



Scottish Law Commission
promoting law reform

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Report on Moveable Transactions Volume 2: Security over Moveable Property

report



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Chapter 16 Outline of the scheme

Introduction

16.1 This second volume of our Report on Moveable Transactions deals with reform of security over moveable property. In this chapter we provide an outline of the scheme which we recommend. In the Discussion Paper we did the same for the provisional scheme.¹ As for reform of the law of assignation of claims, there was considerable support in general for our proposals. We discuss this further below.² We do, however, highlight here the most important differences from the provisional scheme.

The scheme in practice

16.2 The scheme would enable secured lending to take place more easily and widely in Scotland. It would be possible for (a) security to be granted over corporeal moveable assets without having to deliver these to the creditor and (b) security to be granted over certain incorporeal moveable assets without having to transfer these to the creditor.

16.3 In Chapter 17 below we consider the current law in outline and the case for reform. As described in more detail in Chapter 18, the scheme amounts to a package of reforms to modernise the law of security over moveable property in Scotland so as to fulfil the needs of business today. Its underlying theme is that there should be more *options* available to those seeking to use their moveable assets for asset finance. Existing options such as possessory pledges and floating charges would be retained.

Targeted reform

16.4 As discussed also in Chapter 18, we have sought to learn lessons from previous attempts at reform which have failed. We have taken a targeted approach rather than recommending wholesale reform. The desire for commercial law to be broadly similar north and south of the Scotland/England border is accepted.³ Thus there would be no radical rewriting of the law along a UCC–9/PPSA type model given the current lack of support for this among many working in this area in Scotland. “Recharacterisation”, that is to say the compulsory conversion of quasi-security rights into actual security rights, would not be adopted. Nor would notice filing.

Statutory pledge: general

16.5 A new security right for moveable property would be introduced, called a “statutory pledge”. This would be a “true” (or “proper”) security: the grantee would acquire a subordinate right in security, with the provider of the security (normally the debtor) retaining

¹ Discussion Paper, Chapter 3.

² See Chapter 18 below.

³ On this subject more generally, see Lord Hodge, “Does Scotland need its own Commercial Law?” (2015) 19 EdinLR 299. Cf J Hardman, “Some Legal Determinants of External Finance in Scotland: A Response to Lord Hodge” (2017) 21 EdinLR 30.

title to the encumbered property. It would be the moveable property equivalent of the standard security over land.

16.6 The statutory pledge would be a “fixed” security. Thus the creditor’s involvement would be needed to release property from it, in contrast with the floating charge. In the most significant departure from the scheme outlined in the Discussion Paper, there would not be a “floating” version of the statutory pledge or what might be called a “floating lien”. Thus the statutory pledge would generally not be suitable for stock-in-trade where the provider of the security needs to be able to deal with the property freely. In that case the floating charge would continue to be used (assuming that the provider can grant a floating charge).

Statutory pledge: incorporeal moveable property

16.7 It would be competent to grant a statutory pledge over limited classes of incorporeal moveable property, namely financial instruments and intellectual property (IP). As a proper security right, various consequences would follow: (i) where the encumbered property generated an income stream (such as royalties from copyright), the stream would continue to be payable (unless and until default) to the provider of the security; (ii) the provider could grant more than one security right over the same asset, the security rights having priority according to the general law of ranking; and (iii) the provider could transfer the right to another party, subject always to the security right.

16.8 The limiting of the statutory pledge to financial instruments and IP is another important change from the scheme outlined in the Discussion Paper. There are several reasons for it: (a) these are the two types of incorporeal moveable property where the case for reform is most compelling; (b) permitting the statutory pledge over all incorporeal assets would have a more significant effect on unsecured creditors in an insolvency; (c) making statutory provision for fixed security over claims would be problematic without reform of insolvency law; and (d) the assignation in security would remain possible for all incorporeal assets so security can continue to be taken in that way. The statutory pledge could be granted over after-acquired financial instruments and IP, the security right not coming into existence until the provider acquired the property in question.

Statutory pledge: corporeal moveable property

16.9 It would also be competent to grant a statutory pledge over corporeal moveable property. This would be a non-possessory security. It would require registration. It could be granted over after-acquired property.

16.10 In certain cases buyers from the provider would take the property free of the statutory pledge. In particular we recommend that non-business acquirers of goods below a prescribed figure would be protected.

Asset types

16.11 Ships and aircraft would generally be excluded from the scope of the statutory pledge. But we think that the security right could be used for smaller vessels such as yachts which are not registered in the UK Ship Register. Apart from that, all corporeal moveable property, financial instruments and IP could be used as collateral in relation to the statutory pledge. This would of course be subject to issues of situation (*situs*) and to the general

proviso that the asset is one capable of being used as collateral. For example, non-transferable rights such as certain IP licences could not be used as collateral.

The attachment/perfection distinction

16.12 The attachment/perfection distinction to be found in UCC–9 and the PPSAs would not be adopted. Either a statutory pledge would be created and be effective against the world or it would not be. It could not be created as between the provider and the secured creditor, but not as regards third parties.

16.13 The statutory pledge would be a species of the genus “security” and thus would be subject to the general law of rights in security, both statutory and common law, except in so far as the legislation otherwise provided.

Ranking

16.14 The general principles of ranking would apply to the statutory pledge. A statutory pledge over a future asset could not take effect before the asset is actually acquired.

Ability to grant a statutory pledge

16.15 A statutory pledge could be granted by any person, not only companies.

Consumer protection

16.16 Private individuals not acting in the course of a business would be unable to grant a statutory pledge over after-acquired assets, unless they are granting the security to obtain the funds to purchase the asset.

16.17 They would also not be allowed to grant a statutory pledge over assets worth less than a prescribed figure. A court order would be necessary to enforce the security. There would also be protection for the relatively unusual situation where a statutory pledge is granted over someone’s residence, such as a house boat.

Enforcement

16.18 In the case where businesses have granted statutory pledges, enforcement would be extra-judicial, in the interests of speed and keeping costs down. (But of course in some cases where there was a dispute about fact or law, litigation might be unavoidable.) Enforcement would usually result in sale of the asset. There would be other methods of enforcement, namely leasing or licensing of the encumbered property and appropriation of it.

Register of Statutory Pledges

16.19 There would be a new Register of Statutory Pledges (“RSP”), which would be comparable, in broad terms, with the registers used under UCC–9 and the PPSAs. The main difference would be that the statutory pledge document would be registered. The RSP would be public and electronic, and so searchable online. Registration would take place online.

16.20 The RSP would be used for the creation of statutory pledges. Where a statutory pledge is acquired by registration in the RSP, registration would be a necessary condition of

acquisition, rather than merely giving publicity to a right that had already been acquired. This differs from the notice filing approach under UCC–9 and the PPSAs. Where registration was in relation to after-acquired property, the statutory pledge could not be created until the property was acquired, which would be later than the date of registration. For example, company X grants a security over its vehicles present and future to Y and there is registration on 1 June. On 1 July X acquires ten new motor vehicles. The statutory pledge would encumber those vehicles on 1 July.

16.21 The RSP would be administered by the Keeper of the Registers of Scotland in the Department of the Registers and on the same financial basis as most other registers. It would, in general, be automated and require minimum intervention by the Keeper and her staff. The costs of the register would be covered by fees for registration, for searches etc. Thus, as with the Register of Assignations, there should be no cost to the taxpayer.

16.22 Registration would be by the name of the provider of the statutory pledge (normally the debtor), with possible exceptions, for example for motor vehicles where registration could perhaps be both by provider name and by Vehicle Identification Number (VIN). The rules would be fairly demanding as to the identity of the provider. For companies, not only company name and registered office address would be required, but also company number, because whereas names and addresses can change, the company number stays the same. For natural persons we recommend that date of birth should be required as well as name and address.

16.23 Registration would have third-party effect. But there would be defined exceptions where a third party would be unaffected. For example, someone buys goods unaware of a statutory pledge, because the entry for the pledge in the RSP has an inaccuracy which is seriously misleading. The registration is thus invalid and the buyer would obtain an unencumbered title.

16.24 In contrast to the scheme proposed in the Discussion Paper, registrations would remain on the RSP indefinitely, but there would be power for the Scottish Ministers to prescribe a lapse period for the statutory pledge if the RSP were to become cluttered. Decluttering would make the RSP easier to use.

16.25 It would be possible for misleading entries in the RSP to be corrected. The Keeper would have the power to remove those entries which had a manifest inaccuracy such as where there has been a frivolous or vexatious registration. Where an entry for a statutory pledge was redundant because the debt had been repaid, the provider of the security (normally the debtor) could demand that the secured creditor deletes the entry.

16.26 Registration would not be required for security in respect of financial instruments because of the Financial Collateral Arrangements (No. 2) Regulations 2003.⁴

Codification of the law of rights in security over moveable property

16.27 No attempt would be made to codify the law of rights in security over moveable property. But the possibility of future codification would remain.

⁴ SI 2003/3226.

Treatment in insolvency

16.28 The statutory pledge would be a new type of “right in security” and would be subject to the general rules about rights in security to be found in insolvency legislation.

Floating charges

16.29 It would remain competent for companies etc. to grant floating charges.

16.30 Floating charges would continue to apply to land.

Possessory pledge

16.31 The law of possessory pledge would be the subject of certain important reforms: (i) the rules about forfeited pledges contained in the Consumer Credit Act 1974 would be reformed to make them fairer to debtors; (ii) the rule in *Hamilton v Western Bank*⁵ would be overturned and pledge allowed by forms of delivery other than actual handing over to the pledgee;⁶ and (iii) the remedies available for enforcement of a pledge outwith the context of the Consumer Credit Act 1974 would be broadened and be the same as for the statutory pledge. In a change to the scheme set out in the Discussion Paper we do not recommend registration for trust receipt financing. The possibility of further reform to possessory pledge in the future and codification would not be excluded.

International private law

16.32 No changes would be made to international private law. Existing international private law would continue to determine when substantive Scottish law would or would not apply. It may be that some reform to international private law would be desirable but that would be for the future. This too would be a difference from the approach of UCC–9 and the PPSAs, which generally include in the statute provisions regulating the international private law of moveable security.

How near to UCC–9 and the PPSAs?

16.33 The scheme outlined here would draw to some extent on the UCC–9/PPSA approach. The RSP would be broadly similar in relation to the information held, searching and the consequences of errors. But there would also be significant differences. Here are some features of the scheme that would be different from the UCC–9/PPSA approach:

- (a) the absence of recharacterisation;
- (b) there would be transactional filing rather than notice filing and a copy of the security document would be registered;
- (c) there would be separate procedures for altering a register entry for juridical acts affecting the statutory pledge and for corrections of inaccuracies;
- (d) the survival of the floating charge;

⁵ (1865) 19 D 152.

⁶ On one view, Scots law has already implicitly abandoned the *Hamilton* rule. But this is by no means certain. See para 17.18 below.

- (e) the absence of a set of rules about international private law; and
- (f) the absence of a codification, or semi-codification, of secured transactions law in general.

Chapter 17 The current law and the case for reform

Introduction

17.1 In the Discussion Paper we outlined the current law in relation to security over corporeal moveable property, security over incorporeal moveable property and floating charges.¹ While it is unnecessary to restate that here, we do consider it essential to give a brief summary of these areas and the shortcomings of the present law which justify reform.

Security over incorporeal moveable property

(a) *The current law*

17.2 Security over property in Scotland can be classified as either “true” or “functional”.² A “true” security right, also known as a “proper” security right, is where the provider of the security, normally the debtor, retains ownership of the property but grants the creditor what is known in property law as a “subordinate real right”. A “real right” is a right in a particular piece of property. This is often explained as a right which is good against the world. Ownership is the principal real right. The other subordinate real rights include leases of land and servitudes (such as private rights of way) over land.³

17.3 Being a real right, a true right in security is effective against the provider’s successors and in insolvency. For example, Stanley borrows £100 from a pawnbroker and in return pawns his watch. The pawnbroker obtains a real right in the watch, although Stanley remains owner. The effect of the real right is that if Stanley sold the watch to Triin, the pawnbroker’s real right would remain and he could still enforce his security by selling the watch. Similarly, if Stanley became insolvent the watch could be sold and the £100 recovered in that way. Without the security over the watch, the pawnbroker would be left as an unsecured creditor with only his contractual claim against Stanley and be unlikely to recover the debt because of the insolvency.

17.4 In contrast, a “functional security” is where there is no subordinate real right in the property, but ownership is used for security purposes. For example, Glyn is selling a car to Hilda. In the contract of sale he stipulates that ownership is not to transfer until Hilda pays the total price, which they agree that she will pay in three instalments. Meanwhile she gets immediate possession of the car. In this situation, the retention of title clause is effectively acting as a security. And there is only one real right: the right of Glyn as owner. Hilda has no real right (until she pays the final instalment). This means that Glyn is protected if Hilda becomes insolvent as the car remains his.

¹ Discussion Paper, Chapters 4, 6, 7 and 8. In addition, in Chapter 5 of the Discussion Paper we considered the nature of security rights.

² See eg Gretton and Steven, *Property, Trusts and Succession* paras 21.11–21.15.

³ See generally Reid, *Property* paras 3–5 and Gretton and Steven, *Property, Trusts and Succession* ch 2.

17.5 Cars (and indeed watches) of course are *corporeal* moveable property. Our concern here is *incorporeal* moveable property. Under the current law a true security is apparently *not* possible. The exception is the floating charge, but its exact nature is unclear and probably does not become a subordinate real right until enforcement.⁴ Therefore, aside from the floating charge, security can only be obtained over incorporeal moveable property by *transferring* it to the creditor. This is usually done by means of an assignation in security, and being a form of assignation, the general law of assignation applies.

17.6 Most incorporeal moveable property consists of claims. As discussed earlier in this Report,⁵ a claim is the right of one person against another person to have an obligation performed. Typically the obligation is to pay money. For a claim to be assigned in security, the general rules of the law of assignation apply. This means that under the current law there must be intimation to the debtor. The recommendations which we made earlier in relation to assignation would allow registration to be used instead.⁶

17.7 Two types of incorporeal moveable property deserve particular mention in the context of security and the recommendations to be made later.⁷ The first is intellectual property. Assignation usually involves three parties. Thus in the transfer of a monetary claim, there are the original creditor, the new creditor, and the debtor. Intellectual property is incorporeal moveable property, but its assignation involves two parties only, not three: only an assignor and an assignee (But there may be implications for third parties, as where a copyright has been licensed by X to Y, and thereafter X assigns the copyright itself to Z.)

17.8 Despite this difference, assignation remains the only way in Scotland to use intellectual property for security purposes (apart from the floating charge). For example, if Paul holds copyright in a book and wishes to use that copyright as collateral for a loan from Ruth, that can be done, but only by way of an assignation in security, so that the copyright is transferred to Ruth, subject to Paul's personal right against Ruth for a re-transfer if and when the loan is repaid. A real-life example involves Rangers Football Club, which in April 2015, was reported to have granted security over its trade marks by means of assignation.⁸

17.9 Intellectual property is regulated by UK legislation. Registered intellectual property such as patents are registered in UK registers. This raises the issue of the circumstances in which Scottish or English law applies in relation to creating security. As discussed below in Chapter 39, in general terms the law that governs a security right is the law of the place where the property in question is situated: the *lex situs* (the *lex rei sitae*). The predominant view seems to be that the law applicable to security over intellectual property depends on the *situs* of the property and that the *situs* of intellectual property, as between England and Scotland, is determined by the domicile of the holder of the property.⁹

⁴ *National Commercial Bank of Scotland Ltd v Liquidators of Telford Grier Mackay & Co Ltd* 1969 SC 181 at 184. For a full discussion see A D J MacPherson, *The Attachment of the Floating Charge in Scots Law* (PhD Thesis, University of Edinburgh, 2017) especially chapters 2 and 5. English law also finds the nature of the pre-crystallised floating charge problematic: see for instance S Worthington, "Floating Charges: The Use and Abuse of Doctrinal Analysis" in J Getzler and J Payne (eds), *Company Charges: Spectrum and Beyond* (2006).

⁵ See paras 4.12–4.16 above.

⁶ See Chapter 5 above.

⁷ See Chapter 22 below.

⁸ See <http://www.bbc.co.uk/sport/0/football/32280000>.

⁹ "An English patent is a species of English property of the nature of a chose in action and peculiar in character" says Lord Evershed in *British Nylon Spinners Ltd v Imperial Chemical Industries Ltd* [1953] Ch 19 at 26. This

17.10 The Registered Designs Act 1949, the Patents Act 1977 and the Trade Marks Act 1994 have provisions on the registration of security rights over the intellectual property which they govern.¹⁰ As we noted in the Discussion Paper,¹¹ these provisions are not entirely clear and we say more about them below, in Chapter 22.

17.11 The second type of incorporeal moveable property which deserves particular mention is financial instruments, such as company shares and bonds. Security here is achieved by the provider transferring the property to the creditor. In the case of shares and bonds the creditor then requires to be registered by the company as holder.¹² The transferee's right is constituted by registration,¹³ so that a mere agreement is insufficient. Thus in Scottish law no equivalent to the English fixed equitable charge is available.¹⁴

(b) *The case for reform*

17.12 The absence of a true right in security over incorporeal moveable property is a very unsatisfactory feature of Scottish moveable transactions law.¹⁵ It means that security can only be achieved by transfer. The nature of a transfer is that it can only be done once. If Brian assigns in security to Carol his patent for an invention, Brian cannot (other than fraudulently) assign the patent again to Edward. Multiple security rights are not possible. Following the assignation to Carol, all Brian could offer as security is his contingent right against Carol to a re-assignation of the patent, which is cumbersome to achieve.

17.13 A further problem with transfer is the risk to the provider if the creditor becomes insolvent. Thus if Michalina transfers financial instruments such as shares in a company in security to Anne and Anne is sequestrated, what is Michalina's position? Can Anne's trustee in sequestration simply sell the instruments? It may be that he cannot because the law would imply a trust in favour of Michalina,¹⁶ but the position is by no means certain.

17.14 Moreover, debtors may not wish to sign over ownership of their shares. Although such a transfer will not usually mean that the transferee becomes a holding company of the share issuer, arrangements have to be made to make sure that, except if there is default on the secured debt, voting rights can be exercised by the transferor. Dividends and communications from the issuing company also have to be transmitted. There are also complications arising from the legislation which came into force on 1 April 2016 which requires companies and LLPs to have a Person of Significant Control (PSC) Register. These are discussed below.¹⁷ With intellectual property it is necessary to enter into cumbersome arrangements to enable the provider to be able to continue to deal with the property.¹⁸

seems the right approach. Likewise one could say that "a Scottish patent is a species of Scottish property of the nature of incorporeal moveable property and peculiar in character."

¹⁰ Registered Designs Act 1949 s 19; Patents Act 1977 s 33; and Trade Marks Act 1994 ss 24 and 25.

¹¹ Discussion Paper, paras 7.22–7.27.

¹² Except in the case of bearer shares or bearer bonds. But these are to disappear in terms of the Small Business, Enterprise and Employment Act 2015 s 84.

¹³ Cf *Morrison v Harrison* (1876) 3 R 406.

¹⁴ See *Farstad Supply A/S v Enviroco Ltd* [2011] UKSC 16 at para 4 per Lord Collins of Mapesbury.

¹⁵ Discussion Paper, paras 18.4–18.8.

¹⁶ Cf *Purnell v Shannon* (1894) 22 R 74.

¹⁷ See paras 22.26–22.27 below.

¹⁸ See eg A Orr and T Guthrie, "Fixed Security Rights Over Intellectual Property in Scotland" [1996] 18 European Intellectual Property Review 596.

17.15 The current state of the law can be seen to have serious consequences in practice. In an article published in 2017, Jonathan Hardman, an associate at Dickson Minto WS, recalls:

“an informal conversation with a London counterparty on a debt finance transaction in which the counterparty indicated that certain of his international bank clients were unwilling to allow their corporate borrowers a blanket permission to incorporate new Scottish subsidiaries on the grounds that taking fixed securities over their shares was too difficult – but that blanket permissions for the incorporation of English companies and Channel Island companies would pose no issue.”¹⁹

17.16 Ultimately the problems identified in this section follow from the fact that assignation in security gives the creditor *too much*. It is a title transfer, which is not actually what the parties want. Ingenuity must be used to try to undo some of the consequences of that transfer, but the results are never entirely satisfactory. Since assignation in security is merely a form of assignation, it also suffers from the general defects of the law of assignation.

Security over corporeal moveable property

(a) *The current law*

17.17 The principal express security right over corporeal moveable property in Scottish law is pledge.²⁰ Pledge is an ancient security, which is recognised in almost all legal systems.²¹ The provider (“pledger”) retains ownership of property and the secured creditor (“pledgee”) acquires a subordinate real right in it.

17.18 Pledge requires the delivery of the property from the pledger to the pledgee. In other words, the creditor requires to be placed in possession.²² The general law recognises various forms of delivery.²³ First, there is *actual* delivery, where the property is physically handed over or the pledgee is given physical control of the property.²⁴ Secondly, there is *constructive* delivery. The main example of this is where the property is held by a third party custodian, such as a warehouse. Delivery is effected by instructing the custodian to hold to the order of the creditor. Thirdly, there is *symbolical* delivery, which appears to be restricted to bills of lading in relation to goods being shipped. Possession of the goods can be transferred by handing over the bill of lading. Intimation to the shipping company is unnecessary. According to the case of *Hamilton v Western Bank*²⁵ pledge requires actual delivery to the pledgee. While the decision has been the subject of contrary subsequent authority²⁶ and trenchant academic criticism,²⁷ it has never been formally overruled.

