *hypothèque*, it is not surprising that this power is not related to the provisions on acquisition by the creditor. However, these rules do provide that, should the public sale fail, the asset is acquired by the creditor.<sup>122</sup> There is no distinct provision for use or possession of the property but the *saisie* of the property also covers its fruits (the term including civil fruits<sup>123</sup>).<sup>124</sup> The ejection of the debtor does not take place prior to the sale as a matter of course.<sup>125</sup>

4.17 In the case of the *fiducie-sûreté*, where the *fiduciaire* is the creditor, there is direct acquisition of the asset in the case of default.<sup>126</sup> Where the *fiduciaire* is a third party, the creditor becomes entitled to transfer of the asset.<sup>127</sup> Ownership obviates the need for specific rights to use or sell the asset, though the *Code civil* does advert to the possibility of an express provision in the *fiducie*, that a third-party *fiduciaire* should sell the asset herself and remit the price (or the requisite part of it<sup>128</sup>) to the creditor.<sup>129</sup>

#### (e) Germany

4.18 As noted above, realisation of value under German law is by judicial execution.<sup>130</sup> This is governed by the *Zivilprozessordnung*, which provides that execution against land can take the form of registration of a *Sicherungshypothek* (irrelevant in this case), *Zwangsvollstreckung* or *Zwangsverwaltung*.<sup>131</sup> *Zwangsvollstreckung* and *Zwangsvollstreckung* are regulated separately in the ZVG.<sup>132</sup>

4.19 *Zwangsvollstreckung* is judicial auction and *Zwangsvollstreckung* is similar to receivership. The *Zwangsvollstreckung* takes possession of the property.<sup>133</sup> He or she is entitled to undertake necessary maintenance and to use it to generate revenue for the satisfaction of the debt.<sup>134</sup> There is no requirement to pursue one over the other.

#### (f) South Africa

4.20 As noted above, the South African mortgage bond is largely the product of case law and drafting. The right to foreclose, which in the South African context means judicial sale, is

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<sup>118</sup> *Code civil*, art 2388 aliéna 2.

<sup>119</sup> *Code civil*, art 2458.

<sup>120</sup> *Code civil*, art 2458–9.

<sup>121</sup> *Code des procédures civiles d'exécution*, art L311-1.

<sup>122</sup> *Code des procédures civiles d'exécution*, art L322-6 alinéa 1.

<sup>123</sup> *Code civil*, art 582.

<sup>124</sup> *Code des procédures civiles d'exécution*, art L321-3.

<sup>125</sup> *Code des procédures civiles d'exécution*, art L321-1 alinéa 3.

<sup>126</sup> *Code civil*, art 2488-3 alinéa 1.

<sup>127</sup> *Code civil*, art 2488-3 alinéa 2.

<sup>128</sup> Taking into account the creditor's obligation to account to the debtor for any surplus value.

<sup>129</sup> *Code civil*, art 2488-3 alinéa 2.

<sup>130</sup> BGB, § 1147 with § 1191 I.

<sup>131</sup> ZPO, § 866 I.

<sup>132</sup> The ZPO makes explicit reference to this in § 869.

<sup>133</sup> ZVG, § 151 I.

<sup>134</sup> ZVG, §§ 152 I and 155 II.



implied even in the absence of a term to that effect in the bond.<sup>135</sup> The right to use the property and receive its fruits may be agreed but does not arise automatically.<sup>136</sup> A *pactum commissorium* is invalid in South Africa.<sup>137</sup>

(g) *Comparative conclusions*

4.21 As might be expected, given the significant differences in basic structure, the systems examined exhibit a wide range of approaches. The major structural difference is the greater role for judicial execution in the Civilian systems (for this purpose including South Africa). This appears to be associated with a distinct hypothecary right, a view which is supported by the fact that the major Civilian exception to the tendency to favour judicial execution is the *fiducie-sûreté*.

4.22 As might also be expected, given their roots in possessory title, there is a more prominent role for taking possession in England and New Zealand than in the Civilian systems. In all the systems, however, there is a correlation between being in possession and right to the fruits (civil or natural) of the property.

4.23 With the exception of the *fiducie-sûreté*, direct acquisition seems not to be favoured. It is not possible in Civilian systems and the English and New Zealand mortgages restrict its role: directly in the case of New Zealand and indirectly in the case of England, through the right of an interested party to seek sale in lieu of foreclosure.

4.24 In part, the Civilian approach may be because of the role of public officials in the sale: where sale is by public auction, for instance, there is little need for a separate process of direct acquisition. The European tradition of hostility to the *pactum commissorium*,<sup>138</sup> evidenced most clearly today in the law of South Africa, may also play a role. However, the tendency of the Common Law systems to move in this direction as well suggests that there are deeper policies at play. In particular, it might be suggested that realisation of the asset's value as money gives the creditor her interest (which is pecuniary) but both ensures the best available means of valuation (sale on the open market) and makes distribution of any surplus value to other entitled parties (such as the debtor or lower-ranking creditors).

4.25 While extraction of value by use often has a role (particularly when a process of sale is ongoing) it is less attractive as a means of execution than a sale. Sale is a one-off transaction, lease involves an ongoing relationship. As such, it tends to be less attractive to creditors but also from the point of view of any regulatory system which seeks to protect other interested parties by ensuring that best value is obtained because any supervision requires to be much more long term.

4.26 This, together with the need to conceal usury, may explain the tendency in older institutions (such as wadset)<sup>139</sup> for income from the property to take the place of interest on the debt. That approach gave the creditor an incentive to make best use of the property without the need for supervision. Of course, such an approach does nothing to deal with the

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<sup>135</sup> *Nedcor Bank Ltd v Kindo and Another* [2002] ZAWCHC 10. See also *Standard Bank of South Africa Ltd v Saunderson and Others* [2005] ZASCA 131 at para 2 per Cameron and Nugent JJA.

<sup>136</sup> *Barclays Western Bank Ltd v Comfy Hotels Ltd* 1980 4 SA 174 (E). See also *Brits Mortgage Foreclosure* (n 73) 41 fn 121 and *Brits Real Security Law* (n 2) 57.

<sup>137</sup> *Vasco Dry Cleaners v Twycross* 1979 1 SA 603 (A).

<sup>138</sup> On the background in Roman law, see J L Zamora Manzano "Algunas reflexiones sobre la *lex commissoria* y su prohibición ulterior en el *pignus*" (2007) 54 RIDA 519.

<sup>139</sup> Hume *Lectures* Vol IV (n 22) 375–7.

principal sum and would allow the creditor to extract value from the land indefinitely<sup>140</sup> until the debtor manages to find some other means of repayment.

4.27 In light of this, it seems that a system of enforcement which privileges sale and distribution over other means of extracting value is to be preferred and it is important to recognise the interest of other creditors and of the debtor in sale. In contrast to the position with moveable property, it is not unusual for a very significant portion of the debtor's capital to be tied up in a single asset. A creditor who delays sale denies the debtor (and other creditors) access to the surplus value of the asset. Therefore, the creditor should not have free choice between the prerogatives.

**(2) How (if at all) is the creditor required to establish that the debt is due in order to exercise the prerogatives?**

*(a) Scotland*

*(i) Must the debtor be in default?*

4.28 The right to exercise the creditor's prerogatives depends on default in terms of the standard security, as defined by standard condition 9(1) of Schedule 3. It provides as follows:

The debtor shall be held to be in default in any of the following circumstances, that is to say—

(a) where a calling-up notice in respect of the security has been served and has not been complied with;

(b) where there has been a failure to comply with any other requirement arising out of the security;

(c) where the proprietor of the security subjects has become insolvent.

4.29 It is now clear, as a result of *RBS v Wilson*,<sup>141</sup> that where the security is being used to seek satisfaction of the debt, a calling up notice is to be served with the eventual result of putting the debtor in default. What are the conditions under which a calling-up notice can be issued? Standard condition 8 gives the answer, but it is not very illuminating:

The creditor shall be entitled, subject to the terms of the security and to any requirement of law, to call-up a standard security in the manner prescribed by section 19 of this Act.

Section 19(1) provides:

Where a creditor in a standard security intends to require discharge of the debt thereby secured and, failing that discharge, to exercise any power conferred by the security to sell any subjects of the security or any other power which he may appropriately exercise on the default of the debtor within the meaning of standard

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<sup>140</sup> For concern about this in relation to wadset, see Hume *Lectures* Vol IV (n 22) 375–6.

<sup>141</sup> [2010] UKSC 50, 2011 SC (UKSC) 66.

condition 9(1)(a), he shall serve a notice calling-up the security in conformity with Form A of Schedule 6 to this Act (hereinafter in this Act referred to as a “calling-up notice”), in accordance with the following provisions of this section.

4.30 Two things are striking about the legislative design here. Failure to comply with a calling-up notice is cast as a failure to comply with a “requirement arising out of the security”. This can be inferred from the words “any other” in 9(1)(b). This confounds the distinction set out above between exercise of the security and protection of the value of the security. Given that the right in security exists to assist the creditor in obtaining satisfaction of the underlying obligation, a process by which a breach of that is transformed into a breach of an obligation under the security is conceptually unnecessary, untidy and confusing.

4.31 This conflation has negative consequences further on in the process. As will be discussed below, a court order is not necessary to sanction a sale unless the property is residential. Where the court is called to confer power of sale, it must consider the factors set out in sub-section (7) of section 24:

(7) Those matters are—

- (a) the nature of and reasons for the default;
- (b) the ability of the debtor to fulfil within a reasonable time the obligations under the standard security in respect of which the debtor is in default;
- (c) any action taken by the creditor to assist the debtor to fulfil those obligations;
- (d) where appropriate, participation by the debtor in a debt payment programme approved under Part 1 of the Debt Arrangement and Attachment (Scotland) Act 2002; and
- (e) the ability of the debtor and any other person residing at the security subjects to secure reasonable alternative accommodation.

4.32 As is clear from paragraph (b), the default to which this refers is the default under the security, i.e. the failure to comply with the calling-up notice by paying off the whole debt.<sup>142</sup> A strict reading has major implications for the scope to make allowances for the debtor. Consider a debtor who fell three months behind on repayments for a major loan. By the time of the hearing, the debtor may well be in a position to catch-up on the payments which have been missed. This, however, is not enough for paragraph (b): the obligation under the security is to comply with the calling-up notice. That can only be satisfied by discharging the whole debt.<sup>143</sup> This reading may not have been obvious prior to the clarification in *Wilson* that the obligation to pay the loan was not an obligation “under the security”.

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<sup>142</sup> *Northern Rock (Asset Management) plc v Millar* 2012 SLT (Sh Ct) 58 at paras [70]–[74]; *Firstplus Financial Group plc v Pervez* 2013 Hous LR 13.

<sup>143</sup> *Westfoot Investments Ltd v European Property Holdings Inc* 2015 SLT (Sh Ct) 201 para 18. See also, *Holbyn v Barclays Bank plc* [2013] CSOH 104 (affd [2014] CSIH 52, 2015 SCLR 85) at para [15] per Lord Drummond Young, adverting to the possibility that the arrears might be cleared relatively easily but not suggesting that this had any bearing on enforceability. This does not give direct support since the hearing was for a recall of interim interdict on sale. *HSBC Bank plc v Collinge* [2014] SC DUMF 48; 2014 Hous LR 78 rather fences round the issue.