¹⁹ J Hardman, “Some Legal Determinants of External Finance in Scotland: A Response to Lord Hodge” (2017) 21 EdinLR 30 at 31.

²⁰ As an express security, it contrasts with tacit securities, such as lien or the landlord’s hypothec, which arise by operation of law.

²¹ See Steven, *Pledge and Lien* paras 3-01–3-02.

²² See generally C Anderson, *Possession of Corporeal Moveables* (2015).

²³ See generally, Reid, *Property* paras 619–623 (W M Gordon) and Carey Miller with Irvine, *Corporeal Moveables* paras 8.12–8.27.

²⁴ For example, by being given the keys of a car.

²⁵ (1856) 19 D 152.

²⁶ *North Western Bank, Limited v John Poynter, Son & Macdonalds* (1894) 22 R (HL) 1, [1895] AC 56.

²⁷ A F Rodger, “Pledge of Bills of Lading in Scots Law” 1971 Juridical Review 193; G L Gretton, “Pledge, Bills of Lading, Trusts and Property Law” 1990 Juridical Review 23; and Steven, *Pledge and Lien* ch 8.

17.19 Where a private individual pledges assets to a professional pledge-taker, the transaction is known as “pawn” and the creditor as a “pawnbroker”. Pawnbroking is regulated by the Consumer Credit Act 1974.²⁸ The rules on enforcement of pledges (except for pawn where the 1974 Act governs matters) are found in the common law and are relatively restrictive. Thus in the absence of a contractual power of sale in the pledge contract, the pledgee requires to go to court.²⁹

17.20 The floating charge can cover corporeal moveable property, but can only be granted by certain corporate bodies. We discuss it below. There are also available aircraft mortgages³⁰ and ship mortgages, but these are clearly limited in scope to the types of assets with which they are synonymous.³¹

17.21 The restrictive nature of true security rights over corporeal moveables has resulted in considerable use of functional securities, where ownership of property functionally acts as a security. As we noted above, it is common for sellers of goods to retain ownership until the price, or indeed all sums³² owed to them by the buyer, is/are paid. If the buyer becomes insolvent the seller can retrieve the goods. Hire-purchase (HP) works in a similar way to retention of title, but often involves three parties: a supplier sells the goods to a financing company, which then enters into a HP contract with the customer. The relationship between the financing company and the customer is one of hire, but with a purchase option. But once again the key aspect is that there is protection for the creditor (the financing company) in the event of the insolvency of the debtor (the customer).

17.22 Another form of functional security is transfer to the creditor with retention of possession. The financed party can sell the goods to the financing party, retaining possession on the basis of another contract. For example, the other contract could be a finance lease, or operating lease, or HP. Or it could be a sale back, subject to retention of title. In all cases the financing party has, as a result of the original sale, ownership of the goods, and so is protected against the risk of insolvency.

17.23 But such arrangements are subject to a problem. Section 62(4) of the Sale of Goods Act 1979 provides that “the provisions of this Act about contracts of sale do not apply to a transaction in the form of a contract of sale which is intended to operate by way of mortgage, pledge, charge, or other security.” That means that, like other transfers to which the 1979 Act does not apply, such as donations, the common law applies, with the result that delivery is necessary for ownership to pass.³³ Much depends on how the expression “intended to operate by way of mortgage, pledge, charge, or other security” is interpreted. A sale at fair value, followed by a lease on ordinary commercial terms, would be unaffected by the provision. At the other extreme, the provision would strike at a sale at undervalue³⁴ coupled

²⁸ Consumer Credit Act 1974 ss 114–122.

²⁹ Steven, *Pledge and Lien* paras 8-04–8-10.

³⁰ As well as international interests in aircraft objects under the Cape Town Convention. See Chapter 21 below.

³¹ See Chapter 21 below.

³² *Armour v Thyssen Edelstahlwerke AG* 1990 SLT 891, [1991] 2 AC 339.

³³ The common law, following Roman law, requires delivery for the transfer of the ownership of corporeal moveable property. The common law continues to apply in so far as not ousted by statute. For a review of section 62(4) (and its predecessor, section 61 of the Sale of Goods Act 1893) and the relevant case law, see G L Gretton, “The Concept of Security” in D J Cusine (ed), *A Scots Conveyancing Miscellany: Essays in Honour of Professor J M Halliday* (1987) 135–138. See also Carey Miller with Irvine, *Corporeal Moveables* ch 11. Cf S Styles, “Debtor-to-Creditor Sales and the Sale of Goods Act” 1995 *Juridical Review* 365.

³⁴ The reason for the undervalue is that typically a lender will expect “collateral margin” ie that the value of the collateral should exceed the amount of the loan. That provides a margin of safety.

with a contract binding the seller to buy back. But there are cases in between where it is uncertain how the law would be applied. The 1979 Act does not define “security”.

17.24 As section 62(4) does not invalidate the transactions to which it refers, but merely disapplies the Act to them, leaving them to the common law, what sometimes happens is that the goods are delivered to the financing party and immediately re-delivered.³⁵ Whether arrangements such as these work is not certain. It might be argued that the delivery is too transient to be regarded as valid.

(b) *The case for reform*

17.25 The requirement for delivery in pledge makes it an unsatisfactory security right commercially. For it is impossible for a business to function if its creditor has possession of its corporeal moveable assets such as its office furniture, computers and vehicles.³⁶ This is something recognised now by many jurisdictions and has resulted in law reform to introduce non-possessory securities constituted by registration.³⁷ Even where the context is a consumer rather than a business one, pledge has its disadvantages. Art-secured lending is increasing in importance worldwide and non-possessory security, where owners “are still able to enjoy their Dan Flavin or Andy Warhol at home or in the gallery”,³⁸ is favoured. In Scotland the painting has to be handed to a pawnbroker.

17.26 While pledge can be a convenient security where goods such as whisky are stored in a warehouse, or goods being shipped are represented by a bill of lading, the decision in *Hamilton v Western Bank* casts an unwelcome shadow of doubt over such transactions. For example, it was reported in 2016 that a £20 million wine collection stored in a warehouse in Wiltshire was pledged by a businessman to obtain loan funding for a new venture.³⁹ *Hamilton* may deter such a transaction in Scotland. The relatively restrictive nature of our common law in relation to enforcement of pledges is also not suitable for the needs of modern commerce.

17.27 As has been seen, the limitations of pledge have resulted in the use of functional securities. But these too have their drawbacks. Transferring ownership of goods to a creditor while retaining possession may be ineffective because of section 62(4) of the Sale of Goods Act 1979. Hire-purchase is a relatively complex arrangement, typically involving three parties. In addition, it is only available for acquisition finance. It is no good for someone who already owns an asset such as a car and who wants to raise finance against it. In contrast in England and Wales, bills of sale can be used. Although that area of law has unsatisfactory features which have led to the Law Commission for England and Wales

³⁵ See the example given in the Discussion Paper, para 6.41.

³⁶ See eg Hamwijk, *Publicity in Secured Transactions Law* 2–3; A Morell and F Helsen, “The Interrelation of Transparency and Availability of Collateral: German and Belgian Laws of Non-possessory Security Interests” (2014) 22 *European Review of Private Law* 393 at 398; and Calnan, *Taking Security* para 2.04.

³⁷ See eg Hamwijk, *Publicity in Secured Transactions Law* 7–10 and Gullifer and Akseli (eds), *Secured Transactions Law Reform*.

³⁸ Deloitte Art and Finance Report (5th edn, 2017) p 163 available at <https://www2.deloitte.com/content/dam/Deloitte/lu/Documents/financial-services/artandfinance/lu-art-finance-report.pdf>.

³⁹ *The Times* 30 December 2016 (online edition).

recommending its replacement with a new Goods Mortgages Act,⁴⁰ once again this demonstrates a gap in Scottish law.

17.28 Under the current law there are situations in which creditors have no alternative if they wish security other than to hold title to goods such as vehicles. They then have to be liable for the administrative and legal consequences when all they actually wish is a true security right. The point made above in relation to security over incorporeal moveable property holds true here too. Functional security gives the creditor too much. The law requires to be reformed to enable true security.

Floating charges and agricultural charges

(a) The current law

17.29 Floating charges merit their own treatment, because these cover both corporeal and incorporeal property, and indeed both moveable property and land. Originally a product of English equity, they were introduced to Scotland by the Companies (Floating Charges) (Scotland) Act 1961. This implemented the Eighth Report of the Law Reform Committee for Scotland.⁴¹ The main reason for the introduction of the floating charge was the restrictive nature of the common law in relation to security over moveable property.

17.30 As has been mentioned, only certain entities can grant floating charges, in particular companies,⁴² limited liability partnerships⁴³ and, since 2015, building societies.⁴⁴ Usually floating charges are granted over all the entity's assets, but it is also possible to have a "limited asset" floating charge over a particular asset or categories of asset.⁴⁵

17.31 The way in which a floating charge works is that assets acquired by the entity automatically fall under the charge and assets disposed of are automatically freed from the charge. So long as the company stays in business, the charge continues to "float" in the manner described, and so long as the "floating" continues the effect of the charge is very limited. This contrasts in English law with a "fixed" charge which "sticks" to the property meaning that the company is not free to deal with it. But a floating charge can cease to float. When it ceases to float it "crystallises" or (synonymously) "attaches". The former term is used in England, and in practice in Scotland too, but the Scottish legislation uses only the latter term.

17.32 The legislation provides that when a floating charge "attaches" it takes effect as if it were a "fixed" security.⁴⁶ Thus for land it arguably becomes a deemed standard security, for a claim it becomes a notionally intimated assignation, and so on. Attachment can happen in

⁴⁰ See Law Commission, Bills of Sale (Law Com No 369, 2016). It was announced in the Queen's Speech that a Goods Mortgages Bill would be introduced as part of the UK Government's legislative programme. See <http://www.lawcom.gov.uk/project/bills-of-sale/>.

⁴¹ Cmnd 1017 (1960). See R B Jack, "The Coming of the Floating Charge to Scotland: an Account and an Assessment" in D J Cusine (ed), *A Scots Conveyancing Miscellany: Essays in Honour of Professor J M Halliday* (1987) 33.

⁴² Companies Act 1985 ss 462–464.

⁴³ Limited Liability Partnerships Regulations 2001 (SI 2001/1090) reg 4 and Sch 2.

⁴⁴ Financial Services (Banking Reform) Act 2013, Sch 9. See the Financial Services (Banking Reform) Act 2013 (Commencement (No. 8) and Consequential Provisions) Order 2015 (SI 2015/428).

⁴⁵ See eg H Patrick, "Receivership of Foreign Based Companies" 2010 SLT (News) 177.

⁴⁶ Companies Act 1985 s 463; Insolvency Act 1986 s 53(7); and (prospectively) Bankruptcy and Diligence etc. (Scotland) Act 2007 s 47. For a comprehensive analysis see A D J MacPherson, *The Attachment of the Floating Charge in Scots Law* (PhD Thesis, University of Edinburgh, 2017).

three ways: liquidation (winding up), administration and receivership.⁴⁷ However, as a result of the Enterprise Act 2002, floating charges granted after 5 September 2003 are generally not enforceable by receivership. But there are numerous exceptions,⁴⁸ so that the overall picture is highly complex.

17.33 Floating charges granted by companies must normally be registered in the Companies Register under the rules discussed in Chapter 36.

17.34 Finally, mention should be made of agricultural charges. These were introduced by the Agricultural Credits (Scotland) Act 1929, in the wake of similar legislation for England and Wales, namely the Agricultural Credits Act 1928. The 1929 Act enables agricultural co-operatives to grant a floating non-possessory security to a bank.⁴⁹ The effect is similar to a floating charge, though one important difference is that whereas a floating charge can cover property of every type, the agricultural charge is limited to “stocks of merchandise”.⁵⁰ Under the legislation as passed, agricultural charges had to be registered.⁵¹ This requirement was repealed by the Financial Services and Markets Act 2000 (Consequential Amendments and Repeals) Order 2001.⁵² Nowadays agricultural charges are rarely used in practice.

(b) *The case for reform*

17.35 While welcomed by financial institutions, floating charges have not fitted in very well with the general principles of Scottish law.⁵³ Floating charges are creatures of equity and our law does not have the law-and-equity divide recognised south of the border. The result has been many conceptual difficulties, culminating in the landmark House of Lords decision in *Sharp v Thomson*,⁵⁴ which threatened to undermine the very foundations of Scottish property law.⁵⁵ This led to extensive academic criticism.⁵⁶ In 2017 in the Inner House case of *MacMillan v T Leith Developments Ltd (in receivership and liquidation)*⁵⁷ Lord Drummond Young said:

“The introduction of the floating charge into Scots law, and subsequently the concept of receivership, have created significant practical problems. A large part of the difficulty has, I think, been an attempt to reproduce concepts of English equity in a system that has no similar institution. The conceptual structure of English equity is distinctive, being based, in its original form, on a series of general principles that can be adapted to produce justice in individual cases. It is difficult to translate the

⁴⁷ But it is less common in the case of administration. See D Cabrelli, “The curious case of the ‘unreal’ floating charge” 2005 SLT (News) 127.

⁴⁸ The 2002 Act did not disallow receivers, but only administrative receivers. For the definition of these see the Insolvency Act 1986 s 251. For the numerous exceptions see s 72B ff of that Act. The resulting situation is a mess.

⁴⁹ 1929 Act s 5. For the definition of “bank” for this purpose, see the Financial Services and Markets Act 2000 (Consequential Amendments and Repeals) Order 2001 (SI 2001/3649) art 217.

⁵⁰ 1929 Act s 5.

⁵¹ 1929 Act s 8.

⁵² SI 2001/3649 art 216.

⁵³ In the leading English case of *National Westminster Bank plc v Spectrum Plus Ltd* [2005] UKHL 41 at para 50 Lord Hope of Craighead describes the floating charge as a “cuckoo in the nest of Scots property law”.

⁵⁴ 1997 SC (HL) 66. The case involved the transfer of land. In the subsequent case of *Burnett's Tr v Grainger* 2004 SC (HL) 19 the House of Lords rowed back, but in the meantime the matter had been referred to this Commission. See Scottish Law Commission, Report on *Sharp v Thomson* (Scot Law Com No 208, 2007).

⁵⁵ See eg K G C Reid, “Equity Triumphant: *Sharp v Thomson*” (1997) 4 EdinLR 464.

⁵⁶ See eg D Cabrelli, “The Case against the Floating Charge in Scotland” (2005) 8 EdinLR 407. And see also A D J MacPherson, “A Vicious Circle: The Ranking of Floating Charges and Fixed Securities” 2014 Edinburgh Student Law Review 67.

⁵⁷ [2017] CSIH 23.

institutions of English equity into another legal system, especially one based on the more rigorous conceptual structure of Roman law, as is the case with Scots law and most other European legal systems other than English law.”⁵⁸

17.36 Floating charges were the subject of a previous review by this Commission, which resulted in the passing of Part 2 of the Bankruptcy and Diligence etc. (Scotland) Act 2007. It has never been brought into force. The reason for that is discussed in the next chapter. Our focus here is why the floating charge is inadequate by itself to meet the needs of modern business.

17.37 The fact that floating charges can only be granted by certain entities means that there is a significant gap in moveable transactions law in relation to private individuals and bodies which cannot grant a floating charge, such as sole traders, partnerships and limited partnerships. We do not recommend the extension of the floating charge to these other persons, given the difficulties and inadequacies of floating charges law.

17.38 Floating charges also contrast unfavourably with “fixed” securities such as pledge for various reasons, notably:

(a) A floating charge, unlike a fixed security, is subject to the claims of the preferential creditors.⁵⁹

(b) A floating charge, unlike a fixed security, is subject to the “prescribed part”.⁶⁰ This is a sum of money taken from the floating charge-holder and made available to the unsecured creditors.

(c) A floating charge, unlike other security rights, is subject to the expenses of an administration.⁶¹

(d) An administrator’s power to deal with property subject to a floating charge is more extensive than in the case of other types of security right.⁶²

(e) The debtor can alienate the charged assets, in such a way as to remove them from the scope of the charge, without the charge-holder’s consent. That is not the case with a fixed security.⁶³

(f) “Effectually executed diligence” carried out by other creditors before attachment does not trump a fixed security but does trump a floating charge.⁶⁴

⁵⁸ [2017] CSIH 23 at para 121.

⁵⁹ Insolvency Act 1986 s 40 (receivership); Insolvency Act 1986 s 175 (liquidation); Insolvency Act 1986 Sch B1 para 65 (administration).

⁶⁰ Insolvency Act 1986 s 176A. For discussion, see *QMD Hotels Ltd Administrators, Noters* [2010] CSOH 168, 2011 GWD 1–42.

⁶¹ Insolvency Act 1986 Sch B1 para 99(3). (*Re Nortel GmbH* [2010] EWHC 3010, [2011] Pens LR 37 illustrates the significance of this rule.) In England and Wales the same is true of liquidation expenses: Insolvency Act 1986 s 176ZA.

⁶² Insolvency Act 1986 Sch B1 para 70.

⁶³ In English law an exception would be where there is a fixed equitable charge and there is a buyer who takes without notice.

⁶⁴ Companies Act 1985 s 463; Insolvency Act 1986 ss 55 and 60. The precise meaning of this rule is not entirely clear and has been the subject of much litigation. See *Lord Advocate v Royal Bank of Scotland* 1977 SC 155 overruled by *MacMillan v T Leith Developments Ltd (in receivership and liquidation)* [2017] CSIH 23. See also S

17.39 It is apparent from this list that there are many advantages of fixed security over floating charges. But in Scotland effectively the only fixed security offered by the current law over moveable property is pledge. Hence the need for a new fixed security.

17.40 In relation to agricultural charges we consider that there is a strong case for these ceasing to be competent given their lack of use in practice, the lack of the need for registration and the fact that floating charges are normally used instead.⁶⁵

Economic case for reform

17.41 The economic justification for our recommendations is set out in the Business and Regulatory Impact Assessment (BRIA), which is available on our website and is summarised in Chapter 1.

Comparative case for reform

17.42 This chapter has shown that most of the current Scottish law on security over moveable property is non-statute law. The ability for the courts to innovate is limited; change brought about by case law is inevitably modest and incremental.⁶⁶ Today's law of pledge would be readily recognisable to the Scots lawyer of the time of Viscount Stair in the late seventeenth century.⁶⁷ The last significant statutory innovation was the introduction of the floating charge in 1961. As we noted in Chapter 1, the last twenty years have seen significant statutory reforms in other comparable jurisdictions, such as Australia, Jersey, New Zealand and Belgium,⁶⁸ and the publication of several transnational instruments, such as the DCFR and the UNCITRAL Model Law on Secured Transactions. When one considers all of these developments, coupled with the current pressure to reform the law of England and Wales,⁶⁹ it is clear that without significant change, Scottish secured transactions law is going to become even further out of touch with modern international standards.

Wortley, "Squaring the circle: revisiting the receiver and 'effectually executed diligence'" 2000 *Juridical Review* 325.

⁶⁵ See Chapter 38 below.

⁶⁶ Lord Rodger of Earlsferry, "Judges and academics in the United Kingdom" (2010) 29 *University of Queensland LJ* 29 at 32, quoted in K G C Reid, "Smoothing the Rugged Parts of the Passage: Scots Law and its Edinburgh Chair" (2014) 18 *EdinLR* 315 at 338.

⁶⁷ See A J M Steven, "Rights in Security over Moveables" in K Reid and R Zimmermann (eds), *A History of Private Law in Scotland*, vol 1 (2000) 333 at 341.

⁶⁸ There were also significant changes made to French law in 2006. See the French Civil Code arts 2333 ff.

⁶⁹ See para 1.32 above.

Chapter 18 The approach to reform

Introduction

18.1 In this chapter we begin by reviewing briefly the previous unsuccessful attempts to reform secured transactions law in Scotland and also in the United Kingdom generally. We discuss the apparent reasons for this lack of success. We then set out the approach which we have decided to take and explain why we have chosen not to pursue a functionalist approach as exemplified by the Uniform Commercial Code article 9 (UCC–9) and the Personal Property Security Acts (PPSAs).

18.2 Chapter 10 of the Discussion Paper considered in some detail previous reviews of the law and therefore we require only to give a briefer account here.¹ For the most part we leave the issue of company charges registration to Chapter 36 below.

Summary of the UCC–9 and PPSA approach

18.3 The Crowther Report, the Halliday Report and the Diamond Report² all recommended the adoption of a UCC–9/PPSA-type system. Before looking at these, it is necessary to provide a short summary of that approach here, as without this it is difficult to appreciate the level of change which these reports recommended. In Chapter 13 of the Discussion Paper a much fuller account is given.³

18.4 The UCC is a model law, the original version of which was published in 1952 and subsequently adopted by the various US states.⁴ Article 9 deals with secured transactions in relation to moveable property. One of the key impetuses for reform was that US law did not recognise the floating charge.⁵ UCC–9 in turn strongly influenced the PPSAs, beginning in the Canadian provinces and now also to be found in many other jurisdictions, such as New Zealand, Australia and Papua New Guinea.⁶

18.5 The first and most important feature of UCC–9 and the PPSAs is that they take a functional approach to security rights.⁷ Transactions which function as security rights, even although they are not formally security rights (that is to say not true rights in security⁸), are treated as security rights. So, for example, retention of title and hire-purchase are regarded as security rights, as are assignments in security. A trust set up for the purposes of security is also so treated. The consequence of this is that these transactions have to obey the rules of the system, in particular there must be registration in order for there to be priority against

¹ See also Beale, Bridge, Gullifer and Lomnicka, *The Law of Security and Title-Based Financing* ch 23.

² For these, see paras 18.9–18.17 below.

³ See also H Beale, “An Outline of a Typical PPSA Scheme” in Gullifer and Akseli (eds), *Secured Transactions Law Reform* 7–19.

⁴ See further P Winship, “An Historical Overview of UCC Article 9” in Gullifer and Akseli (eds), *Secured Transactions Law Reform* 21–48.

⁵ *Benedict v Ratner* 268 US 353 (1925). This was a New York decision, but accepted in other States too. For the pre-UCC law see G Gilmore, *Security Interests in Personal Property* (1965).

⁶ See generally Gullifer and Akseli (eds), *Secured Transactions Law Reform*.

⁷ See eg Cuming, Walsh and Wood, *Personal Property Security Law* ch 2.

⁸ See paras 17.21–17.24 above.

third parties, such as another creditor who takes security subsequently. This statement is subject to some qualifications. For example, in New Zealand security interests are effective in insolvency without registration.⁹ And, generally under UCC–9 and the PPSAs, possession of the asset by the creditor is an alternative means of perfection.¹⁰

18.6 Secondly, the UCC–9/PPSA approach to registration is very different to what Scottish lawyers are currently familiar with, for example for standard securities in relation to land. The system of registration is called “notice filing”. The document granting the security is not registered. What is registered is a second document, called a “financing statement”. It contains only the barest information,¹¹ normally the details of the security provider and the creditor and the asset category identified from a tick-box list. The registration can happen before or after the security is granted. And the same registration can cover several security interests.¹² Notice filing nowadays normally happens electronically and essentially all the registrar does is maintain the register. Financing statements are not checked by the registrar, in contrast, for example, to the position in the UK when charges (security rights) are registered in the Companies Register.

18.7 Thirdly, UCC–9 and the PPSAs recognise a fundamental distinction between “attachment” and “perfection”. A security interest is said to have “attached” when it can be enforced by the secured creditor against the provider of the security¹³ and “perfected” when it gains priority against third parties.¹⁴ Although perfection can be explained broadly in terms of third party effect, under UCC–9 and the PPSAs mere attachment can in some cases have such effect. Under UCC–9 an attached but unperfected security interest is, it seems, effective against a donee, and also against a buyer who (a) is not in good faith and (b) is not a buyer in the ordinary course of business.¹⁵ And in New Zealand, as noted above, unperfected (unregistered) security interests are effective in insolvency without registration, but not against secured creditors who have registered, or against purchasers. To Scottish lawyers at least the idea of a security interest that does not have priority against third parties is an odd one. The point of a security right lies in having priority, particularly in insolvency. Having said that, the idea of an attached but unperfected security interest has sense. The creditor can use the enforcement methods appropriate to that security, as an alternative to diligence, and that may be an attractive option. For example, diligence can be slow. Moreover, as we have seen, attachment confers on an unperfected security interest a limited degree of third party effect. Be that as it may, the attachment/perfection distinction contrasts with the traditional Scottish approach that a security is either effective or it is not.¹⁶

18.8 Fourthly, under the UCC–9 and the PPSAs transactions such as assignation in security, retention of title in sale, hire-purchase, and certain moveable leases, are

⁹ On which, see M Gedye, “The Development of New Zealand’s Secured Transactions Jurisprudence” 2011 University of New South Wales Law Journal 696 at 702–703.

¹⁰ And in respect of certain financial assets another possibility may be “control”. See Beale (n 3) at 13.

¹¹ A standard work calls it the “bikini” of the UCC: J J White and R S Summers, *Uniform Commercial Code* (5th edn, 2000) para 22-10.

¹² The term “interest” is generally used rather than “right”.

¹³ UCC § 9–203(a): “A security interest attaches to collateral when it becomes enforceable against the debtor with respect to the collateral.” There can be a concluded security agreement without attachment, for attachment calls for certain requirements over and above agreement. These requirements are set out in UCC § 9–203.

¹⁴ The UCC does not seem to state this expressly, but this is the point of the concept.

¹⁵ This limited effect of an unperfected security interest emerges from UCC § 9–317(b) read with UCC § 9–330. On this point see H Sigman, “Perfection and Priority of Security Rights” in H Eidenmüller and E-M Kieninger (eds), *The Future of Secured Credit in Europe* (2008) 143 at 147.

¹⁶ See eg *Bank of Scotland v Liquidators of Hutchison Main & Co* 1914 SC (HL) 1.

“recharacterised”, that is to say regarded as being a transfer of title subject to a reservation of a security interest. This is a complex subject and best demonstrated by an example. Ruth Ltd grants a security to the Saltire Bank over both its present and after-acquired assets. And suppose that later Tom sells goods to Ruth Ltd on credit terms, reserving title (ownership) until payment. Under current Scottish law, the bank’s security would be a floating charge, and Tom would be protected because the effect of the retention of title would be that the goods would not belong to Ruth Ltd until they have been paid for. But the effect of recharacterisation is that Tom has a mere security interest, which, being later in time, is trumped by the bank’s. As this is regarded as unfair, UCC–9 and the PPSAs have a special rule which seeks to reverse the consequences of recharacterisation by providing that a “purchase money security interest” (PMSI) has superpriority. However, PMSI superpriority is subject to procedural rules which in practice mean that it may not be attained. In particular, it is a condition of UCC–9 for certain asset classes that “the purchase-money secured party sends an authenticated notification to the holder of the conflicting security interest” before the debtor obtains possession.¹⁷

Crowther Report

18.9 The Crowther Report was published in 1971.¹⁸ A limited number of its recommendations were implemented by the Consumer Credit Act 1974. Part 5 of the Report called for the adoption of a system based on UCC–9.¹⁹ No draft Bill was attached to the Report.

18.10 Whilst the Crowther Committee considered that the new law based on UCC–9 based should broadly be uniform throughout the UK, it concluded that the substantial differences in the background law as between England and Wales, and Scotland meant that it would be desirable for there to be two separate statutes.²⁰

18.11 The Government responded to the Crowther Report with a White Paper, *Reform of the Law of Consumer Credit* (1973).²¹ This had very little about Part 5 of the Report, but stated that the Government “were not convinced that the possible benefits of the Committee’s recommendations to the credit industry and to some consumers would outweigh the possible social disadvantages to others.”²² The “possible social disadvantages” were not specified. The White Paper added that the Government “will be prepared to reconsider this issue” in the future.

Halliday Report

18.12 Following the Crowther Report, this Commission set up a working party:

“To consider the legal and technical problems which would arise or be likely to arise in the creation in Scotland of a system of security over moveable property in relation

¹⁷ UCC § 9–324. But this is not required under either the Australian or New Zealand PPSAs.

¹⁸ The Report of the Committee on Consumer Credit, Cmnd 4596 (1971) chaired by Geoffrey Crowther.

¹⁹ The title of the Crowther Report included the word “consumer”. But the Report’s recommendation that a UCC–9-type system be adopted was not limited to consumer transactions.

²⁰ Crowther Report para 5.2.21. But the Report drew heavy criticism from Professor David Walker who argued that its main proposals were “dangers . . . to the fabric of Scots law.” See D M Walker, “Crowther’s Consumer Credit Chaos Contemplated” 1972 SLT (News) 81 at 85.

²¹ Cmnd 5427.

²² This and the following quotations are from para 8, which seems to be the only paragraph in the White Paper dealing with Part 5 of the Crowther Report.

to all types of loans including consumer loans and to make recommendations in that respect.”²³

18.13 The working party’s chair was Professor John (Jack) Halliday, a former Scottish Law Commissioner. Its report, which was submitted in 1983 but only published in 1986, is available on our website. The Report recommended that a UCC–9/PPSA-type approach should be adopted in Scotland. But certain types of property, such as consumer goods, ships, aircraft and intellectual property would be excluded. There would be recharacterisation.²⁴ There was detailed discussion on ranking and enforcement. In addition, assignments of receivables (even if not by way of security) would have to be registered to be “perfected”.²⁵ The Report had little discussion of floating charges, but like the Crowther Report, it presupposed that they would continue. No legislation followed.

Diamond Report

18.14 In 1985 the then Department of Trade and Industry (a predecessor of the Department for Business, Energy and Industrial Strategy) requested Professor Aubrey Diamond to review the law of security over property other than land. His report appeared in 1989.²⁶ He too recommended the adoption, in both England and Wales, and Scotland, of a UCC–9/PPSA-type system. Floating charges would disappear as a separate institution.²⁷

18.15 For assets in special registers, such as patents, ships etc, Professor Diamond recommended that security rights should continue to be registrable as before, but that additional registration should be required in the new register. A security right registered solely in (say) the patents register would still be valid, but would be invalid in the event of insolvency.²⁸

18.16 Professor Diamond agreed with the Crowther Report that whilst the law should be broadly similar on both sides of the Scotland/England border, separate legislation would be desirable.²⁹

18.17 The Government rejected the Diamond Report,³⁰ and so it was not implemented, except for some of the recommendations about Part XII of the Companies Act 1985, which were implemented by Part IV of the Companies Act 1989. However, Part IV was never brought into force.

Murray Report

18.18 In 1994 the Department of Trade and Industry appointed a committee under Professor John Murray QC to review the law of security over moveable property in Scotland.

²³ Foreword to the Report by Working Party on Security over Moveable Property, March 1986, available at: http://www.scotlawcom.gov.uk/files/8812/8024/7156/Halliday_Report.pdf.

²⁴ On recharacterisation, see para 18.8 above.

²⁵ Halliday Report, para 32.

²⁶ A L Diamond, *A Review of Security Interests in Property* (Department of Trade and Industry, 1989). He benefited from the large number of responses to his preliminary consultation paper. He also took considerable care to learn about Scots law and about views in Scotland.

²⁷ Diamond Report, para 16.12.

²⁸ Diamond Report, para 12.3.5.

²⁹ Diamond Report, paras 8.4.1–8.4.8.

³⁰ See G McCormack, *Secured Credit under English and American Law* (2004) at 67 for an outline of the reasons given by Government. In brief (i) most people (allegedly) wanted no change, (ii) change would (allegedly) be disruptive and expensive and (iii) there was a possibility that matters would be overtaken by EU legislation.

The committee duly reported.³¹ It rejected a UCC–9 approach, apparently on three grounds: (a) the effect on unsecured creditors; (b) its complexity and (c) the fact that it involved notice filing.³²

18.19 The Murray Report had two main proposals: (i) the introduction of a new fixed security, to be known as a “moveable security” and (ii) the extension of the floating charge.

18.20 The moveable security would be created by registration in a new “Register of Security Interests”.³³ This was to be kept by the Registrar of Companies.³⁴ The new register would have had two parts, one devoted to the new moveable security, and the other to floating charges.³⁵ The moveable security would be available for corporeal moveable property and would not require possession by the creditor.³⁶ Consumer goods would be excluded, except in so far as held by a company, such as a manufacturer.³⁷ So too would ships and aircraft. Only corporeal moveable property owned at the time of the security would be covered.³⁸ If it were desired to cover after-acquired assets, repeated grants of security would be necessary. The new security would not extend to the proceeds of a sale of collateral by the debtor.³⁹ The moveable security would also be available for incorporeal moveable property.⁴⁰ Intimation would not be required. For receivables, but not for other incorporeal property, the security would be capable of covering after-acquired property.⁴¹

18.21 In relation to the floating charge, the Murray Report recommended that any debtor should be able to grant this type of security but that in the case of a non-company granter it would be limited to moveables and would not cover consumer goods.⁴² As mentioned above, instead of being registered in the Companies Register floating charges would be registered in a new Register of Security Interests. This recommendation and others, including that floating charges would not come into effect before registration, in contrast to the 21-day “invisibility period” that currently exists,⁴³ are similar to provisions in Part 2 of the the Bankruptcy and Diligence etc. (Scotland) Act 2007. It is discussed in the next section.

18.22 The Murray Report was never implemented.

Bankruptcy and Diligence etc. (Scotland) Act 2007 Part 2

18.23 The last successful attempt at reform of moveable transactions law in Scotland was the introduction of the floating charge in 1961. But, for reasons already mentioned in

³¹ *Security over Moveable Property in Scotland: a Consultation Paper* (Department of Trade and Industry, 1994). For contemporary discussion of the Murray Report, see H Patrick, “Reform of Security over Moveable Property: Some General Comments” 1995 SLT (News) 42 and A J M Steven, “Reform of Security over Moveable Property: Some Further Thoughts” 1995 SLT (News) 120.

³² Murray Report, paras 2.4–2.5.

³³ Murray Report, para 3.11; Draft Floating Charges and Moveable Securities (Scotland) Bill, cl 22.

³⁴ Murray Report, para 3.11; Draft Floating Charges and Moveable Securities (Scotland) Bill, cl 22.

³⁵ Murray Report, para 3.11; Draft Floating Charges and Moveable Securities (Scotland) Bill, cl 22(1).

³⁶ Murray Report, paras 3.4 to 3.5; Draft Floating Charges and Moveable Securities (Scotland) Bill, cl 9.

³⁷ Murray Report, para 3.5; Draft Floating Charges and Moveable Securities (Scotland) Bill, definition of “exempt property” at cl 30.

³⁸ Murray Report, para 3.4; Draft Floating Charges and Moveable Securities (Scotland) Bill, cl 12.

³⁹ Murray Report, para 3.5; Draft Floating Charges and Moveable Securities (Scotland) Bill, cl 9(3).

⁴⁰ Murray Report, para 3.4; Draft Floating Charges and Moveable Securities (Scotland) Bill, cl 9(3).

⁴¹ Murray Report, para 3.4; Draft Floating Charges and Moveable Securities (Scotland) Bill, cl 9(3).

⁴² Murray Report, para 3.3. The Draft Floating Charges and Moveable Securities (Scotland) Bill, cl 1 confers the power to create floating charges; clause 30 defines “exempt property” in the case of companies and non-companies.

⁴³ See para 36.7 below.

Chapter 17, some might question how successful this has been. Floating charges were referred to this Commission for review as part of a wider review of registration of rights in security by companies.⁴⁴ In 2004 we published our Report.⁴⁵ This recommended a new legislative scheme. There would be a new “Scottish Register of Floating Charges” to be run by Registers of Scotland. Floating charges affecting assets in Scotland would require to be registered there and not in the Companies Register.

18.24 The Report was accepted by the Scottish Government and given effect to by Part 2 of the Bankruptcy and Diligence etc. (Scotland) Act 2007. But, after the legislation was passed, the Committee of Scottish Clearing Bankers wrote to the Scottish Government and argued that it should not be brought into force on the basis that it would result in increased cost to business.⁴⁶ The main argument was that whereas a UK company with property in Scotland and England which is to be encumbered by a floating charge has to register only once in the Companies Register under the current law, under Part 2 of the 2007 Act two registrations would be required.⁴⁷

18.25 The Scottish Government then established a technical working group under the auspices of Registers of Scotland to consider the issue. Its report, which was published in 2011,⁴⁸ set out three options: (1) implement Part 2 without amendment; (2) implement with amendments; and (3) do not implement. The Scottish Government carried out a consultation on the report in 2012 and has said nothing since. It now appears highly unlikely that Part 2 will ever be brought into force.

Law Commission for England and Wales project

18.26 At the same time as registration of rights in security by companies was referred to us, there was a different and broader reference to the Law Commission for England and Wales, to:

“(1) examine the law on the registration, perfection and priority of company charges; (2) consider the case for a new scheme of registration and priority of company charges, including charges created by (a) companies having their registered office in England or Wales, wherever the assets charged are located; and (b) overseas companies and companies having their registered office in Scotland, where the charge is subject to English law; (3) consider whether such a scheme should apply both to security in the strict sense and to ‘quasi-security’ interests such as conditional sales, retention of title clauses, hire-purchase agreements and finance leases, including the extent to and means by which such interests should be made subject to the law governing securities; (4) examine the law relating to the granting of security and ‘quasi-security’ interests by unincorporated businesses and individuals over property other than land, including the feasibility of extending any new scheme for company charges to such interests, and the extent to and means by which such ‘quasi-security’ interests should be made subject to the law governing securities; and (5) make recommendations for reform.”

⁴⁴ The reference followed on from recommendations in the final report of the Company Law Review Steering Group: *Modern Company Law for a Competitive Economy* (2001).

⁴⁵ Scottish Law Commission, Report on Registration of Rights in Security by Companies (Scot Law Com No 197, 2004).

⁴⁶ See Register of Floating Charges Technical Working Group: Report to Scottish Government (2011) Appendix 3, available at <http://www.scotland.gov.uk/resource/doc/254430/0121799.pdf>.

⁴⁷ See G Yeowart, “A register of floating charges over Scottish assets: a new “Slavenburg” problem?” (2012) 8 JIBFL 470.

⁴⁸ See fn 46.

18.27 Three publications resulted: (i) Registration of Security Interests: Company Charges and Property other than Land (2002),⁴⁹ (ii) Company Security Interests: A Consultative Report (2004)⁵⁰ and (iii) Company Security Interests (2005).⁵¹

18.28 Broadly speaking, the first two proposed the adoption, for England and Wales, of a system based on the UCC–9/PPSAs. But whilst there existed strong support for that approach, it also attracted strong opposition.⁵² The final report of 2005 therefore contained more limited recommendations. It abandoned two UCC–9/PPSA principles: (i) the recharacterisation of conditional sales, hire-purchase and finance leases as security interests, and (ii) the enactment of a comprehensive code of personal property security law.

18.29 Another difference from the UCC–9/PPSA approach was that the floating charge would continue as a separate institution. But the final report kept another key feature of UCC–9 and the PPSAs, namely that assignments of receivables should be registrable.⁵³ It also continued to recommend the UCC–9/PPSA registration system of notice filing.⁵⁴

18.30 A new register would be set up, to be called “the Register of Charges and of Sales of Receivables”. This would be kept by the Registrar of Companies. This was because the scope of the Law Commission’s project was limited to company law. By contrast, a principle of UCC–9 and the PPSAs is that the law of security interests should apply uniformly as between different types of debtor (albeit subject to consumer protection rules) – an approach taken by the great majority of countries round the world which have this type of system. But the Commission’s intention was that the system, once established for companies, could later be extended to transactions by non-companies.

18.31 Some of the proposals in the final report were implemented by the Companies Act 2006 (Amendment of Part 25) Regulations 2013,⁵⁵ which came into force on 1 April 2013.⁵⁶ But many, including the proposals for notice filing and for registration of assignments of receivables, were not. The failure to implement led to the establishment of the Secured Transactions Law Reform Project, which seeks to bring forward recommendations for reform of English law.⁵⁷ The City of London Law Society is also working on reform and has produced a draft Secured Transactions Code.⁵⁸

Analysis

General

18.32 The question which naturally follows from the above survey is: why have all these previous attempts to reform secured transactions law been unsuccessful? It is easy to

⁴⁹ Consultation Paper No 164.

⁵⁰ Consultation Paper No 176.

⁵¹ Law Com Report No 296.

⁵² Not least from two influential bodies, the City of London Law Society and the Financial Markets Law Committee. See G McCormack, “Pressured by the Paradigm: the Law Commission and Company Security Interests” in De Lacy (ed), *The Reform of UK Personal Property Security Law: Comparative Perspectives* 83 at 84.

⁵³ Law Com Report No 296, Part 4.

⁵⁴ Law Com Report No 296, Part 3.

⁵⁵ SI 2013/600.

⁵⁶ See Chapter 36 below.

⁵⁷ See <https://securedtransactionslawreformproject.org/>. See also para 1.32 above.

⁵⁸ See City of London Law Society, draft Secured Transactions Code. See para 1.32 above.

answer this. The attempts failed because there was insufficient support for the reform proposed on each occasion, from stakeholders and government. But such an answer does not take us very far, as it leads immediately to the supplementary question: why was there a lack of support? We look at this in turn in relation to (i) a UCC–9/PPSA approach; (ii) the Murray Report; and (iii) Part 2 of the Bankruptcy and Diligence etc. (Scotland) Act 2007.

(i) *UCC–9/PPSA approach*

18.33 The Crowther, Halliday and Diamond Reports and the Law Commission for England and Wales all supported the UCC–9/PPSA approach, but to no avail. It is possible to identify reasons why. First, this would have been radical law reform and, in the view of many, was too radical. Thus Professor Michael Bridge has written of the Law Commission project: “Drawing upon the wisdom of hindsight, it is possible to say that a more modestly presented series of incremental reforms might have evoked less opposition.”⁵⁹

18.34 The second and related reason to this is that the current law does not suffer from the level of inadequacy which afflicted secured transactions law in the USA, Canada and elsewhere prior to the introduction of UCC–9 and the PPSAs.⁶⁰ We mentioned above that earlier US law did not recognise the floating charge.⁶¹ Neither does Jersey law.⁶² Where PPSAs have been introduced, the new register has typically replaced a multiplicity of previous registers.⁶³ In the UK, but only in respect of companies and LLPs, there is already a “one stop shop” in the form of the Companies Register.⁶⁴

18.35 The third and again related reason is that the familiarity of current law, notwithstanding its inadequacies, is appreciated by some. Professor Eric Dirix, the architect of Belgium’s legislation of 2013 reforming that country’s law of security over moveable property, has put it thus: “the modernisation of the system of security rights may not be of the highest priority to the average practitioner, who has only limited information on how other legal systems have evolved. To use the metaphor of the Dutch professor Scholten, when he was contemplating the introduction of a new civil code in the Netherlands, ‘It is as if one lives in an old big house. One keeps grumbling about its inconveniences, but after all it is home.’”⁶⁵ In the same vein but with a different tone, Professor Hugh Beale, the lead Commissioner on the Law Commission for England and Wales project, has written: “I agree

⁵⁹ M G Bridge, “The Scope and Limits of Security Interests” in H Eidenmüller and E-M Kieninger (eds), *The Future of Secured Credit in Europe* (2008) 180 at 184. See also R Calnan, “What is wrong with the law of security?” in De Lacy (ed), *The Reform of UK Personal Property Security Law* at 187 and N McGrath, “Commentary on the international standards and the reform of English personal property securities law” in N O Akseli (ed), *Availability of Credit and Secured Transactions in a Time of Crisis* (2013).