4.33 In *Firstplus Financial Group plc v Pervez*,<sup>144</sup> Sheriff Reid argues that a calling-up notice may be used to demand payment of only a part of the debt on the basis of the broad definition of debt in section 9(8) of the 1970 Act. It is worth bearing in mind that while this sub-section does define “debt” broadly as “any obligation due, or which will or may become due, to repay or pay money”, section 19 says that the calling-up notice can be used where the creditor “intends to require discharge of *the* debt secured” rather than of a debt secured. One might take the view that, while the broad definition means that a security can be used for a wide range of obligations, once this has been done section 19 only countenances calling-up of the whole debt. Of course, a creditor who issues a calling-up notice is not obliged to pursue it and therefore the point may not make a great deal of difference. Whatever the correct view, the whole amount demanded in the calling-up notice must be discharged and that will be the whole debt in the majority of cases.

4.34 The other important aspect of the statutory rules on calling-up is the absence of any reference here to default on the debt. The right to exercise the prerogatives is triggered by failure to comply with the calling-up notice. However, the legislation says nothing about when a calling-up notice can validly be served (or about what, if any, are the consequences of a calling-up notice when there is no default). The question of when a calling-up notice can be served is left for the parties to determine.<sup>145</sup>

4.35 It must, however, be the case that, unless a debt is payable on demand, a calling-up notice will not justify sale unless the debtor is presently liable under the principal obligation.<sup>146</sup> The main reason for this is that, without present liability it is difficult to say that there is any obligation to discharge unless one is to accept the quite remarkable proposition that any obligation which is secured by a standard security is converted into an obligation payable on demand merely by service of the calling-up notice.<sup>147</sup>

(ii) *How is the default established?*

4.36 As will be discussed below, a court order is needed if the property is residential unless the property is voluntarily surrendered.<sup>148</sup> Otherwise, however, the creditor is entitled to sell the property<sup>149</sup> or pursue the other prerogatives without recourse to the court,<sup>150</sup> provided that the debtor is willing to surrender possession. In practice, however, it is not uncommon to seek declarator that the creditor is entitled to sell. If nothing else, a court action will be necessary to eject a recalcitrant debtor who is still in occupation.<sup>151</sup>

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<sup>144</sup> 2013 Hous LR 13 at para [47].

<sup>145</sup> It is perhaps also worthy of note that there is no reference to when a calling-up notice may be given in the styles for the standard security in Sch 2 to the 1970 Act.

<sup>146</sup> Some rather oblique support for this position can be gleaned from *Promontoria (Chesnut) Ltd v Ballantyne Property Services* [2016] SC EDIN 74, where the debtor alleged a promise not to enforce. The promise was not established but the assumption on all sides appears to have been that, had it been established, the subsequent calling-up notice would have been ineffective. In *Firstplus Financial Group plc v Pervez* 2013 Hous LR 13 at para [55], the sheriff adverts to the possibility of a calling-up notice being given in circumstances when it would be invalid. For the requirement of liability in order to enforce in general, see *J Sykes & Sons (Fish Merchants) Ltd v Grieve* 2002 SLT (Sh Ct) 15.

<sup>147</sup> See, however, *Gardiner v Jacques Vert plc* 2002 SLT 928 and *AIB Group (UK) plc v Guarino* 2006 SLT (Sh Ct) 138 which hold that there is no requirement for any steps to establish the debt prior to the service of the calling-up notice.

<sup>148</sup> 1970 Act, s 20(2A).

<sup>149</sup> 1970 Act, s 20(2).

<sup>150</sup> 1970 Act, s 20(1) and (3)–(5).

<sup>151</sup> G L Gretton and K G C Reid *Conveyancing* (4<sup>th</sup> edn, 2011) para 22-33.

4.37 The calling-up notice ceases to be effective in sanctioning sale five years after the date of the notice, or of the first exposure for sale, whichever is later, in the case of non-residential property and five years from the date of the notice in the case of residential property.<sup>152</sup>

4.38 Therefore, other than in the case of residential property there is little in the way of verification either that the creditor was justified in serving the calling-up notice or that the debtor has failed to comply with it. However, a debtor who believes that the creditor is not justified in pursuing enforcement by these means can seek suspension of the enforcement.<sup>153</sup>

*(b) England*

4.39 As noted above, the equity of redemption does not arise until the debt is due and this means that foreclosure is not possible before default. Similarly, the statutory power of sale or receivership is not triggered until the sum secured is due<sup>154</sup> and cannot be exercised until either the equivalent of a calling-up notice has been served and not satisfied after three months, two months of interest arrears have accrued or there is breach of some other (non-payment) term.<sup>155</sup> The logic of distinguishing between the moment when a power of this type arises from the time at which it becomes exercisable is perhaps open to question<sup>156</sup> but otherwise the position is fairly clear.

4.40 In theory, these powers can be exercised without court order. Accordingly, there is little scope for judicial verification of whether there has been default.<sup>157</sup> To some extent, this is mitigated by the practical need to secure an order for possession in order to ensure that the creditor can give any buyer vacant possession.

4.41 As will be discussed below, the position is somewhat different in the case of residential property and consumer debtors.

*(c) New Zealand*

4.42 There is no direct provision in the New Zealand legislation requiring default for exercise. However, the general common law background suggests that default is required. Such a requirement is clearly implied by section 119 of the Property Law Act 2007:

No amounts secured by a mortgage over land are payable by any person under an acceleration clause, and no mortgagee or receiver may exercise a power specified in subsection (2), by reason of a default, unless—

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<sup>152</sup> 1970 Act, s 19(11) and (12). The suggestion, in *Bank of Scotland v Tait* [2007] CSIH 46; 2007 SC 731 at para [27], that sub-section (11) “simply put a statutory bar on the pursuers' further ability to use only the calling-up notice as a link, or warrant, in the exercise of their power of sale” but left open the option of seeking judicial warrant to sell seems to be based on the pre-*RBS v Wilson* view that the calling-up notice was only one of three routes to sale.

<sup>153</sup> As was the case in *Gardiner v Jacques Vert plc* 2002 SLT 928.

<sup>154</sup> 1925 Act, s 101(1)(i) and (iii).

<sup>155</sup> 1925 Act, ss 103 and 109.

<sup>156</sup> The consequence of the distinction is that an innocent third party who purchases from one who has the power but who is not entitled to exercise it is protected: Harpum et al *Megarry and Wade* (n 24) para 25-016.

<sup>157</sup> Harpum et al *Megarry and Wade* (n 24) para 25-017.

- (a) a notice complying with section 120 has been served (whether by the mortgagee or receiver) on the person who, at the date of the service of the notice, is the current mortgagor; and
- (b) on the expiry of the period specified in the notice, the default has not been remedied.

4.43 The powers specified in subsection (2) have been discussed above: entry into possession, extraction of value by a receiver and sale. Thus, default triggers the right to exercise these prerogatives, subject to compliance with the notice procedure but without the need for any court procedure which might verify the default.<sup>158</sup>

4.44 It is possible, however, to enter into possession, or for a receiver to manage and extract without giving notice or prior to the expiry of the notice period if the court thinks fit to give leave for such a course of action. Again, the wording of the provision clearly presupposes the need for a default and, in these cases, the court hearing means that the default can be verified.<sup>159</sup>

4.45 Furthermore, the power to call up the debt by notice is regulated by para 11 of Part 1 of Schedule 2 of the Act, which sets out the covenants implied in mortgages. It sets out the grounds for calling up as follows:

- (a) the mortgagor fails to pay any amounts secured by the mortgage on the due date; or
- (b) the mortgagor fails to perform or observe any covenant expressed or implied in the mortgage; or
- (c) the mortgagor sells, transfers, exchanges, leases, parts with possession of, or otherwise disposes of the mortgaged land or any part of it without the prior written consent of the mortgagee; or
- (d) the mortgagor agrees to do any of the things referred to in paragraph (c) without the prior written consent of the mortgagee; or
- (e) the mortgaged land or any part of it is taken under any enactment; or
- (f) the mortgagor becomes bankrupt or, in the case of a company, is placed in liquidation or, in the case of an overseas company, is being liquidated under section 342 of the Companies Act 1993; or
- (g) the mortgagor is a body corporate and, as a result of all or any of the following, the effective management or control of the body corporate is materially different from that when the mortgage was executed:
  - (i) a change in the legal or beneficial ownership of any of its shares:
  - (ii) an issue of new capital:

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<sup>158</sup> See also s 124.

<sup>159</sup> Property Law Act 2007, ss 126.

(iii) an alteration of voting rights or other rights attaching to any of its shares; or

(h) the mortgagor is a body corporate and a receiver or statutory manager is appointed for all, or substantially all, of the assets of the mortgagor or for the mortgaged land or any part of it; or

(i) the whole or any part of the mortgaged land or any interest in the land is sold in exercise of a power of sale in any mortgage over the land.

4.46 Here we see a mix, familiar from the Scottish context, of grounds which relate to the payment of the debt and those which relate to the preservation of the value of the collateral. As in Scotland, some of these, such as a change in the capital of a corporate owner might be thought to be a touch draconian.

(d) *France*

4.47 In France, for the *hypothèque*, sale is by means of judicial execution and therefore a *titre exécutoire* (essentially a warrant to execute) is requisite.<sup>160</sup> However, one such *titre* is a notarial act including consent to execution.<sup>161</sup> *Hypothèques* are invariably created by notarial deed with such a consent to execution.<sup>162</sup> However, the process of *saisie immobilière* requires a demand for payment<sup>163</sup> which must set out the sums due.<sup>164</sup> If there is no default, the sum is not due and therefore the *saisie* cannot proceed. Compliance with these requirements is assessed at the (mandatory) hearing where the sale is sanctioned by a judge.<sup>165</sup>

4.48 Where the creditor seeks to acquire the property, either by judicial grant or in terms of the *hypothèque* agreement, the creditor needs to qualify as a *créancier hypothécaire impayé*, again that implies a debt being due and unpaid.<sup>166</sup> Similarly, the acquisition rule applicable to the *fiducie-sûreté* is triggered by default in payment of the debt (though the legislation makes little or no provision about the nature of the dispute). In the case of the *fiducie-sûreté*, no judicial process is necessary, so there is no procedure for establishing the debt.<sup>167</sup>

(e) *Germany*

4.49 Despite its abstract nature, a *Grundschild*, which has been created for the purpose of securing a claim, can be resisted with defences applicable by virtue of the security contract (which links the security with the abstract claim).<sup>168</sup> This means that a bar on the enforceability of the claim is also a bar on the enforceability of the security so the debt must be due in order to be enforced.

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<sup>160</sup> *Code des procédures civiles d'exécution*, art L111-2 and L311-2.

<sup>161</sup> *Code des procédures civiles d'exécution*, art L111-3, 4°.

<sup>162</sup> *Runder Tisch-Grundpfandrecht* (n 73), Frage IV.1).

<sup>163</sup> *Code des procédures civiles d'exécution*, art R321-1 alinéa 1.

<sup>164</sup> *Code des procédures civiles d'exécution*, art R321-3, 4°.

<sup>165</sup> *Code des procédures civiles d'exécution*, art R322-15 alinéa 1.

<sup>166</sup> See further, M Dols-Magneville *La réalisation des sûretés réelles* (PhD Thesis, Toulouse, 2013) n° 86–90.

<sup>167</sup> Dols-Magneville *La réalisation des sûretés réelles* (n 166) 93.

<sup>168</sup> BGB § 1192 la read with § 1157.

4.50 As in France, the basic position is that a title such as a court decree is needed before the *Hypothek* and *Grundschild* are enforced.<sup>169</sup> Further, however, and also as in France, judicial execution can also take place on the basis of a notarial deed containing consent to summary execution.<sup>170</sup> As might be expected, the vast majority of German heritable securities take this form.<sup>171</sup> This means that creditors are rarely required to demonstrate that the debt is due and unpaid at the start of enforcement. However, both judicial sale and *Zwangsvverwaltung* take place as a result of application to the court, which provides an opportunity for the validity of the title to execute to be contested.<sup>172</sup> The right to execute must be demonstrated to the court dealing with the execution.<sup>173</sup>

(f) *South Africa*

4.51 Since the right to extract value, by sale or otherwise, arises from the terms of the mortgage bond in South Africa, the requirements for default depend on their terms.<sup>174</sup> However, execution requires a judgment in the creditor's favour by the court, thus a debt must be due in order to justify any execution.<sup>175</sup> Thus some form of default is necessary and must be verified in court prior to execution.

(g) *Comparative conclusions*

4.52 Two major trends are evident in this area. First, there is a greater tendency within the Common Law systems (as in Scotland) to characterise default in terms of breach of the security rather than simply considering the security as securing performance of the underlying obligation. Furthermore, the "breach of security" approach is associated with allowing exercise of the security in order to protect its own value, as is evident in Scotland and New Zealand but of which there is no trace in the Civilian systems.

4.53 The second major issue (to which South Africa is a significant exception) is the tendency to allow direct enforcement without the need for litigation to establish that the debt is due. This is perhaps to be expected from the approach taken in Scotland and the Common Law countries.

4.54 What is striking, however, is the prevalence of the equivalent of summary diligence as a means of avoiding an initial court action in France and Germany. Even, however, in those situations, there is a significant degree of debtor protection. In contrast to the position in Scotland, consent to summary diligence requires that the relevant document has to be prepared and executed under the supervision of a notary who is an independent party in both France and Germany. Secondly, the process of sale is itself subject to court supervision, providing an opportunity for challenges to the validity of the enforcement to be raised.

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<sup>169</sup> ZPO, § 704.

<sup>170</sup> ZPO, § 794 I (5).

<sup>171</sup> *Runder Tisch-Grundpfandrecht* (n 73), Frage IV.1.

<sup>172</sup> ZPO, §§ 15 and 146.

<sup>173</sup> ZPO, § 16.

<sup>174</sup> *Brits Real Security Law* (n 2) 64.

<sup>175</sup> Uniform Rules of Court 2009 (HCR) 45(1) and Rules Regulating the Conduct of the Proceedings of the Magistrates' Courts of South Africa 2010 (MCR) 36(1) and (7).



**(3) Is some notification to the debtor (and anyone else) necessary in order to exercise the prerogatives?**

*(a) Scotland*

4.55 In light of *RBS v Wilson* it is clear that a creditor who is seeking to exercise the security in order to obtain satisfaction of the secured obligation must proceed by way of a calling-up notice. Thus, notification to the debtor is required prior to any enforcement steps, including sale. This notification must state the amount due and give the debtor two months to satisfy the secured claim.<sup>176</sup>

4.56 Where the property is residential, further notifications are required. These are discussed below.

*(b) England*

4.57 As noted above, subject to the terms of the mortgage, the creditor is entitled to take possession straight away, so there is clearly no need for any notification in order to take possession, but such a power is frequently restricted.

4.58 Foreclosure is an act of the court, and as such requires initially service of the summons on the debtor. Further, the initial order granted by the court is an order nisi, setting a date by which the debtor must either redeem the mortgage or see it foreclosed.<sup>177</sup> Thus, the summons is a close functional parallel of a notice demanding payment.

4.59 Separately, the statutory power of sale only becomes exercisable after either failure to comply with a calling-up notice for two months, interest being in arrears for two months or breach of a non-monetary term of the mortgage.<sup>178</sup> There is a degree of parallel here with the post-*RBS* position in Scotland. The major difference, however is that there is no specific requirement to serve a demand in the case of interest in arrears.

*(c) New Zealand*

4.60 Section 119 of the Property Law Act 2007 subjects both the creditor's key prerogatives (taking possession, appointing a receiver and selling the land) and any acceleration clause to a statutory notice period. The form of the notice is specified in section 120(1) and it closely mirrors the notice requirements seen in Scotland. One striking difference is that, subject to a minimum notice period of 20 working days, the creditor is free to set the length of the notice period:

The notice required by section 119 must be in the prescribed form and must adequately inform the current mortgagor of—

- (a) the nature and extent of the default; and
- (b) the action required to remedy the default (if it can be remedied); and

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<sup>176</sup> 1970 Act, Sch 6 Form A.

<sup>177</sup> Harpum et al, *Megarry & Wade* (n 21), para 25-010.

<sup>178</sup> 1925 Act, s 103.

(c) the period within which the current mortgagor must remedy the default or cause it to be remedied, being not shorter than 20 working days after the date of service of the notice, or any longer period for the remedying of the default specified by any term that is expressed or implied in any instrument; and

(d) the consequence that if, at the expiry of the period specified under paragraph (c), the default has not been, or cannot be, remedied,—

(i) the amounts secured by the mortgage and specified in the notice will become payable; or

(ii) the amounts secured by the mortgage and specified in the notice may be called up as becoming payable; or

(iii) the powers of the mortgagee or receiver specified in the notice will become exercisable; or

(iv) more than 1 of those things will occur.

4.61 New Zealand thus, has a clearly set out and widely applicable notice requirement. It ought to be borne in mind, however, that in the case of mortgage debentures,<sup>179</sup> receivers may be appointed and acceleration clauses may take effect without this notice.<sup>180</sup> Further, the court can grant leave to enter possession without any notice having been served or prior to the expiry of the period and the statute leaves wide discretion on this matter.<sup>181</sup> However, this discretionary power does not extend to the prerogatives which can lead to permanent loss of the property: creditor acquisition and sale.

#### (d) France

4.62 The general default rule in France is that an obligation becomes exigible on demand being made to the debtor. However, it is possible for the parties to provide to the contrary in the contract as in a term loan.<sup>182</sup>

4.63 Furthermore, where sale is by means of *saisie immobilière*, the first stage is *saisie*, which is done by service on the debtor (or third-party owner).<sup>183</sup> Detailed provision on the content of the notice is found in the regulatory part of the *Code des procédures civiles d'exécution*. *Inter alia*, this requires an indication of the basis of the claim, the amount due, a charge to pay and a prohibition on dealing with the property.<sup>184</sup> The notice is also published on the land register.<sup>185</sup>

4.64 The position is a little different where a *fiducie-sûreté* is involved. On its face, article 2488-3 of the *Code civil* provides that, where the creditor is the *fiduciaire*, she acquires ownership when there is default in payment. This suggests that no further notification (or

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<sup>179</sup> I.e. “an instrument creating a charge on property of a body corporate that comprises all, or substantially all, of the assets of the body corporate”: Property Law Act 2007, s 4.

<sup>180</sup> Property Law Act 2007, s 125(1).

<sup>181</sup> Property Law Act 2007, s 126.

<sup>182</sup> *Code civil*, art 1134.

<sup>183</sup> *Code des procédures civiles d'exécution*, art L321-1 alinéa 1.

<sup>184</sup> Art R321-3. For the less extensive provisions on notice to a third party detentor, see arts R321-4–5.

<sup>185</sup> *Code des procédures civiles d'exécution*, art R321-6.

indeed action) is needed in such cases. However, even in such cases, an initial demand will be necessary to put the debtor in default unless there is agreement to the contrary. Where the *fiduciaire* is a third party, the creditor has the option of either sale or acquisition of the collateral.<sup>186</sup> This requires an election by the creditor and thus notice to the *fiduciaire*.

(e) *Germany*

4.65 In Germany, enforcement is by means of judicial execution and no process of judicial execution can commence until the relevant decree or document has been served on the debtor.<sup>187</sup> Further, the *Zwangsvorsetzung* or *Zwangsvverwaltung* must be ordered by a court.<sup>188</sup> The following parties are entitled to participate in the action:

- those with a registered right in the property;
- those who can demonstrate a competing right to execution against the property, a right in the property (or in a right which burdens the property)<sup>189</sup>, a claim (including under a lease) to possession of the property and have registered with the court.<sup>190</sup>

4.66 Service is made by the court rather than the creditor.<sup>191</sup> In principle, it should be made on all parties to the action.<sup>192</sup> However, those mentioned at the second bullet point might only emerge once the action has been commenced so service cannot be made on them prior to commencement.

4.67 When the court orders enforcement, this must be registered in the land register<sup>193</sup> and served on the debtor.<sup>194</sup> The date of the sale (by default, an auction) is appointed by the court.<sup>195</sup> Unless there are particular grounds to decide otherwise, the court should fix a date no more than six months away.<sup>196</sup> The parties to the execution proceedings mentioned above must be notified of this.<sup>197</sup>

(f) *South Africa*

4.68 As noted above, enforcement of a mortgage in South Africa takes place by judicial sale which is based on a writ of execution, regarding which the debtor must be called as a defender. The next stage is attachment by the sheriff.<sup>198</sup> Attachment is effected by service of a notice on the owner, the registrar of deeds or other registration authority, on any non-owner who occupies the property, on anyone with a prior-ranking registered right and on the local authority.<sup>199</sup> The form of the notice is set out in the High Court Rules and sets out the

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<sup>186</sup> *Code des procédures civiles d'exécution*, art L321-1 alinéa 2.

<sup>187</sup> ZPO, § 750.

<sup>188</sup> ZVG, § 15. The rules are drafted with reference to the *Zwangsvorsetzung* but applied *mutatis mutandis* to the *Zwangsvverwaltung* by § 146 ZVG.

<sup>189</sup> In limited circumstances, off-register transfer is possible in Germany. For instance, on the conclusion of a *Zwangsvorsetzung*: § 90 ZVG.

<sup>190</sup> ZVG, § 9.

<sup>191</sup> ZVG, § 3.

<sup>192</sup> ZVG, §§ 3–8.

<sup>193</sup> ZVG, § 19 I.

<sup>194</sup> ZVG, § 22 I.

<sup>195</sup> ZVG, § 36 I.

<sup>196</sup> ZVG, § 36 II.

<sup>197</sup> ZVG, § 41.

<sup>198</sup> In South Africa, the sheriff is the equivalent of a sheriff officer or messenger at arms in Scotland.

<sup>199</sup> HCR 46(3); MCR 43(2)(a).

basis of the claim, the amount due and the sheriff's authority to realise the sum.<sup>200</sup> The sheriff must fix a date for the sale which should be at least one month after service of the notice of attachment and inform all other sheriffs in the district.<sup>201</sup> The creditor has a duty to publicise the sale in a newspaper in the Government Gazette.<sup>202</sup>

*(g) Comparative conclusions*

4.69 There is a variety in the systems considered regarding both the degree of specification of the information in the notice and to whom it must be given. To some extent, the differences seem to arise from the underlying difference between (a) court-directed process, which tend to follow the general approach of civil procedure to enforcement processes and (b) regimes of direct sale, which have their own rules. The end point, however, is generally the same : a recognition that a number of parties have an interest in being made aware of the enforcement process and in participation in it.