⁶⁰ See eg G McCormack, “Personal Property Security Law Reform in England and Canada” 2002 JBL 113 at 117; H Beale, “The Exportability of North American Chattel Security Regimes: The Fate of the English Law Commission’s Proposals” (2006) 43 Canadian Business Law Journal 178 at 186. On the position in New Zealand, see M Gedye, “A Distant Export: The New Zealand Experience with a North American Style Personal Property Security Regime” (2006) 43 Canadian Business Law Journal 208.

⁶¹ See para 18.4 above.

⁶² See R Goode, “Reforming the Law of Secured Transactions in Jersey” in Gullifer and Akseli (eds), *Secured Transactions Law Reform 207* at 212. For an overview of Jersey rights in security law, see R F MacLeod, *Property Law in Jersey* (2016) 48–52.

⁶³ For example, the new Personal Property Securities Register in Australia replaced over 70 separate registers. See <http://www.lawsociety.com.au/resources/areasoflaw/PPS/index.htm>.

⁶⁴ But for criticism see G L Gretton, “Registration of Company Charges” (2002) 6 EdinLR 146. While this article pre-dates the significant changes made to the legislation on 1 April 2013 (see Chapter 36 below), many of the criticisms still hold. Australia had company charges registration legislation before its PPSA, but it too had inadequacies. See A Duggan, “A PPSA Primer” (2011) Melbourne University Law Review 865 at 869.

⁶⁵ E Dirix, “The New Belgian Act on Security Interests” (2014) 23 International Insolvency Review 171 at 175.

that the current system works – just as steam trains still work”.⁶⁶ Of course there are also costs in introducing a new system – in particular of setting up the new register and of training lawyers and others – but experiences from elsewhere⁶⁷ suggest that this is not a particularly strong argument.

18.36 Fourthly, not all the features of the UCC–9/PPSA approach commend themselves to stakeholders, compared with current English and Scottish law. For example, at the moment there is no need to register and thus incur registration dues in respect of functional securities, such as retention of title and hire-purchase.⁶⁸ In contrast, for example, in New Zealand there was a registration regime for motor vehicle hire-purchase agreements prior to the introduction of its PPSA.⁶⁹

18.37 Fifthly, the UCC–9/PPSA approach with its “attachment/perfection” distinction does not fit so easily with Scottish property law as it does with the underlying property law in common law jurisdictions.⁷⁰

(ii) *The Murray Report*

18.38 The approach taken by the Murray Report was a more limited one. Although there was not implementation as such, the proposals on floating charges influenced Part 2 of the Bankruptcy and Diligence etc. (Scotland) Act 2007. The reasons for the non-implementation are not entirely clear. One may be that the Report was sponsored by the then Department of Trade and Industry in London prior to devolution. Scotland-only commercial law reforms at Westminster are unusual and have to compete with other priorities.

18.39 Five years after the Murray Report and following devolution, the Scottish Justice Minister commissioned research into the “perception that businesses in Scotland are being inhibited in raising capital because, under Scots law, they cannot create a security over moveable property without giving up possession”.⁷¹ This led to the publication of the Central Research Unit’s Report on Business Finance and Security over Moveable Property (2002). It concluded that there was “little empirical evidence to support the suggestion that business finance is more difficult to obtain in Scotland because SMEs⁷² are unable to grant a non-possessory security over moveable assets, or that it is more difficult for unincorporated Scottish SMEs to obtain finance because they cannot grant a floating charge.”⁷³

18.40 It might be asked: why then is this Commission promoting reform of secured transactions law in the light of that conclusion? First, as we have noted earlier,⁷⁴ there was strong support from stakeholders for us to consider this area in the consultation on our Seventh Programme of Law Reform (published in 2006) and Eighth Programme of Law

⁶⁶ Beale, “The Exportability of North American Chattel Security Regimes: The Fate of the English Law Commission’s Proposals” at 198.

⁶⁷ See Discussion Paper, paras 20.4–20.6.

⁶⁸ See eg G McCormack, “Personal Property Security Law Reform in Comparative Perspective – Antipodean Insights?” (2004) 33 Common Law World Review 3 and J Ziegel, “A Canadian academic’s reactions to the Law Commission’s proposals” in De Lacy (ed), *Reform of UK Personal Property Security Law* 117 at 119.

⁶⁹ Motor Vehicles Securities Act 1989. See D Brown, “The New Zealand Personal Property Securities Act 1999” in De Lacy (ed), *Reform of UK Personal Property Security Law* 328 at 332–333.

⁷⁰ See para 18.7 above.

⁷¹ Parliamentary Written Answer S1W-1719 (29 September 1999).

⁷² Small and medium-sized enterprises.

⁷³ Business Finance Report at 2.

⁷⁴ See para 1.15 above.

Reform (published in 2010) given the deficiencies in the law, which we identified in the previous Chapter of this Report. There was subsequently a high level of support from consultees to the Discussion Paper and also from our advisory group as we worked on this Report. Secondly, the Business Finance Report acknowledged that workarounds are used to circumvent the restrictive nature of the common law, such as hire-purchase, trusts and writing contracts under English law.⁷⁵ Implementation of our Report would mean that stakeholders are no longer forced to use such workarounds and instead could use a secured transactions law that is fit for purpose.

(iii) *Part 2 of the Bankruptcy and Diligence etc. (Scotland) Act 2007*

18.41 This reform failed because, while it would have clearly improved the conceptual coherence of floating charges within Scottish property law, it did not have the support of key stakeholders: the banks. As we saw above, they opposed reform on the basis that it would have potentially increased registration costs.

18.42 We think it true to say that there is a wider point here, namely the desire in the commercial sphere for the law north and south of the Scotland/England border to be similar, if not the same. This can be traced back to the nineteenth century, if not earlier.⁷⁶ Thus a reform which pulls Scottish commercial law in a different way from the law of England and Wales is likely to attract opposition from the business community.⁷⁷

18.43 A parallel can be drawn from the experience in Louisiana. Like Scotland, it is a so-called mixed legal system, being influenced strongly by both Roman and English law.⁷⁸ Thus it is the only US state with a Roman law heritage. This was essentially the reason why Louisiana was the last state to adopt UCC–9, doing so in 1990. One of the main reasons for the adoption was the desire among financial institutions for there to be a uniformity between Louisiana and the other states, which would facilitate cross-state transactions and reduce transaction costs.⁷⁹

Is now the time for a UCC–9/PPSA approach?

18.44 In the light of the fate of the earlier attempts at reform described above, we concluded in the Discussion Paper that now is not the time for a UCC–9/PPSA approach in Scotland. We said:

“Some types of reform, such as recharacterisation, would be problematic while English law remains in its present form. For [this and other] reasons, our approach is not to seek perfection⁸⁰ in one step. The best can be the enemy of the good, and it seems better to us to develop a reform package that will be major but nevertheless

⁷⁵ Business Finance Report at 10–11.

⁷⁶ See eg W A Wilson, “Scottish Commercial Law” 1966 JBL 320; Lord Rodger of Earlsferry, “The Codification of Commercial Law in Victorian Britain” (1992) 109 LQR 570; A D M Forte, “A Great Future Behind It? Scottish Commercial Law and the Millennium” (1994) 2 European Review of Private Law 375; Lord Hodge, “Does Scotland need its own Commercial Law?” (2015) 19 EdinLR 299 and J Hardman, “Some Legal Determinants of External Finance in Scotland: A Response to Lord Hodge” (2017) 21 EdinLR 30.

⁷⁷ See also Discussion Paper, paras 1.22–1.23.

⁷⁸ See eg V V Palmer and E C Reid (ed), *Mixed Jurisdictions Compared: Private Law in Louisiana and Scotland* (2009).

⁷⁹ See eg H Gabriel, “Louisiana Chapter Nine (Part One): Creating and Perfecting the Security Interest” (1989) 35 Loyola Law Review 311.

⁸⁰ Perfection in the ordinary sense of the term rather than in the UCC–9/PPSA sense.

limited, aware that further reform may be needed, but leaving such further reform until the initial package has been implemented”.⁸¹

18.45 Nevertheless, to test the position we sought the views of consultees on the UCC–9/PPSA approach. Question 4 in the Discussion Paper asked whether they agreed that Scots law should not adopt the attachment/perfection distinction in any of its various forms. All consultees who directly addressed this question agreed. These included the Faculty of Advocates, the Law Society of Scotland, the Judges of the Court of Session and the WS Society. The Judges said: “The paper – it is thought wisely – rejects the complications of making such a distinction”. Professor Eric Dirix stated: “I agree with the approach of the Commission. The introduction of the attachment/perfection distinction would add needlessly to the complexity of the system.” Scott Wortley said: “I have difficulty in seeing the utility of the attachment/perfection distinction – particularly in a system with a civilian approach to property law.”

18.46 Question 80(a) in the Discussion Paper asked consultees whether they agreed that, even if the issue of Article 4 of Directive 2000/35/EC⁸² is not an obstacle, Scots law should not, at least at the present time, introduce a system of recharacterisation⁸³ of quasi-securities. There was unanimous agreement from consultees.⁸⁴ Dr Hamish Patrick stated: “Recharacterisation should only be introduced on a UK basis given the consequences for financial institutions and businesses trading throughout the UK.” Andrew Kinnes said: “My securitisation and cashflow colleagues were very pleased to hear that the proposals do not include recharacterisation.” The WS Society responded: “This is a highly controversial topic and, whatever the arguments for or against, this is exactly what might stand in the way of the other necessary reforms if it is proceeded with.”

18.47 In question 80(b) we asked consultees whether, if they agreed with the previous proposal, they thought that Scots law should adopt a “halfway house” in relation to quasi-securities, namely registrability without full recharacterisation. If so, we asked, should it apply to certain cases only (such as trusts) or all cases? Almost all consultees who responded to this question did not favour registration, at least at the present time. This included Dr Ross Anderson, the Faculty of Advocates, the Law Society of Scotland and several law firm consultees. Jim McLean wrote that it would “just be a nuisance and a reason to choose another law.” Scott Wortley, however, supported registration of trusts acting as commercial securities. Begbies Traynor, in their response to question 1 of the Discussion Paper⁸⁵ favoured a register of trusts.

18.48 Question 80(c) asked whether, if either a full recharacterisation or “halfway house” approach is adopted, there should be categories (for example, sales to consumers) where registration should not be required. It also asked whether there should be grace periods. For most consultees, this question was superseded by their answers to the earlier parts of question 80.

⁸¹ Discussion Paper, para 1.26.

⁸² In the Discussion Paper, para 21.22 we argued that Article 4 of this Directive, which is on combating late payment in commercial transactions, may forbid recharacterisation of retention of title clauses.

⁸³ On recharacterisation, see para 18.8 above and the Discussion Paper, Chapter 21.

⁸⁴ See now also J MacLeod, “Thirty Years After: The Concept of Security Revisited” in A J M Steven, R G Anderson and J MacLeod (eds), *Nothing so Practical as a Good Theory: Festschrift for George L Gretton* (2017) 177 at 190–192.

⁸⁵ Question 1 asked if there were other areas of moveable transactions law, not considered in the Discussion Paper, which should be reformed. See para 18.73 below.

18.49 Following these responses, we hold to the position in the Discussion Paper and do not propose a UCC–9/PPSA approach. We are reinforced in this view by the fact that the latest work of the City of London Law Society on reform of secured transactions law in England and Wales, that is to say a draft code, eschews a recharacterisation approach.⁸⁶

Our recommended new scheme

General

18.50 In Chapter 3 of the Discussion Paper we summarised the new scheme on which we sought the views of consultees. Its highlights were that (a) a new register, called the Register of Moveable Transactions (“RMT”) should be set up; (b) assignments of claims should be capable of being completed by registration in the RMT as an alternative to intimation to the debtor;⁸⁷ and (c) a new security should be introduced, which would be created by registration in the RMT. The new security would be non-possessory for corporeal moveable property and it would also be possible for it to be granted over incorporeal moveable property. For the latter it would thus offer an alternative to transferring the property, for example, financial instruments such as company shares, or intellectual property, such as patents, to the creditor.

18.51 When we suggested this scheme we took account of the lessons to be learned from past unsuccessful reform proposals. While the scheme, if implemented, would amount to major reform, it is less ambitious than the introduction of UCC–9/PPSA legislation. The scheme acknowledges the desire for Scottish commercial law to be broadly consistent with the commercial law of England and Wales. It offers new options for those engaging in moveable transactions. They can choose to use them if they wish. The floating charge and other existing options would continue to be available.

A piecemeal approach

18.52 Our scheme therefore amounts to what can be described as piecemeal law reform. In an important essay, from the standpoint of English law, Professor Louise Gullifer has critically assessed such an approach:

“There are a number of difficulties with piecemeal reform. First, it only addresses problems that immediately present themselves, rather than considering and tackling problems which have been worked around by market participants or which come from the nature of the system itself. Second, it does not tackle the complexity of the existing system, and may even exacerbate this. Third, considerations of policy underlying the entire system are not considered, only those relating to the specific area being reformed. Fourth, piecemeal reform may be difficult to fit within the existing system; it may give rise to unforeseen inconsistencies, and may, indeed, give rise to more problems than it solves.”⁸⁸

⁸⁶ See <http://www.citysolicitors.org.uk/attachments/article/121/Secured%20Transactions%20Code%20-%20Discussion%20draft.pdf>. Although of course there are others in England and Wales who advocate a UCC-9/PPSA approach. The Secured Transactions Law Reform Project appears sympathetic to it. See <https://securedtransactionslawreformproject.org/>.

⁸⁷ We deal with the assignment aspects of the scheme in volume 1 of this Report.

⁸⁸ L Gullifer, “Piecemeal reform: Is it the answer?” in F Dahan (ed), *Research Handbook on Secured Financing in Commercial Transactions* (2016) 421 at 428.

18.53 We consider, however, that at present in Scotland wholesale reform is simply not feasible. This type of reform in other countries has typically involved the adoption of a UCC–9/PPSA-type approach which our consultees rejected. Wholesale reform would also require the replacement of the floating charge, which would go directly against the views of our consultees.⁸⁹ It would necessitate too legislation in a number of reserved areas such as the law of business associations, corporate insolvency law and intellectual property law.⁹⁰ Even leaving aside the impact of Brexit, the prospect of achieving Scotland-only legislation at Westminster in these areas is in our view very low and the experience of Part 2 of the Bankruptcy and Diligence etc. (Scotland) Act 2007 described above shows that there would be opposition to such an approach.⁹¹

18.54 The complexity of achieving even piecemeal reform of this area is demonstrated by the fact that it has taken us six years from the publication of our Discussion Paper to present our recommendations in this Report. Wholesale reform would take considerably longer. Even discounting the opposition from consultees, basing new legislation closely on an existing PPSA⁹² would not be an easy option to implement as the law of secured transactions needs to fit with underlying property law. As Professor Michael Bridge has noted:

“A free-standing version of Article 9 cannot be transplanted into another legal system without considerable thought being given to all features of the legal terrain, especially the property law of the receiving jurisdiction, into which it is being transplanted.”⁹³

The problems caused by the adoption of the floating charge from English law should not be repeated.⁹⁴

Support for the scheme

18.55 The Discussion Paper question 2 asked whether the scheme we proposed would be appropriate. To this question, we received a considerable number of thoughtful responses, containing many helpful points of detail.

18.56 The vast majority of consultees expressed strong support in principle. We quote from the responses of the Asset Based Finance Association (ABFA), CBI Scotland, the Committee of Scottish Clearing Bankers, the Federation of Small Businesses, ICAS/R3⁹⁵ and the Scottish Council for Development and Industry in volume 1 of this Report.⁹⁶

⁸⁹ See Chapter 20 below.

⁹⁰ See paras 1.39–1.40 above.

⁹¹ See paras 18.41–18.43 above.

⁹² As has happened, for example, in Malawi where the NZ PPSA 1999 has been followed. See M Dubovec and C Kambili, “Secured Transactions Law Reform in Malawi: the 2013 Personal Property Security Act” in Gullifer and Akseli (eds), *Secured Transactions Law Reform* 183–206.

⁹³ M Bridge, “Secured Credit Legislation: Functional or Transactional Co-Existence” in S V Bazinas and N O Akseli (eds), *International and Comparative Secured Transactions Law: Essays in honour of Roderick A Macdonald* (2017) 1 at 16.

⁹⁴ See para 17.35 above.

⁹⁵ Institute of Chartered Accountants of Scotland/Association of Business Recovery Professionals.

⁹⁶ See paras 3.20–3.27 above.

18.57 In addition, the then Department for Business Innovation and Skills (DBIS)⁹⁷ said: “As a general point we very much welcome the proposal that will allow loans under Scots law to be secured on moveable property.”

18.58 In a subsequently published symposium paper, Dr Hamish Patrick commented that:

“overall the Commission’s proposals are to be welcomed, as a pragmatic opportunity to remedy some significant practical defects in the Scottish law of security. They would also appear to have a better prospect of being implemented than previous attempts at reform.”⁹⁸

18.59 Similarly, there was support from academic experts, including Professor Eric Dirix, who, as we have mentioned previously, was the leading figure in the recent Belgian reforms, Dr Ross Anderson,⁹⁹ David Cabrelli and Scott Wortley. Professor Gerry McCormack said: “In general terms, I think the recommendations in the DP are to be commended as sensible, pragmatic, politically shrewd, in line with international trends and seemingly grounded in commercial realities.” Magdalena Raczynska expressed the following view:

“My overall comment is that it is an excellent and comprehensive paper that seems to target the problems that have arisen in Scotland without being overly ambitious. It has come to my attention during the discussions at the Symposium¹⁰⁰ that there is a concern that the project may not be sufficiently ambitious. Limited ambition is better than over-ambition. There are countless examples of projects, which either never came to fruition despite a desire and good ideas to improve the current law because they were trying to do too much.”

18.60 As we worked towards the completion of this Report and finalising our recommendations we kept key stakeholders informed. Colin Borland, Senior Head of External Affairs, Devolved Nations at the Federation of Small Businesses, told us:

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

18.61 When we set out our proposals to the Scotch Whisky Association it consulted its members on these. It subsequently informed us that it believed “in principle, that the proposals would be of benefit to the Scotch Whisky industry”.

18.62 ABFA also surveyed its members. Several commented that the ability to take the statutory pledge would decrease the interest rates and fees charged on loans. This effect is supported by empirical studies.¹⁰¹ ABFA members also commented that the existence of the

⁹⁷ In July 2016 this became the Department for Business, Energy and Industrial Strategy.

⁹⁸ H Patrick, “A View from Practice” (2012) 16 EdinLR 272 at 278.

⁹⁹ In a subsequently published article Dr Anderson described the Discussion Paper as “excellent”. See R G Anderson, “Scottish Share Pledges in the Supreme Court” (2012) 16 EdinLR 99 at 104. Elsewhere he has commented that it “is of the highest quality”. See R G Anderson, “Critique” (2012) 16 EdinLR 267 at 271.

¹⁰⁰ See para 1.16 above.

¹⁰¹ G Castellano, “Reforming Non-Possessory Secured Transactions Laws: A New Strategy” 2015 MLR 611 (; E Benmelech and N K Bergman, “Collateral Pricing” (2009) 91 Journal of Financial Economics 339; J R Booth and L C Booth, “Loan Collateral Decisions and Corporate Borrowing Costs” (2006) Journal of Money, Credit and Banking 67 and World Bank, “Getting Credit: The Importance of Registries” (2014) in *Doing Business 2015: Going Beyond Efficiency*.

statutory pledge would encourage them to provide more finance than they currently do to businesses in Scotland.

18.63 The Finance and Leasing Association also sought the views of its members. Again there was significant support for our proposals. One member commented:

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

18.64 In July 2017 we consulted on an advanced version of our draft Bill and again consultees were broadly supportive of the security provisions within it.

Doubts, concerns, opposition

18.65 The Judges of the Court of Session and the Faculty of Advocates expressed doubts about whether reform of the law was needed. The Judges referred directly to the opposition to the earlier proposals¹⁰² of the Law Commission for England and Wales:

“Given the importance of some degree of coherence between the positions north and south of the border, this state of affairs in England and Wales raises a question as to the prudence of proceeding with major law reform in this area in Scotland.”

In our view, this overlooks the point that there is a more pressing need for reform north of the border, for the reasons set out in Chapter 17. Further, the proposed scheme eschews the UCC–9/PPSA approach because of the need for there to be consistency with the law of England and Wales.