4.70 It is also worth bearing in mind that a final opportunity for the debtor to pay either through the requirement of a hearing for authorisation and organisation of the sale, or through a requirement of a formal demand to establish default or both (as in France), is common.

**(4) Is sale carried out privately or done by a public official?**

*(a) Scotland*

4.71 The rules on the conduct of the sale in Scotland are found in section 25 of the 1970 Act. They are not extensive. The creditor is entitled to sell either by private bargain or by exposure to sale (i.e. auction). Curiously, there is no direct provision for how the transfer pursuant to the sale is to be effected. However, section 26(1) clearly presupposes a disposition granted by the creditor:

Where a creditor in a standard security has effected a sale of the security subjects, or any part thereof, and grants to the purchaser or his nominee a disposition of the subjects sold thereby, which bears to be in implement of the sale, then, on that disposition being duly [ registered or ] recorded, those subjects shall be disburdened of the standard security and of all other heritable securities and diligences ranking *pari passu* with, or postponed to that security.

4.72 This implies that the creditor has the power to dispense the property subject to the security.

*(b) England*

4.73 The statutory power of sale allows the creditor to choose between either private sale or public auction.<sup>203</sup> There is no provision for the intervention of the court or a public official in the sale. Section 104 of the Law of Property Act 1925 enables the creditor exercising the power to convey the property free of all rights ranking behind the mortgage. It also protects

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<sup>200</sup> HCR 46(2), First Sch, Form 20.

<sup>201</sup> HCR 46(7)(a); MCR 43(6)(a).

<sup>202</sup> HCR 46(7)(c); MCR 43(6)(c).

<sup>203</sup> 1925 Act, s 101(1)(i).

purchasers from impeachment of their title on the basis that the creditor was not entitled to sell or on the basis of procedural irregularities in the enforcement process.

(c) *New Zealand*

4.74 The Property Law Act 2007 regulates rather than confers the creditor's power of sale. It does, however, regulate it quite closely and clearly presupposes sale by the creditor rather than by a public official. Thus, section 176 imposes on the mortgagee exercising the power of sale "a duty of reasonable care to the following persons to obtain the best price reasonably obtainable" and section 179 entitles the mortgagee to step into a contract of sale entered into by the debtor. The creditor has a power to convey the land free of interests which do not have priority over the mortgage in question.<sup>204</sup>

(d) *France*

4.75 Although sale in exercise of a *hypothèque* is by means of *saisie immobilière* and therefore under the supervision of the court, it is open to the parties to agree a *vente amiable* under the court's supervision.<sup>205</sup> The *Code des procédures civiles d'exécution* equates this with a voluntary sale<sup>206</sup> and the sale itself is effected by the debtor.<sup>207</sup> However, a minimum price is fixed by the judge<sup>208</sup> and the creditor is entitled to bring the debtor before the judge to have the forced sale procedure resumed.<sup>209</sup> At first sight, it might seem a little surprising that there is so much procedural apparatus surrounding a consensual solution but it should be borne in mind that there may be third party interests such as those of lower ranking creditors at stake. In this case, or in the absence of an agreement to pursue a *vente amiable*, sale is by public auction in the presence of the judge.<sup>210</sup> The court confers title on the successful bidder in the auction.<sup>211</sup>

4.76 In the case of *fiducie-sûreté*, any sale is by the *fiduciaire* and not subject to any procedural restrictions.<sup>212</sup>

(e) *Germany*

4.77 German law makes no provision for sale in exercise of the security other than by public auction, on the conduct of which there are very detailed rules.<sup>213</sup> However, this is an aspect of German law which has attracted some criticism. Consultees and members of the advisory group in the German Justice Ministry's recent review of the ZVG favoured the introduction of the option of private sale.<sup>214</sup> However, the research group's proposal did not extend to a simple right to sell privately. Rather, the seller would make a notorially executed offer to buy the property at a price set by an expert appraiser (i.e. a surveyor), to take effect at the end of an officially determined period. (The length of this period is not disclosed in the

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<sup>204</sup> Property Law Act 2007, s 183(4) and Land Transfer Act 2017, s 103.

<sup>205</sup> *Code des procédures civiles d'exécution*, art L322-1.

<sup>206</sup> *Code des procédures civiles d'exécution*, art L322-3.

<sup>207</sup> *Code des procédures civiles d'exécution*, art R322-22 alinéa 1.

<sup>208</sup> *Code des procédures civiles d'exécution*, art R322-21.

<sup>209</sup> *Code des procédures civiles d'exécution*, art R322-22 alinéa 2.

<sup>210</sup> *Code des procédures civiles d'exécution*, art L322-5.

<sup>211</sup> *Code des procédures civiles d'exécution*, art L322-10.

<sup>212</sup> *Code civil*, art 2488-3 alinéa 2.

<sup>213</sup> ZVG, §§ 66–94.

<sup>214</sup> Bundesministerium der Justiz und für Verbraucherschutz *Das ZVG auf dem Prüfstand: Teil I Rechtstatsachen – Kurzfassung* (2017) 12.

report.) During the period, the property is to be marketed and, if a better price is offered, sold. If not, the creditor will buy the property at the pre-determined price. This commitment was considered to provide some balance to compensate the debtor for there not being a public sale.

(f) *South Africa*

4.78 Sale in execution in South Africa is by public auction.<sup>215</sup> There is no explicit provision conferring on the sheriff a power to dispose the property but courts have held it to be implied by the requirement in the rules that the sheriff register the sale.<sup>216</sup> There is also case law which accepts that, while a so-called *parate executie* clause (which permits direct sale by the creditor) is invalid, a post-default agreement that the creditor sell the property on behalf of the debtor is permissible.<sup>217</sup>

4.79 This provides something of a work-round where that is desired. It is important to note, however, that even this is not equivalent to the creditor's right of private sale as it is known in Scotland. First, it depends on the co-operation of the debtor once he is in default. Secondly, the creditor is strictly speaking the debtor's agent in the sale (albeit) *in rem suam*. That has implications for lower-ranking creditors who would be cleaned out by a sale in execution but not by a sale by the debtor.

(g) *Comparative conclusions*

4.80 There is no consistent position in relation to the means of sale but the introduction of the *fiduciaire-sûreté* in France and moves towards something close to private sale in Germany suggest a desire in some quarters to move away from the inflexibility of the public auction.

**(5) How is adequate value ensured?**

(a) *Scotland*

4.81 The complete absence of supervision or oversight of the process of sale is striking. There are, however, established duties regarding the conduct of the sale, giving a basis for posterior creditors to seek redress should the sale not be conducted properly. In Scotland the creditor is obliged "to advertise the sale and to take all reasonable steps to ensure that the price at which all or any of the subjects are sold is the best that can be reasonably obtained." This redress takes the form of an action for damages rather than invalidating the sale.<sup>218</sup> Thus, the debtor or lower-ranking creditors require to demonstrate both that the creditor failed in her duties and that a loss has been caused by that failure.<sup>219</sup> In such circumstances, the "true" price can be established with the aid of expert witnesses providing a valuation.<sup>220</sup>

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<sup>215</sup> HCR 46(10); MCR 43(10).

<sup>216</sup> *Schoerie NO v Syfrets Bank Ltd and Others* 1997 1 SA 764 (D) 778 per van Reenen J.

<sup>217</sup> *Brits Real Security Law* (n 2) 64–5; *In re Cradock Building Society* (1896) 13 SC 99; *Isacor Housing Utility Co v Chief Registrar of Deeds* 1971 (1) SA 613 (T).

<sup>218</sup> *Imperial Hotel (Aberdeen) Ltd v Vaux Breweries Ltd* 1978 SC 86; *Dick v Clydesdale Bank plc* 1991 SC 365; *Gordaviran Ltd v Clydesdale Bank plc* 1994 SCLR 248.

<sup>219</sup> *Dick v Clydesdale Bank plc* 1991 SC 365; *Davidson v Clydesdale Bank plc* 2002 SLT 1088; *Peters v Belhaven Finance Ltd* 2016 SLT (Sh Ct) 156.

<sup>220</sup> *Wilson v Dunbar Bank plc* [2008] CSIH 27, 2008 SC 457 at para 6.

4.82 The extent of advertising is not specified and has not really been clarified by the case law beyond the suggestion that “something more than the bare minimum of advertising is required” and that the two general duties to take all reasonable steps and the duty to advertise are two aspects of the same central responsibility.<sup>221</sup> The duty to take all reasonable steps to secure the best price has been taken to refer to the best price at the time when the creditor decides to sell but this duty does not require the creditor to delay or bring forward a sale.<sup>222</sup>

4.83 Courts have been reluctant to take a more extensive supervisory role. In principle, interdict is available if it is clear that the creditor will sell in breach of her duties but the threshold for such intervention is high and there is no positive duty on the creditor to demonstrate compliance prior to sale.<sup>223</sup>

#### *(b) England*

4.84 As noted above, the statutory power of sale confers a wide statutory discretion on the creditor in the sale. There is no statutory provision imposing a duty to seek the best price or to advertise. However, extensive case law has established that Equity imposes on the creditor a duty to the debtor and to others with an interest in the equity of redemption to act in good faith and to seek to protect their interests insofar as this can be done without prejudicing her own interests.<sup>224</sup> This includes a duty to seek the best price available at the time of sale but no duty to incur expenses in making improvements.<sup>225</sup>

#### *(c) New Zealand*

4.85 Unlike in England, the creditor in New Zealand is under a statutory duty of reasonable care to “obtain the best price reasonably obtainable as at the time of sale”.<sup>226</sup> The duty is owed to the current mortgagor, any former mortgagor<sup>227</sup> and others with lower ranking rights in the property. There is no separate duty to advertise.

4.86 However, the Property Law Act 2007 also makes provision for public auction by the Registrar or under the direction of the court.<sup>228</sup> In the latter case, the court has wide discretion as to how the sale is to be conducted but the legislation does specify in some detail the matters on which the court must give direction.<sup>229</sup> The rules on the conduct of the public auction are fairly detailed. There is specific provision for advertisement, the general rule being the use of a local newspaper.<sup>230</sup> However, the Registrar of the High Court has authority to advertise in other newspapers if local advertisement “is unlikely to enable the vendor mortgagee to discharge the duty of care under section 176(1)”.<sup>231</sup> This is interesting,

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<sup>221</sup> *Peters v Belhaven Finance Ltd* 2016 SLT (Sh Ct) 156 at paras 42–50 per Sheriff Mohan. The quotation is from para 50.

<sup>222</sup> *Dick v Clydesdale Bank Plc* 1991 SC 365 at 371 per LP Hope.

<sup>223</sup> *Gordaviran Ltd v Clydesdale Bank Plc* 1994 SCLR 248; *Taylor v Hadrian's SARL* [2012] CSOH 59.

<sup>224</sup> The main cases are summarised in Harpum et al, *Megarry & Wade* (n 21), para 25-018.

<sup>225</sup> *Silven Properties Ltd v Royal Bank of Scotland Plc* [2003] EWCA Civ 1409, [2004] 1 WLR 997.

<sup>226</sup> Property Law Act 2007, s 176(1).

<sup>227</sup> Section 4 of the Property Law Act 2007 defines former mortgagor as “means a person who has ceased to be the owner of the property, but remains personally liable to the mortgagee for the payment of any amounts or the performance of any obligations secured by the mortgage.”

<sup>228</sup> Property Law Act 2007, ss 196–202.

<sup>229</sup> Property Law Act 2007, s 200.

<sup>230</sup> Property Law Act 2007, s 191(1).

<sup>231</sup> Property Law Act 2007, s 191(2).

because it illustrates that the duty to obtain the best price is not obviated by public auction.<sup>232</sup> The High Court also has jurisdiction to order other advertisement of the sale or marketing of the land on the application of an interested party.<sup>233</sup>

(d) *France*

4.87 As noted above, in the case of a *vente-amiable*, the price is set by the judge. In the case of sale by auction, the open competition is intended to secure the best price (as discussed above in relation to Germany). The *partie réglementaire* of the *Code des procédures civiles d'exécution* contains extensive rules on the publication and conduct of the auction.<sup>234</sup> A good general sense of the rules can be gained from the opening article of the section:

The forced sale is effected after advertisement aimed at informing the greatest possible number of bidders according to the conditions set out in the present section.<sup>235</sup>

4.88 There are general rules requiring a list of specified details to be published at a public place and in the equivalent of the legal gazette for the relevant area and for a shorter list of details to be published in a local or regional periodical.<sup>236</sup> These general rules on advertisement can be adjusted by the judge supervising the auction on the application of the creditor, debtor or another interested party.<sup>237</sup>

4.89 The creditor is entitled to fix the opening bid for the auction, at which price the creditor will acquire the property in the event of the auction failing. If the price set by the creditor is manifestly insufficient, the debtor can apply to court to have it amended but this only affects the opening bid at the auction, not the price which the creditor acquires the property if the auction fails.<sup>238</sup> There is a certain logic to this division: the debtor has a clear interest in avoiding the price being depressed by a low opening bid which might suggest that there was something wrong with the property but, if the reserve is not met, it is difficult to see why the debtor should be entitled to demand that the creditor pays over the market value.

4.90 Where there is a sale by a *fiduciaire-sûreté*, on the other hand, there are no procedural rules regarding the conduct of the sale. It is probable,<sup>239</sup> however, that an obligation to seek the best price arises from the general rule that “contracts must be negotiated, formed and executed in good faith”, given that the *fiducie* is created by contract.

(e) *Germany*

4.91 As in France, the primary means by which the proper value is ensured is by a public auction. Again, as in France, there are fairly detailed rules on what information must be

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<sup>232</sup> See Property Law Act 2007, s 176(1).

<sup>233</sup> Property Law Act 2007, s 191(3).

<sup>234</sup> Arts R322-30–R322-58.

<sup>235</sup> Art R322-20, my translation. The original text is: “La vente forcée est poursuivie après une publicité visant à permettre l'information du plus grand nombre d'enchérisseurs possible dans les conditions prévues à la présente section.”

<sup>236</sup> Arts R322-31–2.

<sup>237</sup> Arts 322-37–8.

<sup>238</sup> *Code des procédures civiles d'exécution*, art L322-6.

<sup>239</sup> *Code civil*, art 1104.



publicised and where it must be published.<sup>240</sup> One difference from France is that it is for the court to determine the proper means of publication, which may be either print or electronic.<sup>241</sup> In practice, publication is almost universally done online.<sup>242</sup>

4.92 In addition, the value of the property is determined by the court.<sup>243</sup> If the highest bid at the auction is not at least 70% of this value, any other creditor who would be left out of pocket were the property to be sold for that price can petition for the cancellation of the auction. However, this application will be denied if the creditor who is pursuing the sale can show that she would suffer a disproportionate harm as a result of such a cancellation.<sup>244</sup> Further, if the highest bid at auction is not at least half of the determined value, then the auction will be cancelled.<sup>245</sup>

4.93 The recent review expressed some dissatisfaction with the determination of the price by the courts, noting a wide variation in practice and suggesting more detailed rules on how such value was to be established.<sup>246</sup>

*(f) South Africa*

4.94 As in France and Germany, the public auction is intended to ensure the best price for the property and there are rules regarding advertisement of the auction. This must be published in the Government Gazette and in one local newspaper and details given of the property, the time and date of the auction and the conditions of the sale.<sup>247</sup> Often the price obtained is well below market value, although it should be borne in mind that the market conditions in South Africa are quite different from those in Scotland.<sup>248</sup>

*(g) Comparative conclusions*

4.95 There is a fairly clear division between the Common Law and Civilian approaches with regard to the role of a public auction. Where there is such an auction, regulation of its conduct and advertisement takes the place of a duty on the creditor to secure the best price. This approach, however, typically requires a public official to administer the sale. Such an approach is not unknown in Scotland. It is broadly that approach which is taken to the sale of corporeal moveables, which are subject to the diligence of attachment.<sup>249</sup> It is noteworthy, however, that both France and Germany show evidence of a move towards allowing more scope for private sale.

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<sup>240</sup> ZVG, §§ 37–9.

<sup>241</sup> ZVG, § 39 I.

<sup>242</sup> See the official portal <<https://www.zvg-portal.de/>>.

<sup>243</sup> ZVG, § 74a V.

<sup>244</sup> ZVG, § 74a I.

<sup>245</sup> ZVG, § 85a.

<sup>246</sup> *Das ZVG auf dem Prüfstand* (n 213) 11.

<sup>247</sup> HCR 46(7)(c); MCR 43(6)(c).

<sup>248</sup> Scott and Dirix “Calling up a mortgage bond” (n 2) at 592; L Steyn *Statutory Regulation of Forced Sale of the Home in South Africa* (LLD Thesis, Pretoria, 2012) 137.

<sup>249</sup> Debt Arrangement and Attachment (Scotland) Act 2002, ss 27–30.

## **(6) How is the value of the property established in cases of creditor acquisition?**

### *(a) Scotland*

4.96 As noted above, creditor-acquisition (somewhat imprecisely referred to as foreclosure) is only available for standard securities where an attempt has been made to sell the property but where efforts to sell would not suffice to meet the secured debt and any other secured debts ranking equally with or prior to it.<sup>250</sup> Even, where this is the case, the creditor requires court sanction to acquire the property, and it is open to the court to order re-exposure of the property instead. This suggests that the means for determining the value (and for ensuring adequate value) is the market.

4.97 Should this fail, there is no official valuation. Rather the value attributed to the property, is that at which it was last exposed to sale. Given that the property did not fetch such a price when marketed, it is unlikely to be worth such a sum. Therefore, there is a strong incentive against application for foreclosure.

### *(b) England*

4.98 In its initial form, foreclosure did not require valuation of the property or any legal process. Failure to pay simply resulted in final loss of the property. Now, however, a court order is needed. Strictly, there is no valuation process but the debtor and lower ranking creditors are entitled to apply for sale in lieu of foreclosure. They can be expected to do so in cases where the value of the property exceeds the debt due to the first-ranking creditor. Further, the court has wide jurisdiction to “open”, i.e. to reverse the foreclosure.<sup>251</sup> Among the potential grounds for this, however, is a wide disparity between the debt and the value of the property.<sup>252</sup> Thus, while there is no valuation, other processes restrict the possibility of a windfall to the creditor.

### *(c) New Zealand*

4.99 As was noted above, the right to foreclose was abolished in New Zealand. If the creditor wishes to acquire the property she must seek sale by public auction or under the direction of the court and then buy it. Thus, the normal marketing process determines the value of the property.<sup>253</sup>

### *(d) France*

4.100 Where the creditor acquires property subject to a *hypothèque*, it is open to the parties to fix the price, which failing, it is fixed by a judge. The creditor must consign the surplus value if there are lower ranking creditors and pay the sum to the debtor if there are not.<sup>254</sup> In the case of *fiducie-sûreté*, the value is to be fixed either by an agreed expert or judicially. The parties are barred from agreeing otherwise (which might be used by the creditor to force the debtor to agree to an artificially low valuation).<sup>255</sup> Again, surplus value must be paid over.<sup>256</sup>

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<sup>250</sup> 1970 Act, s 28(1).

<sup>251</sup> *Campbell v Holyland* (1877) 7 Ch D 166.

<sup>252</sup> (1877) 7 Ch D 166 at 173 per Jessel MR.

<sup>253</sup> Property Law Act 2007, s 176(2).

<sup>254</sup> *Code civil*, art 2460.

<sup>255</sup> *Code civil*, art 2488-3.

<sup>256</sup> *Code civil*, art 2488-4 alinéa 1.

*(e) Germany and South Africa*

4.101 In both systems, acquisition of the property is by participation in a public auction which establishes the price. As has been noted above, concerns have been expressed in South Africa as to the effectiveness of this as a means of ensuring adequate value. The problem was sufficient to motivate a rather adventurous judgment from Swain J in *ASBA Bank Ltd v Bisnath NO*.<sup>257</sup> In that case, the creditor had bought the property in execution for less than the outstanding debt and then sold the property on. Swain J held that the mortgage was not discharged by the judicial sale and that the proceeds of the subsequent sale should also be credited to the debtor.<sup>258</sup>

4.102 The decision has been robustly criticised and is almost certainly wrong. As Scott and Dirix point out, Swain J's view that there is something anomalous about a creditor in this case being able to acquire the property free of the security misunderstands the fact that execution discharges the security and, having concluded that the mortgage survives the execution, it is difficult to see what (other than payment of the debt) could ever kill it off.<sup>259</sup>

4.103 It is worth asking, however, why such a bizarre approach was taken and it is at least plausible that part of the motivation was the apparent injustice of a creditor acquiring the property very cheaply at auction and then selling on at a considerable profit.

*(f) Comparative conclusions*

4.104 Direct creditor acquisition is now comparatively unusual in the systems examined. With the exception of France, there is a clear desire to let the market fix the value of the property where possible. Given the German experience of valuation in another context, this might be considered wise.

**(7) Are there constraints on the use that may be made of the property?**

*(a) Scotland*

4.105 Under standard condition 10(3), default (including failure to comply with a calling-up notice) entitles the creditor in a standard security to enter into possession and to receive and recover rents. Having entered into possession, the creditor is entitled to let the subjects or grant rights of occupancy and carry out maintenance and management.<sup>260</sup>

4.106 Confusingly, the power to let the subjects is also found in section 20, sub-sections (3)–(4) of the Act. These provisions draw a distinction between (a) leases for seven years or less, where the creditor has an apparently untrammelled discretion to let the property and (b) those for over seven years, where court sanction is required. For the latter, the creditor must state the proposed tenant, duration and conditions of the lease for approval and notice must be served on the debtor and other heritable creditors.<sup>261</sup> The power to lease the property for up to seven years does seem extensive, particularly given that it is not matched by a best value rule equivalent to that applicable in the case of sale.

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<sup>257</sup> 2007 (2) SA 583 (D & CLD).

<sup>258</sup> 2007 (2) SA 583 (D & CLD) at 589–590.

<sup>259</sup> Scott and Dirix "Calling up a mortgage bond" (n 2) at 593.

<sup>260</sup> 1970 Act, Sch 3, paras 10(3)–(6).

<sup>261</sup> 1970 Act, s 20(3).