18.66 While the Faculty praised the Discussion Paper as “a significant and positive contribution to the development of the law in an important field”, it noted the apparent lack of empirical evidence in relation to businesses facing difficulties in obtaining loan finance. It then said: “therefore there is reason to question whether the reforms proposed to the law of security are commercially necessary”. For the reasons set out in Chapter 17 and in the BRIA, and given the strong support for reform from other consultees, we disagree. The Faculty also raised the difficulty of trying to reconcile the need to make the proposed new security right a “strong” security which banks and financial institutions would favour with the need to protect good faith third parties who in certain transactional contexts cannot be expected to search the new register. But this challenge is not unique to Scotland. Modern legislation in other jurisdictions endeavours to strike a balance in this respect and this is our approach too.¹⁰³

18.67 Others had concerns on issues of detail. Three deserve comment here as they were shared by a number of consultees. The first was the proposal that the new security should have both a fixed and floating nature. This came in for criticism as not being sufficiently explained. Several consultees felt also that the case for a floating version, referred to in the Discussion Paper as a “floating lien”, would create an unnecessary and untidy overlap with the floating charge. We accept these criticisms for the reasons given in more detail in Chapter 20. We now recommend that the new security right is fixed only.

¹⁰² See paras 18.26–18.31 above.

¹⁰³ See Chapter 24 below.

18.68 The second concern, expressed by the Law Society of Scotland, a number of law firm consultees and Jim McLean, was whether it was sensible for the scheme to apply to consumers. When we explored this concern with some of these consultees, they stated that they considered that there was a more pressing need for reform in a business context and they did not wish to see that reform being delayed by consumer specialities. We have given this issue considerable thought and discussed it with other stakeholders including the FLA and the Consumer Credit Trade Association. As discussed further in Chapter 19, we hold to the view in the Discussion Paper, that the scheme should apply to consumers, but with appropriate protections. This is in line with comparator legislation elsewhere.

18.69 Thirdly, there was concern about the inter-relationship of the scheme with insolvency law. The Faculty of Advocates, Scott Wortley and Donald McGruther CA criticised the fact that insolvency law was not considered in the Discussion Paper. Tom Hughes CA stated: “I have reached the conclusion that Insolvency Law as a whole needs overhauled, particularly in the corporate sector.” But to have added insolvency law and then, necessarily, the related area of diligence to the scope of the project would have made it considerably larger and resulted in publication of this Report taking many more years. This Report is already one of the largest that this Commission has ever published. Moreover, there is the significant complication that personal insolvency law is devolved to the Scottish Parliament but corporate insolvency law is reserved to the UK Parliament. The principal statute is the Insolvency Act 1986. Work to reform corporate insolvency law would therefore clearly need to proceed on a UK-wide basis. Our approach follows that of the Law Commission for England and Wales, which in its project on company security rights said that the reforms that were being proposed would not make significant changes to insolvency law.¹⁰⁴ In any event some of the Faculty’s more specific concerns in relation to insolvency law concerned the “floating lien”, which we are now not pursuing.¹⁰⁵

18.70 There was more particular anxiety about the effect of our scheme on unsecured creditors and on meeting the expenses of an insolvency, a view expressed trenchantly when we convened a meeting with insolvency specialists in September 2015 to discuss the impact of our likely recommendations.¹⁰⁶ These points were also made by ICAS and R3 in their responses to our draft Bill consultation in July 2017. It was argued that if there were additional ways in which to create security then there would be less left for creditors who do not take security. While there is some force in this, for a number of reasons we do not think it is a compelling justification simply to leave the law unreformed in its current unsatisfactory state.

18.71 First, the new scheme would enable creditors who are unsecured at present, due to the restrictive nature of the current law, to take security. Secondly, the scheme in many situations is aimed at allowing security to be taken in a more efficient way than existing forms of security. Thus instead of having to transfer shares in a company to a bank, the new security right (the statutory pledge) could be used. Instead of assigning a patent, the

¹⁰⁴ See eg Law Commission, Registration of Security Interests: Company Charges and Property other than Land (Law Com CP No 164, 2002) para 3.411.

¹⁰⁵ See Chapter 20 below.

¹⁰⁶ We are grateful to the representatives of ICAS/R3 and others who attended that meeting. We have particularly appreciated the help of Donna McKenzie Skene of the University of Aberdeen and Roy Roxburgh, formerly of Maclay, Murray & Spens in relation to the interface of the project with insolvency law.

statutory pledge could be granted over it.¹⁰⁷ Thirdly, we expect the statutory pledge to be used mainly by companies and LLPs. The insolvency of these entities is regulated by the Insolvency Act 1986, which as mentioned above, applies both in Scotland, and in England and Wales. In functional terms, the new security right is the equivalent of the English fixed charge. Thus the effect of the scheme is to put secured creditors of Scottish companies and LLPs on the same footing as the secured creditors of English and Welsh companies and LLPs against a common insolvency-law background. Fourthly, we have modified our proposals in the Discussion Paper by not proceeding with the floating lien. The reasons for this are discussed in Chapter 20. This would reduce the effect on unsecured creditors, particularly of non-corporate bodies. Fifthly, for reasons discussed further in Chapter 22, we recommend that the scope of the statutory pledge at least initially is limited to two classes of incorporeal moveable property: financial instruments and intellectual property. This would lessen its effect on other interests in an insolvency. Sixthly, retention of title would remain possible and sellers of goods would be able to protect themselves through that device, although suppliers of services would not have this option available to them. Seventhly, because of the restrictions which we recommend below in relation to the grant of a statutory pledge by private individuals we think that its introduction would have little impact on non-business insolvencies.¹⁰⁸

18.72 There was very limited opposition in principle to the scheme. The principal opponent was Chris Dun.¹⁰⁹ In his consultation response he stated his view that the current law was “incompatible with modern commercial practice.” But he was “wary in particular of a solution which involves yet another register. This seems to create a cumbersome system.” He had several concerns. But we believe that we can offer some reassurance regarding these. First, he was worried that the scheme would supersede the current law. It would not. The scheme would supplement the current law and provide parties with further options. Secondly, he was concerned about recharacterisation. We do not recommend recharacterisation. Thirdly, he did not want to see the loss of the floating charge. We recommend the retention of the floating charge. Mr Dun favoured a solution which “would allow for the grant of a security over moveable property without notice, but with specified protections to third parties without notice.” Here we differ from him, as the trend internationally is very much for a register-based system because it improves transparency. Systems such as those in Germany and the Netherlands, where registration is not required, are coming under increasing critical scrutiny in this regard.¹¹⁰

Issues not covered in the Discussion Paper

18.73 We also asked consultees if there were any issues in the field of moveable transactions law that stand in need of reform that were not covered by the Discussion Paper.¹¹¹ Only a few additional issues were mentioned. One was insolvency law, which we

¹⁰⁷ Although we accept that the new security could be taken by several creditors over the same asset, whereas a transfer can only be to one.

¹⁰⁸ See paras 19.36–19.51 below.

¹⁰⁹ Mr Dun kindly agreed to join our advisory group in 2014.

¹¹⁰ See eg A Morell and F Helsen, “The Interrelation of Transparency and Availability of Collateral: German and Belgian Laws of Non-possessory Security Interests” (2014) 22 *European Review of Private Law* 393; Hamwijk, *Publicity in Secured Transactions Law* ch 4 and M Brinkmann, “The Peculiar Approach of German Law in the Field of Secured Transactions and Why it Has Worked (So Far)” in Gullifer and Akseli (eds), *Secured Transactions Law Reform* 339–354.

¹¹¹ Discussion Paper, para 1.42.

cover above. As mentioned earlier,¹¹² Begbies Traynor argued for a register of trusts, but when we canvassed such a possibility in our trusts project it drew strong opposition.¹¹³ Professor Stewart Brymer suggested that there might be a register of ownership of moveable property such as vehicles. This is outwith our scope.

Conclusion

18.74 As we have seen, most of our consultees supported the scheme set out in the Discussion Paper, although there were comments on detail, which we have taken account of in preparing this Report. In particular, we consider now that the new security should be fixed only and there should not be a floating lien. A modestly revised version of the scheme is set out above in Chapter 16. We recommend that:

- 71. The law on security over moveable property should be reformed on the lines set out in Chapter 16.**

¹¹² See para 18.47 above.

¹¹³ Scottish Law Commission, Report on Trust Law (Scot Law Com No 239, 2014) paras 3.9 and 3.11.

Chapter 19 Security over moveable property: general

Introduction

19.1 In Chapter 18 we set out the support from consultees in relation to the reform of security over moveable property in Scotland along the lines of the scheme described in the Discussion Paper. Central to that scheme was the proposal to introduce a new form of security right which would require registration. The security right would be a “true” security. Ownership would remain with the party granting the security right and the secured creditor would acquire a subordinate right in the property.

19.2 As regards corporeal moveable property the new security right would be *non-possessory*. It would complement the existing security right of pledge, which is *possessory*. For the reasons explained fully in the following chapter we recommend that the new security right should be a fixed security only. Pledge too is a type of fixed security. The essential difference between the two types is that one is created by delivery (placing the secured creditor in possession of the property being encumbered) and the other would be created by registration. As we shall explain, this has influenced our recommendation below that the new security right should be called a “statutory pledge”. This approach has the advantage of enabling some of the core rules of possessory pledge to be placed on a modern statutory footing and facilitating a broadly common battery of enforcement remedies for both types of security right.

A new type of pledge

19.3 If a new security right over moveable property is to be introduced it requires a name. In the Discussion Paper we expressed the view that a snappy name would be desirable.¹ There we used “new moveable security” as a working title, but we were clear that this was all it could be, as this term would not be suitable for legislation. The Murray Report² used the term “moveable security” for its proposed security, which would have been competent in relation to corporeal moveable property (without possession) and incorporeal moveable property (without intimation). While that term provides a match with “heritable security” it suffers from the flaw that “moveable security” (like “heritable security”) is a more generic term and this is capable of including pledge, aircraft mortgages, ship mortgages etc.³ In the Discussion Paper we suggested “registered moveable security”, which we noted, was not very snappy. Again, however, there are other registered moveable securities, such as the floating charge. Another possible name - “moveable hypothec” - is imperfect because

¹ Discussion Paper, para 16.82.

² See paras 18.18–18.22 above.

³ See A J M Steven, “Reform of Security over Moveable Property: Some Further Thoughts” 1995 SLT (News) 120.

“hypothec” means non-possessory security⁴ and, in general terms, only corporeals and not incorporeals can be possessed.⁵ Further, it is not a familiar term to non-lawyers.

19.4 In response to our question as to what the new security right should be called, we had a variety of responses from consultees. David Cabrelli favoured “moveable security”. The Aberdeen Law School and Chris Dun both suggested “moveable property security”. John MacLeod thought “registered moveable security” was appropriate. Dr Ross Anderson suggested a formulation using the word “hypothec”.⁶ Dr Hamish Patrick had no strong views, but mooted “moveable security interest”. Several law firm consultees as well the Law Society of Scotland did not have strong opinions. Magdalena Raczynska proposed “charge”,⁷ but this is a technical term in English law and might lead to possible confusion with the floating charge. The Keeper of the Registers of Scotland considered it important that the new form of security should be given a name that is simple, descriptive and not easily confused with other forms of security or diligence.

19.5 There was thus no consensus among consultees as to what would be an appropriate name. We have given the matter careful consideration and ultimately we have decided on the name “statutory pledge”.⁸ Our reasons are as follows. First, “pledge” is a familiar word in the context of rights in security and the word has an additional sense, namely “promise”.⁹ The party granting the security is promising that the asset being encumbered will be available to the secured creditor if there is default. Moreover, other jurisdictions use the term “pledge” in the context of their law of rights in security over moveables. Examples include French law in relation to the equivalent term “gage”,¹⁰ German law in its use of “Pfand”¹¹ and Dutch law in relation to “pand”.¹² Sometimes, as in French law, the term is restricted to corporeal moveables.¹³ Sometimes it is not.¹⁴ We note also that the English translation of recent important and broad-ranging legislation reforming security over moveable property in Belgium is the “Belgian Pledge Act of 11 July 2013”.¹⁵

19.6 Secondly, the name is relatively snappy. Thirdly, for the reasons which we give in the next chapter, the new security right, like pledge, is to be a fixed security only. Fourthly, this approach effectively creates a second type of pledge in Scottish law. The common law possessory pledge gains a brother or sister, the statutory pledge. But, being siblings, it is possible to apply common terminology and rules to them. In particular, it allows their enforcement rules to be put onto the same footing, a matter which we discuss further in Chapters 27 and 28 below. As we say there, it is difficult to see why there should be

⁴ Stair 1.13.14; Gloag and Irvine, *Rights in Security* 406.

⁵ The subject is not without controversy. See eg T Rübner, “Possession of Incorporeals” in E Descheemaeker (ed), *The Consequences of Possession* (2014) 171.

⁶ See also R G Anderson, “A Critique” (2012) 16 *EdinLR* 267 at 271.

⁷ This name was also suggested to us informally by Richard Calnan.

⁸ We also considered the term “registered pledge”, a term which was independently suggested to us by Dr Craig Anderson when we consulted on our draft Bill in July 2017. The difficulty with this term is that in some instances because of the Financial Collateral Arrangements Regulations the new security can be created without registration. See Chapter 37 below.

⁹ See Steven, *Pledge and Lien* para 2-04.

¹⁰ French Civil Code art 2337.

¹¹ German Civil Code §§ 1204–1296.

¹² Dutch Civil Code arts 3:236–3:259.

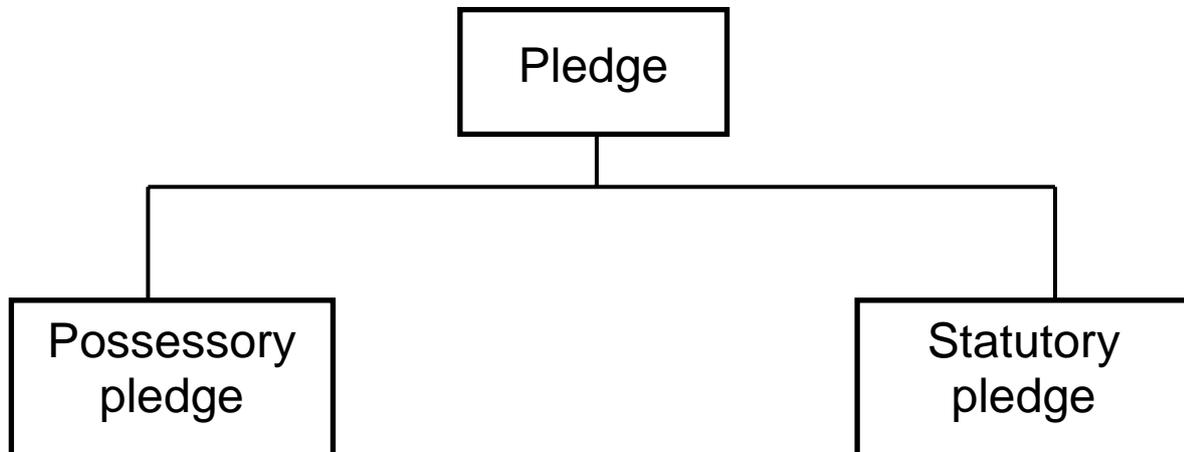
¹³ For incorporeal moveables the term is “nantissement”. See French Civil Code art 2355.

¹⁴ The term “pand” is used broadly in Dutch law for security over moveable property, including over financial instruments and intellectual property.

¹⁵ See E Dirix, “The New Belgian Act on Security Interests in Movable Property” (2014) 23 *International Insolvency Review* 171.

different enforcement remedies depending on whether a security right has been perfected by possession or registration. This indeed is the position under UCC–9 and PPSAs.

19.7 The result of this approach is shown by the diagram below.



19.8 We recommend that:

72. (a) There should be a new right in security over moveable property.
- (b) It should be a new type of pledge called a “statutory pledge”.

(Draft Bill, s 43(1), (2)(b) & (4))

The parties

General

19.9 In the draft Bill we use the term “provider” for a person who grants a pledge, be that a possessory pledge or statutory pledge. The person in whose favour the pledge is granted is referred to as the “secured creditor”.¹⁶

19.10 It might be thought that an obvious term for the granter of the security right is the “debtor”. This is the term used in UCC–9¹⁷ and some of the PPSAs.¹⁸ Nevertheless, it is possible for the person owing the debt and the granter of the pledge to be different persons. This is known as third-party security.¹⁹ For example, Simon could grant a statutory pledge over his car to a bank in respect of a loan by the bank to his wife Tamsin. In doing this Simon does not become personally liable for repayment, but if the debt is not repaid the car

¹⁶ We have been influenced here by the DCFR IX.–1:201(12) and (13).

¹⁷ UCC § 9–102 (a) (28).

¹⁸ Eg NZ PPSA 1999 s 16(1).

¹⁹ See Gretton and Steven, *Property, Trusts and Succession* para 21.19. See also Drobniq and Böger, *Proprietary Security in Movable Assets* 271–272 and 273–274. See too the Belgian Pledge Act of 11 July 2013 art 10 (which provides for art 5 of the new Book III title XVII of the Civil Code).

will have to be sold. In other words, the right of the bank against Tamsin is secured over Simon's car. Thus Simon is the provider of the security and Tamsin is the debtor.

19.11 We favour the terms "provider" and "secured creditor" over "pledger" and "pledgee", which are used in the context of the existing law of pledge, because they are more generic terms used in modern legislation on security rights elsewhere. They are also, we consider, more accessible to lay persons.

19.12 We recommend:

73. (a) The person to whom a pledge is granted should be referred to as the "secured creditor".

(b) The person who grants the pledge should be referred to as the "provider".

(Draft Bill, s 43(5))

Successors

19.13 The parties to the pledge may not stay the same. Thus the pledge might be assigned to a new secured creditor. The provider may die and the provider's property then would vest in the executor. It is important therefore that the terms "provider" and "secured creditor" include successors. Equivalent provision is made in the legislation on standard securities.²⁰

19.14 In the case of the provider, the definition should include successor owners of the encumbered property, against whom the pledge can equally be enforced. On the other hand successor owners who take the property free of the pledge because of the good faith acquisition provisions which we recommend elsewhere²¹ should not be included.

19.15 We recommend:

74. (a) The term "provider" should include any successor in title or representative of a provider (unless the successor or representative is a person who acquired the encumbered property unencumbered by the statutory pledge in question).

(b) The term "secured creditor" should include any successor in title or representative of a secured creditor.

(Draft Bill, s 116(1))

²⁰ Conveyancing and Feudal Reform (Scotland) Act 1970 s 30(1) (definitions of "creditor" and "debtor"). And see also the Belgian Pledge Act of 11 July 2013 art 29 (which provides for art 24 of the new Book III title XVII of the Civil Code).

²¹ See Chapter 24 below.

What is secured?

Terminology

19.16 It is commonly understood that security rights secure the payment of debts.²² Thus Neil may buy a house with a loan from a bank. In return the bank obtains a standard security (known to the layperson as a “mortgage”) from Neil. This means in principle that the house can be sold to satisfy the debt if Neil fails to keep up his loan repayments. Thus, the Conveyancing and Feudal Reform (Scotland) Act 1970, provides that: “A grant of any right over land or a real right in land for the purpose of securing any debt by way of a heritable security shall only be capable of being effected at law if it is embodied in a standard security.”²³

Monetary and non-monetary obligations

19.17 Normally, a security right will secure the payment of a monetary debt.²⁴ But sometimes security rights are granted in respect of non-monetary obligations.²⁵ Thus the 1970 Act defines “debt” as including an obligation *ad factum praestandum*, in other words an obligation to do something.²⁶ While a pledge should be capable of securing performance of a non-monetary obligation, ultimately all that can be obtained from enforcement of a security against an asset is money. Thus it would seem that what is actually secured is the right to payment of damages if there is default.²⁷ Unless there is a liquidated damages clause in the security agreement, enforcement against the asset is problematic.

Restricted or unrestricted?

19.18 Security rights can either be restricted or unrestricted.²⁸ A restricted security right secures a fixed amount. Thus John may pawn his watch to a pawnbroker for £100. The watch only secures the repayment of the £100 and no other debts. In contrast, an unrestricted security right secures all sums owed by the debtor to the secured creditor. This is the normal position for standard securities. Take the following example. April buys a house for £200,000 with the help of a £150,000 loan from a bank. In return the bank will take a standard security, which it will register in the Land Register. The standard security will state that it secures “all sums due and to become due”. This means that if April borrows further money from the bank, say to add a conservatory, that sum would also be secured. The unrestricted security avoids the expense and inconvenience of having to grant a fresh security.

19.19 In the Discussion Paper we proposed that the rule for the new type of security right should be the same as for standard securities. In other words, the statutory pledge would be

²² Strictly what is secured is the right to performance of the debt. See DCFR IX.–2:401. But the terms “secured debt” and “secured obligation” are in general usage. See eg UNCITRAL Model Law on Secured Transactions article 7 and City of London Law Society draft Secured Transactions Code section 18 (pp 62–65).

²³ Conveyancing and Feudal Reform (Scotland) Act 1970 s 9(3).

²⁴ On the different meanings of the term “debt”, see M Hogg, *Obligations: Law and Language* (2017) 54–60.

²⁵ For common law examples, see *Moore v Gledden* (1869) 7 M 1016 and *Edmonstone v Seton* (1886) 16 R 1.

²⁶ Conveyancing and Feudal Reform (Scotland) Act 1970 s 9(8)(c). See also the Companies Act 1985 s 462(1) which provides that floating charges can secure “any debt or other obligation (including a cautionary obligation).”

²⁷ See G L Gretton, “The Concept of Security” in D J Cusine (ed), *A Scots Conveyancing Miscellany: Essays in Honour of Professor J M Halliday* (1987) 126 at 128–129. See also D J Cusine and R Rennie, *Standard Securities* (2nd edn, 2002) para 3.05.