4.107 The specific mention of leasing might be taken to exclude other uses, such as the creditor's farming agricultural land herself, on the principle *expressio unius est exclusio alterius*. In most cases this is no bad thing: again, forcing the security holder to lease the property ensures a market transaction, which gives a more reliable indication of value than private use. In practice, most creditors are institutional lenders and therefore few would want to do anything else.

4.108 It might be possible to argue that the right to use the subjects is implied by either the right to possess the subjects or the right of management. The former argument seems flimsy, given that a pledgee clearly has possession but is not, in general, entitled to use the collateral. The latter also seems problematic since "management" suggests activity directed toward care for the subject rather than extraction of value from it, particularly when paired (as it is in subsection (5)) with maintenance and set alongside the right to undertake "any reconstruction, alteration or improvement reasonably required for the purpose of maintaining the market value of the subjects."

*(b) England*

4.109 As in Scotland, most rights to use the property flow from possession, either directly or by a receiver. Given that the creditor's title is possessory, once in possession the creditor is, in principle, entitled to do whatever anyone else with title to the property could do. Once in possession, however, the creditor is accountable for what ought to have been received had the property been managed properly, which constrains the use to be made of the property.<sup>262</sup> This general principle has been specified in a large number of fairly narrow individual rules or decisions on questions like when trees can be cut or mines can be opened and the extent to which improvements are permissible.<sup>263</sup> Overall, the picture is rather piecemeal but the general thread may be said to reflect the constraint that Equity places on the creditor to take due account of other interests when exercising her prerogatives.

4.110 The one aspect of use which requires particular attention is leasing. Even prior to enforcement the peculiar nature of the mortgages means that a particular approach must be taken to leasing mortgaged property. The debtor can lease the property but the creditor has a right to take possession, which can override the lease. Conversely, a lease granted by the creditor would be vulnerable to the creditor's interest being redeemed. In response to this, section 99 of the Law of Property Act 1925 confers on both the creditor and debtor in possession power to grant leases which bind the other. It goes on to specify the (generous) maximum length of such leases: fifty years for occupational or agricultural leases and 999 years for building leases and to specify certain crucial matters considering the terms. In particular, the lease must be for the "best rent that can reasonably be obtained" and provision for repossession within thirty days in the case of non-payment of rent.<sup>264</sup>

*(c) New Zealand*

4.111 As in England, the right to extract value is closely connected with entry into possession. There is relatively detailed statutory provision on the creditor's powers. There is an express power to lease and there is control of the terms as is the case in England.<sup>265</sup>

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<sup>262</sup> *Chaplin v Young* (1864) 33 Bev 330, 55 ER 395.

<sup>263</sup> For a general survey, see Harpum et al *Megarry & Wade* (n 21), para 25-027.

<sup>264</sup> 1925 Act, s 99(6)–(7).

<sup>265</sup> Property Law Act 2007, ss 142–145.

4.112 There is express provision requiring that the creditor “have reasonable regard for the interests of the current mortgagor, any former mortgagor, any covenantor, any mortgagee under a subsequent mortgage, and the holder of any other subsequent encumbrance”<sup>266</sup> when leasing and well as an obligation to “take reasonable care to obtain the best rent reasonably available at the time of entering into the lease.”<sup>267</sup> The former obligation is reflected by the equitable duty to take account of the interest of the debtor and other creditors in English law which is discussed above.

4.113 In addition to these, there are specific provisions on harvesting crops and timber<sup>268</sup> and taking steps to protect or repair the land.<sup>269</sup> When in possession, the creditor has potential liability analogous to that of tenant’s liability for voluntary waste to the debtor and lower ranking right holders.<sup>270</sup> There are relatively detailed rules on the application of income from the property and on the expenses which can reasonably be incurred.<sup>271</sup>

(d) *France*

4.114 The French rules for both the *hypothèque* and *fiducie-sûreté* are clearly directed to sale or acquisition of the property rather than to other means of extracting value. In the case of *fiducie-sûreté*, a great deal is left to the parties’ own discretion in the provision that they make in the *fiducie*. In the case of *hypothèque*, *saisie* restrains the debtor’s rights of enjoyment and administration<sup>272</sup> and includes *saisie* of the fruits of the land.<sup>273</sup>

(e) *Germany*

4.115 Extract of value other than by sale is effected by *Zwangsvverwaltung*, for which there are detailed rules in the ZVG.<sup>274</sup> Perhaps the most striking aspect of these is the rule that where a debtor lives on the property, he and the members of his household are entitled to continue to live on the property and to the use of such garden, agricultural or forestry land as is necessary for satisfaction of the needs of the debtor and his family.<sup>275</sup>

4.116 The *Zwangsvverwalter* is appointed by the court rather than by the creditor.<sup>276</sup> The ZVG takes very seriously the idea that the debtor may himself be appointed as the *Zwangsvverwalter*, in which case the court must also appoint a supervisor to hold the debtor-*Zwangsvverwalter* to account.<sup>277</sup>

4.117 Given that the *Zwangsvverwalter* is a court-appointed administrator, it is perhaps unsurprising that the role is directed quite precisely. The key provision is § 152 I:

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<sup>266</sup> Property Law Act 2007, s 143(1)(a).

<sup>267</sup> Property Law Act 2007, s 143(1)(b).

<sup>268</sup> Property Law Act 2007, s 149.

<sup>269</sup> Property Law Act 2007, s 150.

<sup>270</sup> Property Law Act 2007, s 151. Voluntary waste is a Common Law concept which essentially means acts which damage the property: Harpum et al, *Megarry & Wade* (n 21) para 3-094.

<sup>271</sup> Property Law Act 2007, s 152.

<sup>272</sup> *Code des procédures civiles d’exécution*, art L321-2 alinéa 1.

<sup>273</sup> *Code des procédures civiles d’exécution*, art L321-3.

<sup>274</sup> §§ 146–161.

<sup>275</sup> ZVG, § 149.

<sup>276</sup> ZVG, § 150.

<sup>277</sup> ZVG, § 150c–d.

The *Verwalter* has the right and duty, to undertake all activities which are necessary to maintain the economic state of the plot and to use it properly; he should assert the claims covered by the seizure and realise the value of those rights of use which are not necessary (to maintain the value of the property).<sup>278</sup>

Thus, the use of the property must be directed at the best reasonable means of using the property to pay off the debt, subject to the subsistence rights of the debtor and his family. Detailed provision is also made (along lines which would be expected) for the distribution of income from the property.<sup>279</sup>

(f) *South Africa*

4.118 As in France, the means of enforcement for South African mortgages are very clearly directed at sale, though it would be possible to provide for possession and use in the mortgage bond.<sup>280</sup>

(g) *Comparative conclusions*

4.119 Scotland finds itself aligned with the Common Law countries in permitting a high degree of flexibility in use by the creditor in possession. The right to enter possession is much less prominent in the Civilian systems and where it is permitted, as is the case with the *Zwangsverwalter*, it is closely regulated. Scots law appears to be the system which places the least constraint on the debtor since it lacks even the general Equitable principles which underlie the somewhat piecemeal pattern of rules on the topic which prevails in England. The closest equivalent principle in Scots law would be the rule on catholic and secondary creditors<sup>281</sup> but that does not really operate to protect the debtor.

**(8) What additional protections are there for residential property and/or consumer debtors?**

(a) *Scotland*

4.120 There are two levels of protection regarding residential and consumer property: those focussed on residential property and those in consumer credit legislation.

(i) *Legislation focussed on residential property*

4.121 The Mortgage Rights (Scotland) Act 2001 introduced significant protections for those in residential property, these were refined by the Home Owner and Debtor Protection

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<sup>278</sup> My translation. The original reads: "Der Verwalter hat das Recht und die Pflicht, alle Handlungen vorzunehmen, die erforderlich sind, um das Grundstück in seinem wirtschaftlichen Bestand zu erhalten und ordnungsmäßig zu benutzen; er hat die Ansprüche, auf welche sich die Beschlagnahme erstreckt, geltend zu machen und die für die Verwaltung entbehrlichen Nutzungen in Geld umzusetzen."

<sup>279</sup> ZVG, § 155.

<sup>280</sup> *Bisnath NO v ASBA Bank Ltd* [2008] ZASCA 23, 2008 (4) SA 92 (SCA) at paras 22–5 and *Brits Real Security Law* (n 2) 57.

<sup>281</sup> On which, see Gloag & Irvine *The Law of Rights in Security* (n 6) 58–59.

(Scotland) Act 2010 and by the Applications by Creditors (Pre-Action Requirements) (Scotland) Order 2010.<sup>282</sup>

4.122 The protections take two forms: requirements that notice be given to various parties and additional court supervision of the process of enforcement. Where the security is being called up, the calling-up notice, a notice must be served on the occupier (usually the same person as the debtor),<sup>283</sup> and given to the local authority.<sup>284</sup> The former notice urges the occupier to seek legal advice, in fairly general terms and summarises the rights of entitled residents (those with family law occupancy rights) and tenants.<sup>285</sup>

4.123 At that stage, the property will either be voluntarily surrendered, or the creditor will require a warrant under section 24 (assuming that the creditor wishes to exercise a prerogative which would put the debtor out of possession).<sup>286</sup>

### Voluntary Surrender

4.124 The former option is hedged about by the procedural protections: in addition to the property being unoccupied, the creditor requires written certification from a number of parties: the debtor, the owner of the property and those with family law occupancy rights.<sup>287</sup> Each (relevant) party must have done the following in writing as per section 23A(1)(b):

- (i) certified that that person does not occupy the security subjects and is not aware of the security subjects being occupied by any other person;
- (ii) consented to the exercise by the creditor of the creditor's rights on default; and
- (iii) certified that the consent is given freely and without coercion of any kind.

4.125 Thus, there is a degree of procedural protection to ensure that the property has indeed been voluntarily surrendered. It comes at the cost of a fair amount of paperwork. However, the absence of any public involvement in the sale means that the level of scrutiny is limited.<sup>288</sup>

4.126 The one quirk in this procedure is that, if there is someone other than those listed, in occupation, the property cannot be voluntarily surrendered, albeit that there is no provision for seeking their consent and that such a person would have no right to make an application to have the process under section 24 continued.<sup>289</sup> This is because sub-paragraph (i) requires certification that the person is not aware of occupation "by any other person". It is not limited to those from whom the certification must be sought. In such a case, where the

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<sup>282</sup> The residential nature of the property is determined by its use as a home and the protections do not extend to juridical persons, even where the property is being used for residential purposes: *Westfoot Investments Ltd v European Property Holdings (Inc)* 2015 SLT (Sh Ct) 201.

<sup>283</sup> 1970 Act, s 19A.

<sup>284</sup> 1970 Act, s 19B.

<sup>285</sup> 1970 Act, Sch 6, Form BB.

<sup>286</sup> 1970 Act, s 20(2A).

<sup>287</sup> 1970 Act, s 23A(2).

<sup>288</sup> The practice of the Keeper of the Registers of Scotland is to rely on the agent's answers regarding power of sale and other links in title: *Registers of Scotland 2012 Act Registration Manual, Securities Section Information, Power of Sale under Standard Securities* (<https://rosdev.atlassian.net/wiki/spaces/2ARM/overview>).

<sup>289</sup> See 1970 Act, s 24E.

person in occupation was amenable, the best course of action would be to persuade that person to vacate the premises prior to seeking the consents from the other parties.