²⁸ See eg Gretton and Steven, *Property, Trusts and Succession* para 21.16.

unrestricted. It could be granted not only for existing obligations but for future obligations too. But of course the parties would be free to agree that the security right should be for a restricted amount. The approach under UCC–9,²⁹ the PPSAs,³⁰ the DCFR Book IX³¹ and the UNCITRAL Model Law on Secured Transactions³² is the same.

19.20 We asked consultees whether they agreed that the new security right should be capable of securing the performance of future obligations. Almost all the consultees who responded to this question agreed. One law firm³³ said: “this is an obvious requirement and is what financiers expect. Legislative certainty on the point would be advantageous to Scotland as a commercial destination.” The WS Society stated: “this appears to be common sense and to tally with what is done in practice with most commercial security in the banking and finance world at present . . . why have different rules for securities over different types of asset?” Brodies said: “We are clear that this should be possible and is entirely consistent with market participant expectations.” Aberdeen Law School agreed in principle, subject to there being a “quick, cheap and effective way” for individuals who have granted the security to check the new register in which the security appears. We discuss searching the register in Chapter 34 below.

19.21 Scott Wortley was the sole consultee against the new security right being unrestricted. He was concerned about the effect on unsecured creditors of introducing a new security right. We discuss this concern elsewhere.³⁴ We think, however, that it would be anomalous and commercially unattractive for the statutory pledge to be restricted to a fixed sum when the floating charge and the standard security are not. It would also make Scottish law inconsistent with the position under comparator legislation, the DCFR and the UNCITRAL Model Law, and could potentially make Scotland a less attractive place for lending by foreign-based financial institutions.

19.22 In relation to possessory pledge, the current law is unclear as to whether the debt can be unrestricted, although there is authority to suggest that it can.³⁵ We see no reason why a possessory pledge should be different from a statutory pledge. It should be capable of being unrestricted.

Other aspects of the secured obligation

19.23 Earlier we discussed how the secured obligation need not necessarily be an obligation against the provider. We gave the example of the bank’s right to repayment by Tamsin of its loan secured against a car owned by Simon.³⁶ We think that the permissibility of this type of arrangement should be stated expressly.

19.24 Where the pledge has been granted in favour of a security trustee, the secured obligation(s) would be owed to the creditors for whom the trustee holds the pledge. But for the purposes of the draft Bill, the trustee would be the “secured creditor”, as it is the grantee

²⁹ UCC § 9–204(c).

³⁰ Eg Saskatchewan PPSA 1993 s 14(1); NZ PPSA 1999 s 71; and Australian PPSA 2009 s 18(4).

³¹ DCFR IX.–2:104(5).

³² UNCITRAL Model Law on Secured Transactions art 7.

³³ Dundas & Wilson.

³⁴ See paras 18.69–18.71 above.

³⁵ Steven, *Pledge and Lien* paras 4-03–4-17.

³⁶ See para 19.10 above.

of the pledge. It should be therefore made clear that the secured obligation may be owed to a person other than the “secured creditor”.

19.25 The secured obligation should also include ancillary obligations of the provider, for example to pay interest, to pay damages (for non-performance) and to pay the reasonable expense of extra-judicial recovery of interest and damages.³⁷

19.26 We therefore recommend that:

75. The secured obligation:

(a) may be any obligation owed, or which will or may become owed, to the secured creditor,

(b) should not require to be an obligation owed

(i) by the provider, or

(ii) to the secured creditor, and

(c) should include ancillary obligations owed to the secured creditor (as for example to pay interest, damages or the reasonable expenses of extra-judicial recovery of interest or damages).

(Draft Bill, s 44(2))

Non-accessory security

19.27 A security right is an “accessory” right.³⁸ It is dependent on the secured obligation. Thus the secured obligation, normally a monetary debt, is the principal and the security right is the accessory. As we have seen, it is not necessary for the debtor and the provider to be the same person.³⁹

19.28 It is also not necessary for there to be a present secured obligation, merely that it is possible for there to be a secured obligation. For example, a company can grant a floating charge to a bank in respect of an overdraft facility. But the facility might never be used. There might never actually be a secured debt, but as long as the coming into being of a secured debt is possible a security may validly be granted.⁴⁰ In contrast a stricter approach is taken with some security rights, particularly historically, in that a present debt is required.⁴¹

19.29 Some legal systems, notably Germany and Switzerland, have developed non-accessory security in relation to land, although the concept is not without its problems.⁴² In

³⁷ See DCFR IX.–2:401. See also the Belgian Pledge Act of 11 July 2013 art 17 (which provides for art 12 of the new Book III title XVII of the Civil Code).

³⁸ Discussion Paper, para 5.28.

³⁹ See para 19.10 above.

⁴⁰ See A J M Steven, “Accessoriness and Security over Land” (2009) 13 EdinLR 387 at 399–400.

⁴¹ In her consultation response Magdalena Raczynska noted this was the traditional position in Polish law.

⁴² Not least where the security is assigned, but the security contract is not so that the security can be enforced although there is no actual debt. In Germany this led to the introduction of the *Risikobegrenzungsgesetz* in 2008 in order to let the debtor plead any defence arising out of the security agreement against a subsequent holder of the security. See generally L P W van Vliet, “Mortgages on immovables in Dutch law in comparison to the

the Discussion Paper,⁴³ we expressed our understanding that there can be situations where a company wants to raise money on the security of certain assets, without being contractually liable for the loan. Thus if the company defaults, the creditor can enforce against the property, but if this does not satisfy the debt, the creditor cannot sue the company for the deficit. We considered that this can be achieved by contractual agreement that the creditor will not enforce its right to recover the debt by personal action. But, nevertheless, we asked consultees whether non-accessory security over moveable property should be competent.

19.30 There was only limited support for this. The Faculty of Advocates answered “yes” but gave no reasons. Chris Dun was in favour, subject to protection for third parties without notice. Dr Ross Anderson considered that non-accessory security should in principle be competent, but thought that the demand was greater for security over land rather than over moveables. Magdalena Raczynska favoured a diluted version of non-accessory security to ensure debtor protection, noting recent problems in German law. David Cabrelli, Dr Hamish Patrick, the WS Society and several law firm consultees were unpersuaded of the need for legislative intervention here. Professor Eric Dirix noted that non-accessory security rights are unknown in the civil law tradition. Scott Wortley argued that any reform should be considered in the context of the law of rights in security as a whole and not for moveables only. We conclude that the case for the statutory pledge (or indeed possessory pledge) to be capable of being non-accessory has not been made out and recommend:

76. There should not be a non-accessory form of pledge.

Who can grant?

19.31 In general any person can grant a security right, provided of course that the person has a relevant asset.⁴⁴ Thus the owner of a house can grant a standard security over that property. The owner of a watch may pledge it. The owner of a ship can grant a ship mortgage over that vessel. There is one notable exception to this general principle. Only companies and a limited number of other corporations⁴⁵ can grant a floating charge.

19.32 In the Discussion Paper we asked whether any person, juristic or natural, should be able to grant the new security. This question was asked in the context of the proposal that the new security should have a floating version, a proposal from which, as will be explained in the next chapter,⁴⁶ we have now departed. Nevertheless, the question remains valid at the more general level.

19.33 An overwhelming majority of the consultees who responded to this question agreed that any person should be able to grant the new security right. Several, including ABFA, Dr Ross Anderson and the WS Society noted that this would be particularly helpful for partnerships, which of course are unable to grant floating charges. A few consultees, including the Faculty of Advocates, had doubts about whether consumers should be able to grant the security. Our view, in line with the position under comparator legislation in

German mortgage and land charge” in M Hinteregger and T Borić (eds), *Sicherungsrechte an Immobilien in Europa* (2009) 285 at 293–297.

⁴³ Discussion Paper, para 5.29.

⁴⁴ Or in the future may have a relevant asset.

⁴⁵ Including limited liability partnerships. See para 17.30 above.

⁴⁶ See Chapter 20 below.

numerous other jurisdictions, is that they should.⁴⁷ They should, however, be protected by certain consumer-specific provisions. We discuss this subject below.⁴⁸ The availability of the statutory pledge to consumers was also something which was supported by the Finance and Leasing Association and the Consumer Credit Trade Association in post-consultation discussions with them.

19.34 For possessory pledges it has always been the case that any person can grant this type of security right.

19.35 We therefore recommend:

77. Any person, juristic or natural, should be able to grant a pledge.

Protection for consumer providers of statutory pledges

General

19.36 The Consumer Credit Act 1974, as well as containing generic provisions on security rights granted by consumers,⁴⁹ sets out certain protections in relation to pledges by “individuals”⁵⁰ to pawnbrokers.⁵¹ These provisions would continue to apply to possessory pledges by such individuals under our new scheme.⁵² These do not, however, limit the classes of asset that can be pledged.⁵³

19.37 There are, however, two major differences between possessory pledge and the new statutory pledge, which make it necessary to consider restricting the availability of the latter. The first is that because the statutory pledge would be a non-possessory security, providers (usually debtors) would not need to relinquish direct possession of their assets. Having to hand the item over concentrates the mind as to whether one can do without it. The second difference is that the statutory pledge, as we shall see in the next chapter, would be capable of being granted over future assets. In principle, someone could grant a statutory pledge over not just their current vehicle, but all future vehicles that the person may come to own. The consequences could be significant.

19.38 In the Discussion Paper we noted that UCC–9 and the PPSAs broadly speaking do not allow security over after-acquired consumer goods.⁵⁴ The DCFR in general does not allow security to be granted by consumers over after-acquired property.⁵⁵ We noted that there is a difference between these approaches, the one restriction relating to the type of property and the other to the type of granter. We said that we inclined to the DCFR formulation and we asked consultees whether they agreed that the new security right should

⁴⁷ See also para 18.68 above.

⁴⁸ See paras 19.36–19.55 below.

⁴⁹ See in particular Consumer Credit Act 1974 ss 105–113.

⁵⁰ This term is defined more widely than might be expected. See para 19.52 below.

⁵¹ Consumer Credit Act 1974 ss 114–122. As we note at paras 1.39–1.42 above the subject matter of the 1974 Act is reserved to the UK Parliament. Our draft Bill is intended to be within the competence of the Scottish Parliament and therefore has no provisions amending the 1974 Act. The provisions which it has on consumer protection are specific to the statutory pledge and would also be subject to the more general provisions on security rights in the 1974 Act.

⁵² See para 27.17 below.

⁵³ But see the more general provision in the 1974 Act s 123(3) on negotiable instruments being taken in security from consumers.

⁵⁴ Discussion Paper, para 16.75.

⁵⁵ DCFR IX.–2:107(1)(b).

not be capable of being granted by a consumer in relation to future property. Consultees generally agreed and we so recommend.

19.39 In the Discussion Paper we went on to ask whether there should be other restrictions in relation to consumer debtors.⁵⁶ For example, should goods exempt from diligence be excluded? We noted, however, that goods that are exempt from diligence can still be subject to hire-purchase etc. It may be thus argued that to exclude such property from the scope of the new security right would be merely to encourage the use of hire-purchase, which in itself is an artificial system. We also made the suggestion that the security right should be valid only to secure purchase finance.

19.40 There was in general strong support from consultees for further restrictions, but differences as to the detail. Brodies, David Cabrelli, John MacLeod, Dr Hamish Patrick and the Law Society of Scotland supported the exclusion of goods exempt from diligence. Chris Dun stated that ordinary household items should be excluded. We agree that there should be protection in respect of such items. As a matter of social policy, individuals clearly should not be able to grant a statutory pledge over their cooker, clothes, bedding or children's toys, even if in practice secured creditors may be unlikely to be interested in such items.⁵⁷ The question, however, is whether drawing on the list of goods exempt from diligence is the best way of achieving that policy.

19.41 It is the Debt Arrangement and Attachment (Scotland) Act 2002 which specifies which goods are exempt. There is not a single list. The exclusions are set out across a number of provisions and are not particularly accessible.⁵⁸ Some of the provisions are nuanced, for example a vehicle will be excluded if it is not worth more than £1,000 and its use is reasonably required by the debtor.⁵⁹ It is sheriff officers in the main who must master the list. For the statutory pledge any would-be creditor would in principle have to know the list. Perhaps this concern is not strong, as the banks and other professional credit providers would usually be the creditor and they would be able to familiarise themselves with the list. But there remains the "nuanced" issue. A sheriff officer,⁶⁰ with whom we discussed the list, stressed that many of the items on it are subject to qualifications such as being "reasonably required" by the debtor.

19.42 We think that there may be a simpler way of achieving the desired policy. This is that there should be a prohibition against individuals granting a statutory pledge over items worth less than a figure to be set by statutory instrument. The amount which we have currently in mind is £1,000, a figure which appears in various places in the list in the 2002 Act. This would exclude essential personal and household items such as ordinary clothes, bedding, furniture, white goods and toys. Most televisions would be excluded too. It is likely that the item that would most commonly be the subject of a statutory pledge granted by a consumer would be a motor vehicle. We were advised by Bruce Wood that valuable musical

⁵⁶ Discussion Paper, para 16.78.

⁵⁷ A similar argument for protection was made by the City of London Law Society in its response to the Law Commission for England and Wales' consultation on bills of sale but this was rejected by the Commission on the ground that "there was little indication that lending secured on essential household goods is, or would become, commonplace." See Law Commission, Report on Bills of Sale (Law Com No 369, 2016) para 4.66.

⁵⁸ See the Debt Arrangement and Attachment (Scotland) Act 2002 ss 11, 45, 46 and 47 and sch 2.

⁵⁹ 2002 Act s 11(1)(b).

⁶⁰ Mr Roddy Macpherson.

instruments would also be of interest to secured creditors. Another possibility would be an art work.

19.43 There is, however, a disadvantage to the threshold-figure approach, of which we were aware, but which was also highlighted to us by Professor Hugh Beale and Professor Louise Gullifer in their response to our draft Bill consultation of July 2017. Sometimes assets form part of a collection, for example books and stamps. The individual items may be worth less than the threshold figure but collectively they may significantly exceed it. But trying to frame an appropriate rule which would catch certain collections but not others, for example furniture and toys, would take us back to a list-approach with the problems outlined earlier.

19.44 A third approach favoured by the New Zealand Law Commission and now implemented by legislation is to draw up a clearer and shorter list than the one currently found in the 2002 Act.⁶¹ Such an approach is an entirely reasonable one but the relatively short New Zealand list applies to security rights under consumer contracts in general and thus also applies to hire-purchase. Our rule would only apply to the statutory pledge. Given the views of consultees that a wider range of assets should be excluded from the scope of the statutory pledge, on balance we recommend a rule preventing the security right being granted over items below a certain prescribed value.

19.45 In relation to such a rule it must be clear whether the threshold value is to be ascertained at the time of the grant of the statutory pledge or at the time of enforcement. For diligence under the 2002 Act it is obviously the value at enforcement which matters, as diligence is not granted.⁶² There are arguments both ways. It is easier to value an asset at the present time than to ascertain its historic value at the time of grant. On the other hand, a rule requiring value above a certain level to permit enforcement might encourage dishonest debtors to devalue the asset. On balance we think that the value should be at the time of grant.

19.46 We further consider that the restriction should only apply to corporeal assets. Later we recommend that the statutory pledge should be restricted for the time being to financial instruments and intellectual property.⁶³ Neither of these can be regarded as essential domestic assets and they are not property which is exempted from diligence.

19.47 There was no support from consultees for the suggestion that for consumers the statutory pledge should only be available for purchase finance. We concluded above that it

⁶¹ See Law Commission of New Zealand in its *Consumers and Repossession* (Report 124, 2012) paras 3.38-3.72 which considers (1) a prohibition on granting security over household goods, including cars up to the value of NZ\$5,000 (about £2,500) and (2) a “protected goods list”. On balance (at para 3.42) it favoured the latter, with the list to be prescribed by statutory instrument: “From the debtor’s perspective, as many submissions commented, there is a risk that if too wide a category of goods were to be exempted from repossession or a blanket prohibition on repossession of goods below a particular value imposed, some would be prevented from accessing credit. From an economic perspective, there would also be the fear that this might prevent poorer people from being able to use whatever limited equity they have to finance credit. Overly paternalistic legislation risks undermining the interests of those it seeks to protect.” At para 3.50 it recommends that medical equipment, bedding, portable heaters, stoves, washing machines and cooking equipment are on the protected goods list, but not televisions and cars. The recommendations were implemented by the Credit Contracts and Consumer Amendment Act 2014 s 51, inserting a new s 83ZN to the Credit Contracts and Consumer Finance Act 2003.

⁶² With the arguable exception of the right to carry out summary diligence.

⁶³ See Chapter 22 below.

should not be possible for consumers to grant the statutory pledge over future assets.⁶⁴ The DCFR does, however, allow security to be granted over a future asset to secure repayment of sums advanced to help acquire the asset in question.⁶⁵ Thus Brian could grant a security right over a specific car which he is in the process of acquiring in order to secure a loan that he has received from a bank towards the purchase. Such a security right, in the language of UCC–9 and the PPSAs, is a PMSI (purchase money security interest). The alternative is to have an unqualified restriction on the statutory pledge being granted over future goods. This would mean that Brian could in principle only grant the statutory pledge over the car to the bank once he became owner, although the common law doctrine of accretion would arguably apply. As the parameters of that doctrine, not least in relation to moveable property are unclear,⁶⁶ we think that it would be preferable to have an express rule along the lines of the DCFR provision. We note also that the Law Commission for England and Wales has recommended a similar approach for goods mortgages, its recommended replacement for bills of sale, which would be available for consumers.⁶⁷

19.48 Finally, the DCFR also has a rule that where a consumer grants a security right over moveables the assets to be encumbered must be identified individually.⁶⁸ Thus it is impermissible to grant a security right over “my vehicles” or “my computers”. Drobniq and Böger in their commentary on the provision note:

“While this requirement in certain cases may be time-consuming and therefore may even increase the expenses of contracting, still it is a useful way of avoiding surprise and raising awareness of the risks which the consumer security provider may incur in case of non-performance of the obligation to the secured creditor.”⁶⁹

19.49 Similarly the Law Commission for England and Wales recommended in its Consultation Paper on Registration of Security Interests: Company Charges and Property other than Land:

“(t)he need to hand the property over to the pawnbroker is likely to bring home to the consumer the significance of what she is doing and the risk that, if she defaults in payment, the property may be lost. We think this ‘cautionary’ function is important but we also think that it would be possible to build sufficient safeguards into any notice-filing system. . . In particular, we consider that it would be possible for consumers to be permitted to create security interests over their existing personal property if the items concerned are individually listed in the security agreement (and, in this context, a description along the lines of ‘all existing property’ should not be sufficient).”⁷⁰

19.50 We therefore consider that where a consumer grants a statutory pledge it should be a requirement that the property to be encumbered is specifically identified in the constitutive

⁶⁴ See para 19.38 above.

⁶⁵ DCFR IX.–2:107(1)(b).

⁶⁶ See Anderson, *Assignment* paras 11-46–11-52. See also paras 5.88–5.92 and 5.99–5.100 above.

⁶⁷ Law Com No 369, 2016 paras 4.68–4.73. The Report is to be implemented by a Goods Mortgages Bill, announced in the 2017 Queen’s Speech.

⁶⁸ DCFR IX.–2:107(1)(a).

⁶⁹ Drobniq and Böger, *Proprietary Security in Movable Assets* 295.

⁷⁰ Law Com CP No 164, 2002 para 10.31. See too the Law Commission of New Zealand in its *Consumers and Repossession* (Report 124, 2012) paras 3.17-3.22 implemented by the Credit Contracts and Consumer Amendment Act 2014 s 51, inserting a new s 83ZF to the Credit Contracts and Consumer Finance Act 2003.

document of the statutory pledge (or if relevant an amendment document adding property to the statutory pledge).⁷¹

19.51 Our recommendations can be set out as follows. We use the term “individual” to mean “consumer” and we discuss how that term should be defined in the following paragraphs.⁷²

78. (a) Where the provider of a statutory pledge is an individual the encumbered property should require to consist only of assets separately identified in the constitutive document (or in any amendment document) and which are either:

- (i) the provider’s property at the time that document is granted, or**
- (ii) acquired by the provider after that time if the acquisition is financed by credit and an obligation to repay that credit is the secured obligation.**

(b) A corporeal asset so identified should require, immediately before that document is granted, to have a monetary value exceeding £1,000 or such other prescribed amount.

(Draft Bill, s 52(1) to (3))

What is a consumer?

19.52 The Consumer Credit Act 1974 uses the term “individual” to refer to consumers. That term is defined more widely than might be expected as including:

- “(a) a partnership consisting of two or three persons not all of whom are bodies corporate; and
- (b) an unincorporated body of persons which does not consist entirely of bodies corporate and is not a partnership.”⁷³

Certain credit agreements made with individuals are, nevertheless, outwith the scope of the 1974 Act, notably loans of more than £25,000 taken out for business purposes and loans of more than £60,260 to high net worth individuals.⁷⁴

19.53 In contrast the Consumer Rights Act 2015 defines a “consumer” more narrowly as “an individual acting for purposes that are wholly or mainly outside that individual’s trade,

⁷¹ On constitutive document and amendment documents, see Chapter 23 below.

⁷² See paras 19.52–19.55 below.

⁷³ Consumer Credit Act 1974 s 189(1). For discussion, see W C H Ervine, *Consumer Law in Scotland* (5th edn, 2015) para 8-35.

⁷⁴ Consumer Credit Act 1974 s 8 and the Financial Services and Markets Act 2000 (Regulated Activities) Order 2000 (SI 2001/544) arts 60C and 60H. In broad terms, individuals are considered to be of “high net worth” if they have a net income of £150,000 or more, or assets of £500,000 or more (not including a home or pension). For this exception to apply, the debtor must make a declaration agreeing not to have the usual protections and obtain a statement from an accountant providing details of their income or assets. See Law Commission, Bills of Sale (Law Com CP No 22, 2015) para 4.13.

business, craft or profession.”⁷⁵ Similarly, the DCFR provides that a consumer is “any natural person who is acting primarily for purposes which are not related to his or her trade, business or profession.”⁷⁶ Likewise, the New Zealand Credit Contracts and Consumer Finance Act 2003 limits a consumer credit contract to where the debtor is a natural person and the credit is to be “used, or is intended to be used, wholly or predominantly for personal, domestic, or household purposes”.⁷⁷

19.54 The question is how widely the consumer protection recommendations set out in the paragraphs above should be applied. In other words, how broadly should “individual” be defined? Following reflection we consider that “individual” should be given its ordinary meaning of “natural person”. We are not convinced that the broader definition in the 1974 Act is apposite. Sole traders or small partnerships should not, we believe, have to identify specifically business assets when granting a statutory pledge or be restricted from granting it over low-value property such as tools or equipment which collectively may be worth thousands of pounds and therefore may be of interest to a prospective lender. We think that such an approach would restrict access to business finance. Our advisory group agreed. Therefore, while the protections should apply to individuals within the natural meaning of that word, they should not apply to sole traders in relation to assets used, or to be used, wholly or mainly for business purposes. Thus Peter, a sole trader plumber, would be able to grant a statutory pledge over equipment used by him for his business no matter the value of the individual items.

19.55 We recommend:

79. The restrictions on the grant of a statutory pledge in relation to individuals should not apply to sole traders as respects any assets used, or to be used, wholly or mainly for the purposes of that sole trader’s business.

(Draft Bill, s 52(4))

Moveable property

19.56 The possessory pledge is restricted to moveable property.⁷⁸ The statutory pledge too would be a security over moveable property. For immovable (heritable) property the appropriate security is the standard security.⁷⁹ In the Discussion Paper we noted that UCC–9 and some of the PPSAs provide for personal property security interests to extend to “fixtures”, that is moveables that have become part of immovable property by accession.⁸⁰ But other PPSAs, notably New Zealand, have not followed this approach. We expressed the view that we too should not follow it, because it results in complexity whereby assets are subject simultaneously to land law and to the statutory pledge regime. We asked consultees if they agreed.

⁷⁵ Consumer Rights Act 2015 s 2(3).

⁷⁶ DCFR I.–1:105(1).

⁷⁷ Credit Contracts and Consumer Finance Act 2003 s 11(1)(a) and (b).

⁷⁸ Steven, *Pledge and Lien* ch 5.

⁷⁹ Our future project on heritable securities will consider reform of the standard security.

⁸⁰ Discussion Paper, para 16.49.

19.57 Consultees generally agreed. These included Brodies, the Faculty of Advocates, the Judges of the Court of Session and the Law Society of Scotland. Scott Wortley said that “permitting moveable securities to cover heritable property would cause potential problems for conveyancing practice.” But Professor Eric Dirix suggested that any conflict between a statutory pledge and a standard security over the same property could be decided by reference to the date of registration.

19.58 Several consultees raised wider questions in relation to the law of accession. For example, ABFA and the WS Society mentioned the desirability of clarifying the law on accession of one corporeal moveable to another corporeal moveable.⁸¹ While we see the force of this it goes beyond the scope of this project. As Dr Hamish Patrick noted: “any alternative [to the approach proposed] really requires reconsideration of the law of fixtures and various other issues relating to heritable property rights”. The Law Society of Scotland appreciated that some of the wider issues may “more properly be considered in the context of the many vexed questions which arise in commercial practice under the law of accession of moveables to land and the law of fixtures.”

19.59 Brodies sought clarification on the issue of “whether . . . temporary accession and subsequent separation of the moveable property from heritable property should have the effect of defeating the new moveable security.” Assuming that accession has actually occurred the statutory pledge would indeed be defeated because it is only capable of covering moveable property. However, if the property was subsequently separated and the statutory pledge was granted over both present and future assets,⁸² it could become subject to the security right again.

19.60 We recommend:

- 80. It should be competent to grant a statutory pledge over moveable property but not over property that has acceded to immovable (heritable) property.**

(Draft Bill, s 43(1))

Corporeal and incorporeal property

19.61 Moveable property divides into corporeal moveable property and incorporeal moveable property. The former has a physical presence, the latter does not. We deal with the two different types of moveable property in Chapters 21 and 22 below.

Transferability

19.62 For both possessory and statutory pledges the encumbered property should require to be transferable.⁸³ A pledge ultimately needs to be enforceable by realising the asset – normally by selling it – and that is effectively precluded if it is non-transferable. For

⁸¹ On which, see Reid, *Property* paras 588–591.

⁸² On the ability of the statutory pledge to cover future assets, see the next chapter.

⁸³ See eg the Belgian Pledge Act of 11 July 2013 art 12 (which provides for art 7 of the new Book III title XVII of the Civil Code).

possessory pledge there is case law that companies cannot encumber their Register of Shareholders⁸⁴ or letters of guarantee.⁸⁵

19.63 For the statutory pledge, certain intellectual property licences may have restrictions on their transfer and we also mention this issue in Chapter 22. We consider that as long as the property is transferable, even if there are restrictions on that transferability, it should be capable of having a pledge granted over it.⁸⁶

19.64 We recommend:

81. The encumbered property should require to be transferable (whether or not its transferability is restricted in some way).

(Draft Bill, s 44(4))

Proceeds and fruits

19.65 A general feature of UCC–9 and the PPSAs is that where the debtor sells the collateral, the proceeds of sale (and of insurance policies for fire loss etc) are automatically subjected to the security interest.⁸⁷ The Murray Report, however, rejected this approach.⁸⁸ We too rejected it in the Discussion Paper.⁸⁹ Partly this was for the reason that proceeds rules are complex and add very considerably to the complexity of legislation on secured transactions law arguably without sufficient countervailing benefits. Our other reason was that if the new security were permitted to cover after-acquired assets then it could cover proceeds too, not by virtue of a special rule, but simply by virtue of the scope of the security right. Thus if a provider granted the new security over its stock and receivables, and an item of stock was sold on credit, the receivable that arose because of the sale would be covered.

19.66 A clear majority of our consultees agreed with us. Brodies and the Law Society of Scotland considered this “likely to be the only practicable solution”. Other law firm consultees expressed a similar view. Dr Ross Anderson stated that “The English law on proceeds is a warning sign to undesirable sophistry.” In contrast Jim McLean considered a proceeds rule to be “indispensable”. Professor Eric Dirix recommended one. Professor Hugh Beale argued that secured creditors would expect such a rule in order to protect them against unauthorised transfers, where the transferee obtained an unencumbered title under good faith acquisition rules.⁹⁰

19.67 For reasons explained later,⁹¹ we recommend that the statutory pledge should not be available in respect of receivables. This policy change removes the argument that a

⁸⁴ *Liquidator of Garpel Haematite Co Ltd v Andrew* (1866) 4 M 617.

⁸⁵ *Robertson v British Linen Co* (1890) 18 R 1225.

⁸⁶ For an alternative approach, see the Security Interests (Jersey) Law 2012 s 1 definition of “intangible movable property” as including “licences and quotas having commercial value, whether or not they are transferable”. The idea is that while a licence or quota in principle cannot be transferred the relevant authority issuing it may be willing to agree to its transfer. See the Canadian case of *Saulnier v Royal Bank of Canada* [2008] 3 SCR 166, discussed in R M Goode, *Principles of Corporate Insolvency Law* (4th edn, 2011) para 6-11. But the statutory pledge would not, at least initially, be available in respect of these types of property.

⁸⁷ UCC-9-203(f); DCFR IX.–2:306.

⁸⁸ Murray Report para 3.5; Draft Floating Charges and Moveable Securities (Scotland) Bill, cl 9(3).

⁸⁹ Discussion Paper, para 16.48.

⁹⁰ See H Beale, “A View from England” (2012) EdinLR 278 at 280. On good faith acquisition, see Chapter 24 below.

⁹¹ See paras 22.5–22.18 below.

statutory pledge could cover proceeds by express provision. Nevertheless, there are other ways in which proceeds could be encumbered. Where the provider of a statutory pledge is a company, the likelihood is that a floating charge will be granted at the same time. It can extend to proceeds, a point noted by some of our consultees.⁹² Another possibility is for proceeds to be expressly assigned in security by means of registration in the Register of Assignations under our recommendations elsewhere.⁹³

19.68 We remain of the view that proceeds rules are complex and of course under UCC–9 and the PPSAs they are generic to all security rights over moveables. Our recommendations are far more limited. The law on proceeds is arguably best considered in relation to the law of rights in security as a whole, which is clearly beyond our scope. Accordingly, we do not recommend a general proceeds rule.

19.69 Nevertheless, we consider that there would be benefit in setting out default rules in relation to the narrower subject of fruits. It appears to be the case that a possessory pledge of corporeal moveables covers natural fruits.⁹⁴ Thus a pledge of sheep will include any subsequently-born lambs. We think that this should be the default rule for statutory pledges too.

19.70 In contrast, for incorporeal (civil) fruits such as dividends on shares of a company or income derived from a licence of intellectual property, the default rule should be that these are not included. When security is granted over shares the parties normally want things to continue as they are, unless and until there is enforcement. Thus the provider (who remains the shareholder as the statutory pledge is a true security right) should remain entitled to the dividends and likewise in relation to any royalties on a patent. For the reasons discussed below,⁹⁵ the statutory pledge is to be restricted to financial instruments and intellectual property. There is therefore an argument that incorporeal fruits such as dividends, not being financial instruments or intellectual property, must be outwith the scope of the statutory pledge in any event. Our view, however, is that as fruits it should be possible for these to be included if the parties so provided. But the default rule would be that these are excluded. We recommend:

19.71 We recommend:

- 82. The encumbered property should (except in so far as the provider and the secured creditor agree otherwise) include the natural fruits, but not the incorporeal fruits, of the property.**

(Draft Bill, s 44(3)(b))

Construction contracts

19.72 In the Discussion Paper we raised the issue of whether any special regime would be needed as regards the application of the new security right to construction contracts.⁹⁶ Sub-contractors are subject to the risk of insolvency of the main contractor occurring at a time

⁹² Admittedly floating charges have a lower ranking than fixed securities such as the statutory pledge.

⁹³ See volume 1 of this Report.

⁹⁴ Steven, *Pledge and Lien* para 8-01. This does not mean that the secured creditor can generally appropriate them for that party's own benefit. See Steven, *Pledge and Lien* para 7-10.

⁹⁵ See Chapter 22 below.

⁹⁶ Discussion Paper, para 18.24.

when sums are owing to the sub-contractor. We considered that sub-contractors could protect themselves by having the main contractor grant security over the sums due from the employer.⁹⁷ Of course the main contractor might not be willing to oblige but the facility would be there. Consultees were almost unanimous in not seeing the need for any special regime here. Aberdeen Law School doubted whether sub-contractors could demand the grant of the security in a marketplace where there are several tenderers. We recommend therefore:

83. There should not be a special regime for construction contracts.

⁹⁷ We suggested that the new security could be granted over the sums. For the reasons explained in Chapter 22 below we are recommending that the statutory pledge should not, at least initially, be available in respect of sums, but assignation in security completed by registration would be available. The general point therefore continues to hold.

Chapter 20 The statutory pledge: a fixed security

Introduction

20.1 English law recognises security rights known as “charges”.¹ There are two types: “fixed charges” and “floating charges”. In respect of corporeal moveables (chattels), both are non-possessory. Scottish common law recognises neither, but of course floating charges were introduced by statute in 1961.² Only companies, LLPs and a limited number of other entities can grant floating charges. As a result of their introduction the concept of a “fixed security” established itself in legislation on floating charges in Scotland.³ Further, it is an important feature of corporate insolvency which applies throughout the UK.⁴

20.2 But the current law is very restrictive as to fixed securities over moveable property in Scotland. The only one generally available⁵ is the possessory pledge. It is limited to corporeals and requires delivery to the secured creditor. As we have discussed elsewhere,⁶ to take security over incorporeals the only option currently available is to transfer the asset to the creditor. For completeness, we note that when a floating charge is enforced so that it “attaches” to the property of the company or other entity, it becomes a “fixed security”.⁷

20.3 The Scottish courts have unsurprisingly struggled with the fixed/floating distinction.⁸ In English law the situation is hardly better. The landmark House of Lords decision in *National Westminster Bank plc v Spectrum Plus Ltd*⁹ departed from previous authority and prompted a volume of essays.¹⁰ A Discussion Paper published by the Financial Law Committee of the City of London Law Society in 2012 describes the fixed/floating distinction as “a running sore in our legal system”.¹¹

20.4 The broad difference between a fixed charge/security and floating charge is that only with the latter is the provider free to deal with the encumbered property without the consent of the secured creditor. To put it another way, where a floating charge has been granted, the secured creditor does not have “control” of the assets. Thus a retail business which

¹ See eg Beale, Bridge, Gullifer and Lomnicka, *The Law of Security and Title-Based Financing* paras 6.93–6.139 and Calnan, *Taking Security* chs 3 and 4.

² See paras 17.29–17.40 above.

³ See in particular the Companies Act 1985 ss 464 and 486(1).

⁴ See in particular the Insolvency Act 1986 ss 53(7), 54(6), 55(3), 60(1) and 70(1).

⁵ In addition there are some specialist security rights, notably aircraft mortgages and ship mortgages.

⁶ See para 17.5 above.

⁷ Companies Act 1985 s 463, Insolvency Act 1986 ss 53(7) and 54(6). See *National Commercial Bank of Scotland Ltd v Liquidators of Telford Grier Mackay & Co* 1969 SC 181. But floating charges now are generally enforced by the appointment of an administrator. On this see D Cabrelli, “The curious case of the ‘unreal’ floating charge” 2005 SLT (News) 127.

⁸ See eg *Cumberland Development Corporation v Mustone Ltd* 1983 SLT (Sh Ct) 55, criticised in G L Gretton, “Receivership and Sequestration for Rent” 1983 SLT (News) 277.

⁹ [2005] UKHL 41, [2005] 2 AC 680.

¹⁰ J Getzler and J Payne (eds), *Company Charges: Spectrum and Beyond* (2006).

¹¹ City of London Law Society Financial Law Committee, Discussion Paper: Secured Transactions Reform (2012) para 4.24 available at <http://www.citysolicitors.org.uk/attachments/article/121/20121120-Secured-Transactions-Reform---discussion-paper.pdf>.

grants a floating charge over all its assets including its stock-in-trade does not need the secured creditor's involvement to sell the stock to purchasers and give them an unencumbered title. On the sale, the asset simply escapes from the scope of the charge. If the provider, however, becomes insolvent the charge "crystallises" and becomes a fixed security, at which point the assets can no longer be dealt with freely.

20.5 In contrast, where there is a fixed charge/security the creditor's involvement is needed to disencumber an encumbered asset if the debtor sells it. For example, Anna pledges her watch to Ben in security of a loan. As is required by the current law of pledge, Ben must be given possession of the watch. But this does not prevent Anna selling the watch to Carol. Nevertheless, Carol takes the watch encumbered by the pledge. To disencumber the watch requires Ben's consent.

20.6 Two further points should be mentioned about the difference between fixed charges/securities and floating charges. First, the need for the creditor to release the security in order for a purchaser to acquire an unencumbered title makes fixed security unsuitable for assets which a business needs to deal with freely such as stock-in-trade. Thus fixed securities are granted over narrower classes of assets. Secondly, fixed securities have a higher ranking in insolvency than floating charges. Floating charges are postponed to (a) preferential creditors (mainly employees for wages);¹² (b) the "prescribed part" (a carve-out for unsecured creditors);¹³ and (c) the expenses of an administration.¹⁴ Fixed charges/securities are not.

Discussion Paper

20.7 The approach taken in the Discussion Paper was that the new security right should have both a fixed and a floating version. The fixed version would fill a huge void in the current law. But how would the floating version compare to the floating charge? We provisionally labelled this version the "floating lien"¹⁵ and argued that it would have a "superior inner logic"¹⁶ when compared with the floating charge. We conjectured that if the banks began to use the floating lien then the floating charge would "fade away in practice".¹⁷

20.8 The Discussion Paper, nevertheless, recognised the support for the floating charge among financial institutions in Scotland. It asked therefore: "Do consultees agree that the floating charge should not be abolished, at least for the time being?"¹⁸ This question drew the most passionate responses in the entire consultation. The Law Society of Scotland stated that it was "strongly against any move to abolish floating charges". Two major law firms¹⁹ said: "We strongly oppose the proposal to abolish floating charges". ICAS/R3 commented that the Discussion Paper "briefly suggests abolishing the floating charge in its current form." It continued: "We would be concerned that this would put Scotland at a commercial disadvantage to other parts of the UK." These responses demonstrate a strong level of support for the floating charge, even with the conceptual problems it has created for

¹² Insolvency Act 1986 s 59.

¹³ Insolvency Act 1986 s 176A.

¹⁴ Insolvency Act 1986 Sch B1 para 99(3).

¹⁵ Discussion Paper, Chapter 22.

¹⁶ Discussion Paper, para 22.22.

¹⁷ Discussion Paper, para 22.28.

¹⁸ Discussion Paper, para 22.28.

¹⁹ Dundas & Wilson and McGrigors.

Scottish law which we have discussed elsewhere.²⁰ In another part of their response to the Discussion Paper, Dundas & Wilson stated: “We strongly believe that steps to replace the floating charge with a system that differs from that currently existing will be retrograde. The system as currently operated is entrenched and works extremely well in practice.”

20.9 Moreover, some of the responses criticised the idea of introducing a new floating security as in effect duplicating the floating charge. McGrigors stated: “The [Discussion Paper] appears in certain areas to propose a “floating lien” which seems to be a floating charge by another name, and have limited utility.” Dr Hamish Patrick said: “Distinguishing a category of new security as a “floating lien” is misconceived. If a given new (or existing form) security includes future assets and permits disposal of existing and future encumbered assets it is likely to be treated as if it were a floating charge for the purposes of insolvency legislation.” Comments were made to similar effect at the symposium which we held at the University of Edinburgh in October 2011.²¹

20.10 One of the main rationales set out in the Discussion Paper for the “floating lien” was so that the new security right could cover future property. We said:

“On balance we think that the floating lien should be introduced, or, to put the point more correctly, we think that the new security right that we propose should not be limited to present assets.”²²

20.11 This, however, overlooked the fact that in English law fixed (as well as floating) charges can attach to future assets. In the words of a leading text:

“There is little doubt that the mere fact that the charge covers both present and future assets does not prevent it being a fixed charge. The power to add assets to those charged is not inconsistent with a fixed charge. This is hardly surprising. Future assets can be identified with as much specificity as current assets, and, when they come into existence, the charge can attach to them in the same way as it attaches to existing assets.”²³

20.12 While some might wish to qualify the first part of the final sentence, the general proposition holds that a fixed charge may be granted over future property. Thus Magdalena Raczynska commented in her consultation response: “I think that it is possible to conceptualise fixed security as security over future assets as well as present so long as they are identified in the contract or are a result of authorised dispositions of the collateral by the debtor.”

20.13 This point was also made by a number of contributors at the University symposium, notably by Professor Hugh Beale.²⁴ As Professor George Gretton subsequently noted:

“[M]ore than one speaker pointed out that the Discussion Paper imperfectly identifies the concept of “floating”. This concept was adopted into the insolvency legislation on corporate insolvency from English law, but without explanation, so that a Scots

²⁰ See para 17.35 above.

²¹ The papers presented at that symposium are published at (2012) 2 Edin LR 261.

²² Discussion Paper, para 22.22.

²³ Beale, Bridge, Gullifer and Lomnicka, *The Law of Security and Title-Based Financing* para 6.97.

²⁴ And see H Beale, “A View from England” (2012) 16 Edin LR 278 at 279.

lawyer has to work it out from English law. The key point is not “floating in” but “floating out”.²⁵

20.14 Consultees also commented that there needed to be clarity as to when the new security right would be treated as fixed and when it would be treated as floating for the purposes of corporate insolvency legislation. More broadly, however, there was strong support from consultees for the proposition that the new security right should not be limited to present assets (other than in consumer cases).²⁶ We agree that the statutory pledge should be able to be granted over future property and we discuss how it would actually be created in respect of such property in Chapter 23 below.

Fixed only

20.15 The fact that it would be possible for the new statutory pledge to be a fixed security in relation to future property removes some of the impetus for introducing the floating lien. But we consider now that there are other reasons for not doing so.

20.16 In practical terms perhaps the main difference between the floating lien proposed in the Discussion Paper and the floating charge is that the former should be capable of being granted not just by companies, LLPs etc but by any person, excluding consumers. Thus sole traders and partnerships would be able to grant it. On reflection we now have two significant doubts about recommending a floating lien which sole traders and partnerships could grant.

20.17 First, in our consultation we received no compelling evidence that the inability of non-corporate businesses to grant a floating charge as opposed to fixed security was inhibiting access to loan finance.

20.18 Secondly, in the insolvency of companies and LLPs etc, unsecured creditors receive some priority over floating charges as a result of (1) the preferential creditor rules for employees etc and (2) the prescribed part.²⁷ It was accepted in the Discussion Paper²⁸ and consultees generally agreed that the same rules would have to apply where a company or LLP etc granted a floating lien. But the prescribed part has no parallels in sequestration, which is the insolvency process for sole traders and partnerships. While there is protection for preferential creditors in schedule 3 of the Bankruptcy (Scotland) Act 2016, such creditors rank below secured creditors in a sequestration. We are concerned therefore about the position of unsecured creditors in this context if there were to be a new “floating” security. One solution of course would be to recommend an amendment to insolvency law, but this is in principle outwith the scope of this Report.