#### Warrant to exercise the remedies

4.127 Where the property is not voluntarily surrendered, a warrant must be sought under section 24. It is worth bearing in mind that the terms of section 23A mean that this can be necessary even in cases where no ejection under section 5 of the Heritable Securities (Scotland) Act 1894 is necessary. A debtor who absconded or otherwise failed to engage would not require to be ejected but would not provide the written consents required for section 23A.

4.128 This process triggers the need for a further set of notification requirements. Before making the application, the creditor must comply with the “pre-action requirements” set out in section 24A.<sup>290</sup> These include information about the security, the amount due and the arrears and charges for later payment.<sup>291</sup> The creditor is also required to provide information about sources of money advice and assistance and encourage him to contact the local authority.<sup>292</sup>

4.129 Further, the creditor must “make reasonable efforts to agree with the debtor proposals in respect of future payments”<sup>293</sup> and must not make an application for a warrant: if the debtor is taking steps which are likely to result in—

(a) the payment to the creditor within a reasonable time of any arrears, or the whole amount, due to the creditor under the standard security; and

(b) fulfilment by the debtor within a reasonable time of any other obligation under the standard security in respect of which the debtor is in default.

4.130 On its face, this seems quite radical since, as noted above, the general rule under section 24(7) is that the debtor must clear the whole debt in order to escape default under the calling-up notice. The reference to arrears might be taken to suggest that a residential debtor could avoid enforcement by catching up on late payments rather than clearing the whole debt. However, there is a wrinkle. The vast majority of secured loans contain an acceleration clause which will have been triggered by the time the calling-up notice has been served. Thus, by the time the debtor is in default in terms of the calling-up notice, the whole debt is due and not paid and the arrears are therefore the whole unpaid portion of the debt.

4.131 It might be argued that this requirement secures compliance with article 28(1) of the Mortgage Credit Directive, which requires that “Member States shall adopt measures to encourage creditors to exercise reasonable forbearance before foreclosure proceedings are initiated.”<sup>294</sup> However, in the case of voluntary surrender, there is no requirement to

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<sup>290</sup> 1970 Act, s 24(1C).

<sup>291</sup> 1970 Act, s 24A(2)

<sup>292</sup> 1970 Act, s 24A(5)–(6).

<sup>293</sup> 1970 Act, s 24(3).

<sup>294</sup> Directive 2014/17/EU on credit agreements for consumers relating to residential immovable property. Foreclosure is not defined in the directive, but it appears to include sale. Recital 27 includes the following requirement: “At least where the price obtained for the immovable property affects the amount owed by the consumer, Member States should encourage creditors to take reasonable steps to obtain the best efforts price for the foreclosed immovable property in the context of market conditions.” This makes no sense if foreclosure does not include sale. The equivalent term in the



demonstrate reasonable efforts to negotiate payment. It might further be argued that the two-month notice period after calling-up is itself reasonable tolerance and that nothing further is needed.

4.132 The pre-action requirements are further refined by the Applications by Creditors (Pre-Action Requirements) (Scotland) Order 2010, which make further provision on the manner in which the requirements are to be discharged, making specific provision regarding the manner of provision, the timing of communications and providing a list of steps which are deemed “likely to result in payment within a reasonable time”.

4.133 On the face of the provision, having verified that the pre-action requirements have been complied with,<sup>295</sup> the court has broad discretion.<sup>296</sup> However, there are essentially two options: granting the warrant to sell or continuing the proceedings.

4.134 The entitled residents can enter the proceedings and thus make representations about how the discretion should be exercised.<sup>297</sup> The specific factors which require to be considered are set out above. The main purpose of these factors appears to be to prevent premature or vindictive resort to sale. In *Swift Advances plc v Martin*, the Inner House stressed that the legislation should not be interpreted as to require the creditor to accept less than full payment.<sup>298</sup>

4.135 The additional requirements in the Heritable Securities (Scotland) Act 1894 are substantially the same.<sup>299</sup> Warrant under section 24 of the 1970 Act and warrant for ejection under the 1894 Act can be sought in the same proceedings.<sup>300</sup>

#### (ii) Consumer credit legislation

4.136 Generally speaking, a debt and its associated securities are only covered by the Consumer Credit Act 1974 if it is a “regulated agreement”. Section 8(3) of the 1974 Act defines a regulated agreement as a consumer credit agreement which:

(a) is a regulated credit agreement for the purposes of Chapter 14A of Part 2 of the Regulated Activities Order; and

(b) [if entered into on or after 21st March 2016,] is not an agreement of the type described in Article 3(1)(b) of Directive 2014/17/EU of the European Parliament and of the Council of 4th February 2014 on credit agreements for consumers relating to residential immovable property.

Article 3(1)(b) of the Mortgage Credit Directive refers to:

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German text is *Zwangsvollstreckung* and in the French is *saisie*. Both refer to enforcement in general rather than to foreclosure in the narrow sense of the term.

<sup>295</sup> 1970 Act, s 24(5)(a).

<sup>296</sup> 1970 Act, s 24(5).

<sup>297</sup> 1970 Act, s 24B.

<sup>298</sup> [2015] CSIH 65, 2016 SCLR 385, paras 26–27.

<sup>299</sup> 1894 Act, ss 5A–5F. The Applications by Creditors (Pre-Action Requirement) (Scotland) Order 2010 applies to the requirements in the 1894 Act as well.

<sup>300</sup> E.g. *Promontoria (Henrico) Ltd v Firm of Portico Holdings (Scotland)* [2018] SC GRE 5; 2018 GWD 6-87.

credit agreements the purpose of which is to acquire or retain property rights in land or in an existing or projected building.

4.137 Thus, the typical standard security used to finance the purchase of a home appears to be excluded from the scope of the 1974 Act.

4.138 Furthermore, article 60C(2) of the Regulated Activities Order<sup>301</sup> excludes “regulated mortgage contracts” from the scope of regulated credit agreements. These, in turn, are defined in article 61(3) of the order as follows:

a contract is a “regulated mortgage contract” if, at the time it is entered into, the following conditions are met—

(i) the contract is one under which a person (“the lender”) provides credit to an individual or to trustees (“the borrower”);

(ii) the contract provides for the obligation of the borrower to repay to be secured by a mortgage on land in the EEA;

(iii) at least 40% of that land is used, or is intended to be used—

(aa) in the case of credit provided to an individual, as or in connection with a dwelling; or

(bb) in the case of credit provided to a trustee which is not an individual, as or in connection with a dwelling by an individual who is a beneficiary of the trust, or by a related person;

4.139 “Mortgage” is defined in article 61(5) as including “a charge and (in Scotland) a heritable security”.

4.140 There are some further, fairly narrow and technical exclusions in article 61A, which do not require attention at present. The key point, however, is that this definition means that most standard securities over residential property would be excluded.

4.141 Taken together, all this might be thought to lead to the conclusion that the Consumer Credit Act 1974 is not relevant to loans secured over residential property. However, section 126 of the 1974 Act prevents such a conclusion.

4.142 First, subsection (1) provides that “a land mortgage”<sup>302</sup> is only enforceable “on an order of the court” if it secures a regulated agreement, a regulated mortgage contract or a consumer credit agreement which would be a regulated agreement were it not for the exclusion concerning the purchase of land for non-residential purposes in article 60D of the Regulated Activities Order.

4.143 There is significant overlap with section 20(2A) of the 1970 Act, which requires either voluntary surrender or warrant from the court to exercise remedies over residential property after failure to comply with a calling-up notice. It is perhaps open to question, however, whether there is a conflict given that the 1970 Act countenances proceeding without a court

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<sup>301</sup> The Financial Services and Markets Act 2000 (Regulated Activities) Order 2001.

<sup>302</sup> “Land mortgage” is defined in s 189 as including “any security charged on land”.

order in the case of voluntary surrender while section 126(1) of the 1974 Act appears to make no such provision.

4.144 Secondly, subsection (2) of section 126 provides that regulated mortgage contracts which are prevented from being regulated agreements by article 60C(2) of the Regulated Activities Order are nonetheless subject to the rules on judicial control of the exercise of securities in Part 9 of the 1974 Act, as if they were regulated agreements. This extension of the rules does not, however, extend to finance the purchase of a home because that is excluded by section 8(3)(b) of the 1974 Act rather than by article 60C(2) of the Regulated Activities Order.

4.145 None of this is easy to understand, but the net result for consumer residential standard securities appears to be as follows:

- They all require a court order for enforcement because of section 126(1) of the 1974 Act;
- Consumer standard securities which do not secure loans for the purchase or retention of land are subject to the further controls in Part 9 of the 1974 Act.

4.146 An example of the second category might be a “remortgage” which funds renovations to the consumers’ house. The rationale for excluding securities which fund the purchase of property from the further controls is perhaps open to question. It might be argued that extra protections would discourage lending and thus prevent access to homeownership in such cases, while preventing remortgaging to fund other projects is less of a problem.

4.147 The next question is what controls Part 9 of the 1974 Act imposes. Essentially, they are two-fold: time orders and the imposition of conditions on orders for enforcement. Time orders are regulated by section 129, which allows the court to make provision that a debt be paid “by such instalments, payable at such times, as the court, having regard to the means of the debtor or hirer and any surety, considers reasonable” either in the course of proceedings where the order for enforcement is sought or on application from the debtor after notice has been given that enforcement will be sought. This power has significant scope to mitigate the impact of acceleration clauses on the creditor’s ability to recover.

4.148 The other constraint is the court’s power to suspend the effect of orders for enforcement or to make them conditional on some act by a party to the proceedings under section 135. The court’s discretion is broad: such conditions may be imposed if the court “considers it just to do so”. Thus a court could require a creditor to assist the debtor in accessing social housing support or money advice before an order would become effective.

*(b) England*

4.149 There are three primary sets of constraints on creditors looking to enforce mortgages against residential property in England: those in the Administration of Justice Act 1970, those in the Consumer Credit Act 1974 and those in the Pre-Action Protocol for Possession Claims based on Mortgage or Home Purchase Plan Arrears in Respect of Residential Property (discussed below).

4.150 The constraints imposed by the 1974 Act are the same as those discussed above in relation to Scotland.

4.151 Where a mortgage does not secure a regulated agreement in terms of the Consumer Credit Act 1974, the Administration of Justice Act 1970 applies.<sup>303</sup> Where a creditor seeks possession of a dwelling-house which is subject to a mortgage other than in an action of foreclosure, section 36(1) gives the court wide discretion to adjourn the proceedings or otherwise delay enforcement for such a period as the court thinks reasonable. The court can also subject the delay to conditions regarding payment by the debtor.<sup>304</sup> Thus, the court is effectively able to restructure the debtor's payment obligations within the context of enforcement.

4.152 The Pre-Action Protocol is one of a suite of such protocols approved by the Master of the Rolls and annexed to the Civil Procedure Rules.<sup>305</sup> As such, sanctions for non-compliance are limited, typically involving proceedings being stayed until compliance or modifying the award of costs or interest.<sup>306</sup>

4.153 The content of the protocol is very similar to the pre-action requirements applicable in Scotland, requiring information on help with finding alternative accommodation, payments made so far, arrears and the amount outstanding, contact with the local authority and reasonable efforts to negotiate repayment of the arrears.<sup>307</sup>

4.154 Paragraph 6.1 of the protocol forbids the lender from considering starting a claim for possession where the borrower can demonstrate one of various factors which indicate the likelihood of improved ability to pay in the foreseeable future.<sup>308</sup> Quite how a prohibition on thinking about starting a claim is to be policed is not clear.

4.155 Paragraph 6.2 requires the lender to consider postponing the claim if the debtor can demonstrate reasonable steps that have been or will be taken to market the property at an appropriate price.

*(c) New Zealand*

4.156 New Zealand appears to have no special rules regarding exercise of the creditor's prerogatives with respect to residential property or consumer mortgages. Consumer lending is regulated by the Credit Contracts and Consumer Finance Act 2003. It contains rules on repossession of goods which have been mortgaged in Part 3A but there is no equivalent provision for mortgages of land.

4.157 To some extent, however, the consumer borrowers are protected by another means. Under section 55(1) of the 2003 Act, a consumer borrower who:

is unable reasonably, because of illness, injury, loss of employment, the end of a relationship, or other reasonable cause, to meet the debtor's obligations under a consumer credit contract and who reasonably expects to be able to discharge the

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<sup>303</sup> Administration of Justice Act 1970, s 38A.

<sup>304</sup> Administration of Justice Act 1970, s 36(2).

<sup>305</sup> Practice Direction – Pre-Action Conduct and Protocols (11 February 2017).

<sup>306</sup> Practice Direction – Pre-Action Conduct and Protocols, paras 15–16.

<sup>307</sup> Pre-Action Protocol for Possession Claims based on Mortgage or Home Purchase Plan Arrears in Respect of Residential Property, para 5. On the last point, further detail is provided in para 7, which suggests various restructuring options which should be considered prior to seeking possession.

<sup>308</sup> Particular cases include having made a claim under a payment protection policy or for Universal Credit.

debtor's obligations if the terms of the contract were changed in a manner set out in section 56 may apply to the creditor to agree to that change.

4.158 Of course, it is always open to a debtor to seek to renegotiate the terms of his debt. The difference here is that, while application is to the creditor in the first instance, the final decision as to whether the proposal should take effect is with the court.<sup>309</sup>

4.159 The court's discretion is very wide but section 56 limits the changes which the debtor is allowed to ask for. Essentially, the permitted changes come down to extending the term, reducing the instalments which are due or postponing payments for a specified period.<sup>310</sup> Further, the changes must be the minimum necessary to render performance by the debtor feasible and must be fair and reasonable to both debtor and creditor.<sup>311</sup>

4.160 This approach is perhaps preferable to constraining enforcement directly because the real issue is the debt not the security and this goes to the root of the problem. Against that, it might be argued that the New Zealand system does not pay as much attention to the special significance of loss of the home that other systems recognise.

(d) *France*

4.161 French law has a chapter on *credit immobilier* in the *Code de la consommation* but it does not constrain enforcement. Neither is there any provision constraining *saisie-immobilier* or sale in pursuance of it with respect to residential property.

4.162 However, there is particular provision restricting the availability of *expulsion* (the equivalent of an action for ejection) in relation to a *lieu habité* (dwellingplace). Ejection is delayed for two months, unless the judge reduces this period.<sup>312</sup> Furthermore, the judge has jurisdiction to extend the period further in exceptional circumstances, such as those concerning the time of year and weather conditions.<sup>313</sup>

4.163 It ought to be remembered, however, that a *hypothèque* is enforced by means of the general rules on judicial execution. That itself means a greater degree of procedural notice than would be the case with direct enforcement of that kind that is allowed with respect to non-residential properties in Scotland or England.

4.164 Given the general light touch approach to legislation on the *fiducie-sûreté*, it is perhaps no surprise that there is no provision on this matter in respect of it.

(e) *Germany*

4.165 With the exception of the restriction on *Zwangsverwaltung* discussed above, the protective rules in German law are not focussed on residential property as such. There are, however, a number of particular rules which have application in this context.

4.166 § 756a of the *Zivilprozessordnung* allows the debtor to make application to the court which is supervising the execution to have it set aside "if the measures in question are *contra bonos mores* because of the very particular hardship to which they would give rise in

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<sup>309</sup> Credit Contracts and Consumer Finance Act 2003, s 58.

<sup>310</sup> Credit Contracts and Consumer Finance Act 2003, s 56(1).

<sup>311</sup> Credit Contracts and Consumer Finance Act 2003, s 56(2).

<sup>312</sup> *Code des procédures civiles d'exécution*, art L412-1.

<sup>313</sup> *Code des procédures civiles d'exécution*, art L412-2–4.

light of full consideration of the protection required by the creditor.”<sup>314</sup> On its face, this is a relatively broad provision but the focus of discussion around it in Germany has been on the very extreme cases, particularly where there is a risk of suicide.<sup>315</sup> The plausibility of someone who is a suicide risk making such an application is open to question.

4.167 There are some rules in the ZVG which focus on less extreme cases. § 30a allows the debtor to apply to the court to have the sale delayed for up to six months if there is a prospect of avoiding the sale by paying off the debt provided that such a delay “corresponds with the personal and economic circumstances of the debtor as well as with the nature of the debt and with general fairness.”<sup>316</sup>

4.168 This provision reflects some of the rules found in the pre-action requirements and protocol which seek to discourage enforcement in cases where there is a reasonable prospect of payment by other means. In contrast to the current position in Scotland and in England, however, it is up to the debtor to take the initiative.

(f) *South Africa*

4.169 There has been extensive consideration of the potential for restriction of sale of homes in South Africa.<sup>317</sup> Much of the argument has surrounded section 26(1) of the South Africa Constitution, which provides that “Everyone has the right to have access to adequate housing.” In *Jaftha v Schoeman & Others*,<sup>318</sup> the Constitutional Court prevented a sale in execution on the basis that it would be an unjustifiable infringement of the section 26(1) right. The decision in *Jaftha* was held applicable to mortgage execution in *Gundwana v Steko Development CC*.<sup>319</sup> Essentially, this line of case law requires consideration of the proportionality of the deprivation in light of the creditor’s interest. As the literature shows, it has not been interpreted expansively.

4.170 Alongside these common law challenges, secured loans to consumers are regulated by the National Credit Act 34 of 2005. That Act makes written notice of default, referral to an advisory body and an attempt to agree a solution a prerequisite of judicial enforcement.<sup>320</sup> Further enforcement is not permitted until the debtor has been in default for 20 business days and until 10 business days have passed after the service of the notice and it will not be entertained if another service (such as a debt counsellor) is trying to negotiate payment, if the parties have agreed on a payment plan or if the arrears have been brought up to date.<sup>321</sup>

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<sup>314</sup> My translation. The original reads: “wenn die Maßnahme unter voller Würdigung des Schutzbedürfnisses des Gläubigers wegen ganz besonderer Umstände eine Härte bedeutet, die mit den guten Sitten nicht vereinbar ist.”

<sup>315</sup> *Das ZVG auf dem Prüfstand* (n 214) 12.

<sup>316</sup> My translation. The original reads: “wenn die Einstellung nach den persönlichen und wirtschaftlichen Verhältnissen des Schuldners sowie nach der Art der Schuld der Billigkeit entspricht.”

<sup>317</sup> See Brits *Mortgage Foreclosure* (n 74); Steyn *Statutory Regulation of Forced Sale* (n 247); L Steyn “‘Safe as houses’? – Balancing a mortgagee’s security interest with a homeowner’s security of tenure” (2007) 11 *Law, Democracy & Development* 101; R Brits “Protection for Homes during Mortgage Enforcement: Human-Rights Approaches in South African and English Law” (2015) 132 *SALJ* 566 and R Brits *Real Security Law* (n 2) 68–100.

<sup>318</sup> 2005 (2) SA 140 (CC).

<sup>319</sup> [2011] ZACC 14, 2011 (3) SA 608 (CC), departing from the approach in *Standard Bank of South Africa Ltd v Saunderson* [2005] ZASCA 131, 2006 (2) SA 264 (SCA).

<sup>320</sup> Act 34 of 2005, s 129.

<sup>321</sup> Act 34 of 2005, s 130.

*(g) Comparative conclusions*

4.171 The range of protections, focussing on either the nature of the property or of the debtor is somewhat bewildering. It is difficult to discern much in the way of a meaningful pattern. The constitutional approach in South Africa is distinctive and dependent on an unusual constitutional provision, which is considerably more far-reaching than article 8 of the European Convention on Human Rights.

4.172 Aside from that, however, Scotland and England appear to have the most elaborate battery of particular rules in this area, which suggests that there might be some room for rationalisation, albeit that a large part of the complexity is due to the unfortunate and almost incomprehensible approach that has been taken to consumer credit legislation.

4.173 In contrast, the New Zealand approach has been to leave consumer protection to consumer credit legislation rather than restricting enforcement. This has the distinct advantage of making it considerably easier to work out what is going on.

## **E. GENERAL CONCLUSIONS**

5.01 In contrast to the position with regard to security over moveable property, there is no dominant model which sets the agenda for reform in this area. None of the systems examined can be said to provide a solution which could be borrowed wholesale and applied in the Scottish context.

5.02 The English, and to a lesser extent the New Zealand, approach depends to a large extent on the underlying Common Law of mortgage and associated rules in Equity. Reproducing these rules in statutory form would be a significant endeavour in and of itself. When the adjustments necessary to take account of the differences in underlying property law are taken into account, an attempt to model Scots law on these Common Law systems does not seem a promising model.

5.03 The continental European systems depend heavily on the mechanisms of judicial execution and on public auction. Enforcement by diligence is not likely to appeal in Scotland, at least until the law of diligence against land is reformed. This does, however, present an opportunity to deal with some unfinished business in the context of land attachment.

5.04 One of the more attractive features of the continental systems (and indeed of South African law) is the application of a single regime to enforcement mechanisms which would deprive a debtor of his home. Some thought might therefore usefully be given to a system which could be adapted for diligence.

5.05 With respect to sale by public auction, it is noteworthy that even in those systems where it is the rule, there appears to be some dissatisfaction with its operation. Thus, the present regime of private sale appears preferable though some thought might reasonably be given to procedural protections to ensure that best value is obtained rather than expecting an impecunious debtor to raise a challenge to the conduct of the enforcement.

5.06 The major change since 2000 is the requirement for judicial oversight of exercise against residential property. Here, Scots law is in line with the majority of comparator systems. The possibility of some delay or renegotiation where a consumer debtor has reasonable hopes of recovering the situation is also broadly in line with other jurisdictions.

5.07 The main problem with this aspect of Scots law is the complexity of the rules surrounding the commencement of exercise in the context of non-payment, particularly

where they require to interact with consumer credit legislation. No system (except perhaps New Zealand) can be said to have simple rules in this area and all have struggled to maintain a single set of generally applicable rules and the near impenetrability of consumer credit rules limits the scope for rationalisation.

5.08 This paper suggests that reform of the law concerning the exercise of heritable security will necessarily involve some original thinking based on policy decisions about the priorities and balance of interests which is thought appropriate here. In doing so, however, Scots law has the opportunity to develop a system which is world-leading because, on the evidence of the comparator systems considered, such a root-and-branch reform driven by a principled consideration of the policy aims of the system has not really been undertaken elsewhere. Rather, changes have been made in a rather piecemeal fashion, resulting in inconsistencies and lack of clarity in many cases.