20.19 In contrast, there are no such difficulties with insolvency law in relation to a new fixed security right, because fixed securities rank ahead of preferential creditors and the prescribed part.²⁹ In fact, the effect of introducing a fixed security over moveables in Scotland would be to create a level playing field north and south of the Scotland/England border. As we noted earlier in this Report,³⁰ the WS Society said that reform in this area

²⁵ G L Gretton, “Reform of Security over Moveable Property” (2012) 16 Edin LR 261 at 265 fn 10.

²⁶ Discussion Paper, para 22.22. On consumer protection see paras 19.36–19.55 above.

²⁷ See para 20.6 above.

²⁸ Discussion Paper, paras 22.16–22.19.

²⁹ See para 20.6 above.

³⁰ See para 1.15 above.

should be the first priority for the Commission as there was “no workable fixed security in Scots law.”

20.20 We mentioned above that the Discussion Paper suggested that the introduction of the floating lien could mean that the floating charge would fade away.³¹ On reflection we think that there are at least two reasons why this is unlikely. The first is the ongoing use of floating charges in England and Wales, with which banks and their lawyers are familiar. We recounted earlier the fate of Part 2 of the Bankruptcy and Diligence etc. (Scotland) Act 2007 which sought to put Scottish floating charges law on a separate footing but which has never been brought into force due to stakeholder opposition.³² In his response to the Discussion Paper, Jim McLean stated: “Floating liens should not be introduced in Scotland alone, so long as the floating charge continues to exist elsewhere in the UK.” Brodies noted: “Despite the conceptual issues associated with floating charges our view is that they do nevertheless have their uses benefiting lenders (an arguably enhanced security package and certainly enhanced enforcement mechanism) and for the customer the ability to grant a security package on similar if not entirely consistent terms with other jurisdictions within the UK.”

20.21 There may well be reform of the fixed/floating distinction in England and Wales. The Financial Law Committee of the City of London Law Society published a Discussion Paper on the subject in 2014.³³ And the Secured Transactions Law Reform Project published its own Discussion Paper in 2017.³⁴ Until there is such reform we expect that the floating charge would continue to be the preferred floating security right even were a floating lien to be introduced in Scotland.

20.22 The second reason is that the floating charge can encumber land. The floating lien would only cover moveables. We understand that the ability of the floating charge to attach to land is popular among the banks, not least because of the current enforcement rules on standard securities. The Law Society of Scotland said in its response to our Discussion Paper: “[We are] of the view that if the floating lien is to have many of the characteristics of a floating charge, it will not be attractive, not least since the proposed floating lien will not have the benefits of (i) being a truly universal security (covering heritable assets as well as moveables); and (ii) not providing the same control, viz, the right to appoint an administrator.”³⁵

20.23 We conclude that the priority is to introduce a new fixed security over moveable property in Scotland. We refer to the comments of two major law firm consultees³⁶ in response to the Discussion Paper:

“[W]e share the widely held view that the fundamental need at the moment is to create a non-possessory form of *fixed* security: a practical, effective and widely

³¹ See para 20.7 above.

³² See paras 18.23–18.25 and 18.41–18.43 above.

³³ The discussion paper is available at

<http://www.citysolicitors.org.uk/attachments/article/121/20140219%20Secured%20Transactions%20Reform%20Discussion%20Paper%20%20Fixed%20and%20floating%20charges%20v2.pdf>.

³⁴ The discussion paper is available at <https://stlrp.files.wordpress.com/2017/01/paterson-fixed-and-floating-charges.pdf>. The author is Professor Sarah Paterson.

³⁵ See also the City of London Law Society Financial Law Committee, Draft Secured Transactions Code and Commentary (2016) section 11 (pp 41–43) available at

<http://www.citysolicitors.org.uk/attachments/article/121/Draft%20Secured%20Transaction%20Code%20-%20Commentary%20-%20July%202016.pdf>.

³⁶ Dundas & Wilson, and McGrigors.

accepted form of floating security is available and used under the floating charge regime which we believe is perfectly workable and acceptable.”

20.24 While we continue to have reservations about the law on floating charges and we consider this type of security right further in Chapter 38 below, there is clearly little appetite amongst stakeholders at the present time for the floating lien. Our advisory group agrees that the best way forward is for the statutory pledge to be a fixed security only. Nevertheless, developments in England and Wales, in relation to both secured transactions law and corporate insolvency law in the future may cause the position to be reconsidered.

20.25 There is further advantage in making the statutory pledge fixed only because it makes our new legislative scheme simpler. We have noted elsewhere that previous attempts to reform the law of security over moveables have foundered because they have been too ambitious.³⁷ It also means that some of the questions which we asked in the Discussion Paper are now superseded.³⁸

20.26 We recommend:

- 84. (a) The statutory pledge should be a fixed security only.**
- (b) The definitions of “fixed security” in the Companies Act 1985 and the Insolvency Act 1986 should be amended to include reference to the statutory pledge.**

(Draft Bill, s 65)

Requirements for the statutory pledge as a fixed security

General

20.27 In order to be a fixed security there require to be restrictions on the ability of the provider to deal with the property which is subject to a statutory pledge. The Murray Report accepted this in relation to the new “moveable security” which it proposed. Its draft Bill had a clause dealing with the matter.³⁹ The commentary on that clause notes that it “provides the rule that the grantor of a moveable security may not dispose of or assign property which is subject to that security, without the prior, written consent of the holder of the security. This rule reflects the nature of the moveable security as a fixed security over moveable property (as distinct from a floating charge).”⁴⁰

20.28 In the leading English case of *National Westminster Bank plc v Spectrum Plus Ltd*,⁴¹ Lord Scott of Foscote sought to distinguish fixed and floating charges:

³⁷ See para 18.33 above.

³⁸ In particular, questions 81 (Do consultees agree that if the floating lien is introduced, it would have to be treated, for the purposes of insolvency law, in substantially the same way as the floating charge?), 82 (Specifically, should the special rule in section 245 of the Insolvency Act 1986 apply to the new security, to the extent that the collateral in question had been acquired by the debtor after the registration of the security?) and 83 (If the floating lien is introduced, should it be subject to the “effectually executed diligence” rule?).

³⁹ Draft Floating Charges and Moveable Securities (Scotland) Bill, cl 11.

⁴⁰ Murray Report “Notes on Clauses” 9.

⁴¹ [2005] UKHL 41.

“In my opinion, the essential characteristic of a floating charge, the characteristic that distinguishes it from a fixed charge, is that the asset subject to the charge is not finally appropriated as a security for the payment of the debt until the occurrence of some future event. In the meantime the chargor is left free to use the charged asset and to remove it from the security.”⁴²

20.29 It is the chargor’s (provider’s) freedom to remove the property from the scope of the charge which is the fundamental requirement, as making ordinary use of the property is not inconsistent with the charge being fixed.⁴³ Richard Calnan puts it as follows:

“In theory, the distinction between fixed and floating charges is straightforward. The only difference is that a debtor which has created a floating charge has a prospective general authority to deal with its assets free from the charge before crystallisation, whereas a debtor which has created a fixed charge requires the specific authority of the creditor each time it wishes to deal with the asset concerned.”⁴⁴

20.30 Increasingly, the need for the secured creditor to give consent to dealings with the encumbered property has come to be viewed in terms of that creditor having “control” of that property.⁴⁵ This is particularly true in relation to the vexed issue of charges over receivables and their proceeds.

20.31 Back in 1979 in *Siebe Gorman & Co v Barclays Bank*⁴⁶ it was held sufficient to create a fixed charge over receivables by stating in the charge document that the charge was fixed and requiring the proceeds to be paid into an account with the bank which was the secured creditor. The provider was otherwise free to deal with the proceeds. In *Re New Bullas Trading Ltd*⁴⁷ an approach was approved whereby the charge document purported to create a fixed charge over receivables but a floating charge over their proceeds, in respect of which there was freedom to deal.

20.32 More recently, the courts have taken a noticeably stricter approach to freedom to deal. The Privy Council in an appeal from New Zealand in *Agnew v Commissioner for Inland Revenue*⁴⁸ concluded that *Re New Bullas Trading Ltd* had been incorrectly decided and that in such circumstances only a floating charge was created. Then came the landmark decision in *National Westminster Bank plc v Spectrum Plus Ltd*,⁴⁹ which overruled *Siebe Gorman*. The result is that the label used by the parties in the charge document to describe the charge cannot be definitive.⁵⁰

20.33 To achieve a fixed charge now would seem to require a general prohibition on any dealing with regard to the encumbered property without the consent of the secured creditor.⁵¹ Moreover, the secured creditor must be free to give or not to give consent. There must be a

⁴² [2005] UKHL 41 at para 111.

⁴³ Beale, Bridge, Gullifer and Lomnicka, *The Law of Security and Title-Based Financing* para 6.98.

⁴⁴ Calnan, *Taking Security* para 4.89.

⁴⁵ Beale, Bridge, Gullifer and Lomnicka, *The Law of Security and Title-Based Financing* para 6.106. Confusingly, the “control” required for a fixed charge is not synonymous with “control” under the Financial Collateral Arrangements (No. 2) Regulations 2003 (SI 2003/3226), on which see Chapter 14 above and Chapter 37 below.

⁴⁶ [1979] 2 Lloyd’s Rep 142.

⁴⁷ [1994] BCC 36.

⁴⁸ [2001] UKPC 28, [2001] 2 AC 710.

⁴⁹ [2005] UKHL 41.

⁵⁰ See *Agnew v Commissioner of Inland Revenue* [2001] UKPC 28, [2001] 2 AC 710 at para 32 per Lord Millett.

⁵¹ Beale, Bridge, Gullifer and Lomnicka, *The Law of Security and Title-Based Financing* para 6.107.

true discretion. Thus where the secured creditor is contractually obliged to consent to dealings the charge will be regarded as floating.⁵²

Mandates to deal with the encumbered property

20.34 In the Discussion Paper we proposed that the secured creditor in the new security right should be able to authorise the provider to deal with the encumbered property free of the security on such terms and subject to such conditions as may be agreed.⁵³ We noted that this concept is sometimes known as “licence”, but that a better juridical basis would appear to be mandate. We considered also that the general law of rights in security permits this. In response to our question as to whether consultees agreed that there was no reason why a creditor should not be able to mandate the debtor to deal with the collateral free of the security, most of the consultees were supportive.

20.35 We hold to the view that under the general law of rights in security such an arrangement is permissible. The difficulty, however, as we have seen in this chapter, is that corporate insolvency law in Scotland, following England and Wales, insists on a categorisation of “fixed securities” and “floating charges”. Thus, Dr Hamish Patrick, while agreeing that a mandate to deal should be possible, noted that “distinctiveness from the floating charge is an issue here”. Magdalena Raczynska, disagreeing with the question put to consultees, said: “I think this is destructive to the nature of security – the creditor loses the ability to resort to an asset in the event of the debtor’s default. This is in my view the nature of a floating charge – that the grantor is able to deal away with property and as such should be governed by special rules.”

20.36 We consider now that to allow a general mandate to deal would enable the statutory pledge to be tantamount to a floating charge and not compatible with it being a fixed security. In other words it should not be possible for the secured creditor to give the provider a blanket power to deal freely with the assets. Consent to a dealing should be required on a transaction by transaction basis, as discussed further below.⁵⁴ We recommend:

- 85. The secured creditor should not be able to give the provider a general mandate to deal with the encumbered property free of the statutory pledge.**

Requirements for consent to dealing from secured creditor

20.37 In order to ensure that the statutory pledge satisfies the definition of a “fixed security” for the purposes of corporate insolvency law the indications from case law in England and Wales are that there must be fairly strict requirements for the consent which the secured creditor needs to give.⁵⁵ In other words, the secured creditor requires to have a relatively strong level of “control” over the property.

20.38 The Murray Report proposed that the sanction for breach of the relevant rules should be that the granter of the moveable security would be held to be in default.⁵⁶ For the

⁵² *Gray v G-T-P Group Ltd* [2010] EWHC 1772 (Ch).

⁵³ Discussion Paper, para 16.28.

⁵⁴ See paras 20.37–20.45 below.

⁵⁵ See para 20.33 above.

⁵⁶ Draft Floating Charges and Moveable Securities (Scotland) Bill, cl 14(h).

statutory pledge the parties would be free to make express provision to the same effect, but we do not see a need to have this as an automatic rule. Rather, we consider that what is fundamental is that if the provider of a statutory pledge transfers the encumbered property (or any part of that property) to a third party other than with the appropriate consent, the encumbered property should remain encumbered by the pledge. This would, however, be subject to the rules which we discuss in Chapter 24 below under which certain good faith acquirers of the encumbered property would be protected.

20.39 We think that the consent should require to (a) be written; (b) refer to the particular transfer; (c) not include consent granted more than 14 days before the particular transfer; and (d) be at the discretion of the secured creditor.

20.40 In relation to (a), written consent could be given by means of pen and ink, or electronically (without an advanced electronic signature). We anticipate that an electronic communication would be normal.

20.41 In relation to (b), the consent would need to refer to a specific transfer to a specific person. Thus a consent to “any transfer of any of the encumbered property to a company in the same group as the provider” would not be sufficient as it refers only to a particular *transferee* rather than a particular transfer. The consent thus needs to be “positive”. A “negative consent” provision under which the secured creditor is free to deal until such time, if any, that the secured creditor states otherwise, will not do.

20.42 In relation to (c), the requirement is for reasonable time proximity between the consent and the transfer. This means that it is unlikely to be effective for a consent provision to be inserted into the constitutive document of the statutory pledge. There will normally be a contract of sale between the provider and the third party. Under that contract transfer of ownership might be delayed for some time perhaps because of a retention of title clause.⁵⁷ In such circumstances it may be preferable for the secured creditor to grant a restriction,⁵⁸ because the time at which ownership is eventually to transfer may be unclear.

20.43 In relation to (d), as discussed above⁵⁹ there is authority in England and Wales that the secured creditor must have a true discretion and not be contractually bound to consent. Where encumbered property has been transferred without the required form of consent, it would be possible for the secured creditor to disencumber the property from the statutory pledge by means of a restriction or discharge.⁶⁰

20.44 We are aware that the case law on “control” in English law has not been consistent over the years and that currently the requirements are more severe than they once were. It is not impossible that in the future judicial attitudes may change again. Another possibility is that UK corporate insolvency law is reformed. As we noted earlier,⁶¹ the Financial Law Committee of the City of London Law Society and the Secured Transactions Law Reform Project have both published Discussion Papers on reform of the fixed/floating distinction.

⁵⁷ Although this may not be the case because the secured creditor makes it a condition of consenting that the price is remitted to it forthwith. Therefore ownership transfers immediately, unless of course there is a retention of title clause for all sums and other sums which are owing.

⁵⁸ See paras 23.49–23.54 below.

⁵⁹ See para 20.33 above.

⁶⁰ See paras 23.49–23.54 below.

⁶¹ See para 20.21 above.

With this in mind we think that it is sensible to give the Scottish Ministers power to amend the statutory provisions on consent in the draft Bill.

20.45 We recommend:

- 86. (a) If the provider of a statutory pledge transfers encumbered property to a third party other than with the consent mentioned below, the property should remain subject to the pledge.**
- (b) That consent should be the written consent of the secured creditor to the particular transfer and to the property in question being transferred unencumbered by the pledge, but should not include consent granted more than 14 days before the particular transfer.**
- (c) The granting or withholding of consent should require to be at the discretion of the secured creditor.**
- (d) The Scottish Ministers should have the power to make regulations amending the rules relating to consent.**
- (e) The foregoing recommendations should be subject to the recommendations made elsewhere as regards good faith acquirers.**

(Draft Bill, s 53(1) to (3), (5) & (6))

Practical consequences

20.46 Since the statutory pledge is to be a fixed security this means that it would only be suitable for categories of assets with which the provider does not regularly deal. This is because obtaining creditor consent to disposals under the rules which we recommend above would limit the ability to transact. In particular, the statutory pledge would generally not be suitable for stock-in-trade (inventory). For that type of property the appropriate security right is a floating charge. Some examples may help.

20.47 Example 1. Ian is a florist. His main business assets are his flowers, vases, equipment (such as secateurs) and van. A statutory pledge would be a suitable security right as regards the equipment and van, as selling these assets is not a part of his normal trading activity. In contrast, the statutory pledge would not be appropriate for the flowers and vases as he needs to be able to sell these freely to customers.

20.48 Example 2. MaggieKnockater Modern Motors Ltd is a motor dealership. Its main business assets are its office furniture, equipment and the vehicles which it buys and sells. A statutory pledge would be an appropriate security right in relation to the furniture and equipment, but not for the vehicles. As a limited company, MaggieKnockater Modern Motors could grant a floating charge over all its assets including the vehicles, but as regards the furniture and equipment the statutory pledge as a fixed security would have a higher ranking.

20.49 Example 3. Colpy Combine Harvesters Ltd specialises in the sale of high value agricultural vehicles costing in excess of £100,000 each. While these are its stock-in-trade, on average it only sells a few a week and it takes some time for the sales paperwork to be agreed. It has a close working relationship with its bank. Here the statutory pledge may be

suitable on the basis of the bank consenting to individual sales.⁶² Compared with Examples 1 and 2, the volume of disposals of the stock-in-trade is much lower.

20.50 Example 4. Whitehills Whisky Ltd is a wholesale whisky supplier. It exports whisky abroad. Its whisky is in numbered barrels and there are only a few exports every month. The statutory pledge could be possible here if a system can be set up whereby the secured creditor can authorise the release of particular barrels.

20.51 We are aware that by effectively excluding most stock-in-trade from the scope of the statutory pledge our recommendations would seem to run counter to one of the key objectives of an effective and efficient secured transactions law in the UNCITRAL Legislative Guide on Secured Transactions, namely validating non-possessory security rights in all types of assets.⁶³ It must be remembered, however, that for companies, LLPs and certain other corporate bodies the floating charge fulfils that role and that we had strong representations from consultees not to provide an alternative form of floating security. The UNCITRAL objective of course relates to secured transactions law in respect of moveable property⁶⁴ as a whole. As regards non-corporates, we have set out our reasoning above for making the statutory pledge a fixed security only.

Anti-avoidance

20.52 Finally, it seems necessary to have an anti-avoidance provision to prevent the statutory pledge being used *like a floating charge* in relation to stock-in-trade. In Chapter 24 below we recommend a rule whereby a good faith purchaser takes property unencumbered by a statutory pledge where the seller is acting in the course of a business. The situation therefore can be envisaged where Neil Ltd, a retailer, grants a statutory pledge over its stock-in-trade to Oswald. Neil Ltd's customers are protected because they are in good faith but Oswald gets the benefit of a fixed security over the stock-in-trade in the event of Neil Ltd's insolvency. But in practical terms the statutory pledge is functioning like a floating charge. We think that in such circumstances where the secured creditor is acquiescing in the provider dealing with the encumbered property without obtaining the proper consent to each disposal the statutory pledge should be extinguished.

20.53 We recommend:

- 87. A statutory pledge should be extinguished if the secured creditor acquiesces, expressly or impliedly, in the provider's transfer of the encumbered property or any part of it to a third party other than with the consent required by the legislation.**

(Draft Bill, s 53(4))

⁶² This example was suggested to us by Donna McKenzie Skene.

⁶³ Available at https://www.uncitral.org/pdf/english/texts/security-ig/e/09-82670_Ebook-Guide_09-04-10English.pdf. See p 21.

⁶⁴ And thus not immoveable property (land).

Chapter 21 Corporeal moveable property

General

21.1 This chapter considers security over corporeal moveable property, with particular regard to money, ships, aircraft, spacecraft, rolling stock, and motor vehicles.

21.2 As was seen in Chapter 17 above, the current law in this area is very inadequate. Aside from the floating charge, which can only be granted by companies, LLPs and a limited number of other entities, the only true security right generally available is the possessory pledge. It demands possession to be held by the secured creditor and is thus generally impractical for assets such as equipment and vehicles where a business requires these to be able to trade.

21.3 Scotland lags behind many other jurisdictions in not permitting a non-possessory security over corporeal moveables which is publicised by registration.¹ The case for allowing a fixed non-possessory security right over such property seems irrefutable. Aside from the special cases discussed below, we therefore recommend:

88. It should be competent to create a statutory pledge over corporeal moveable property.

(Draft Bill, s 43(1), (2)(b) & (4))

21.4 As we discussed in Chapter 19 above, this would mean for corporeal moveable property the creation of a pledge would require either delivery (possessory pledge) or registration in the Register of Statutory Pledges (statutory pledge).²

21.5 We turn now to consider special types of corporeal moveable property.

Money

21.6 Money, when in the form of coins and banknotes, is corporeal moveable property.³ But it raises special issues. For this reason, it is excluded from the definition of goods in the Sale of Goods Act 1979.⁴ It has been suggested that money cannot be made the subject of a security right.⁵ From this view we would dissent and refer to legislation elsewhere.⁶ Nevertheless, we consider that money should be outwith the scope of our recommended legislative scheme both for the possessory pledge and statutory pledge. Its inclusion would complicate the enforcement rules because of the special nature of money. Equally, we

¹ See Discussion Paper, Appendix B. Permitting non-possessory security rights is one of the core principles of the European Bank for Reconstruction and Development's Model Law on Secured Transactions and a key objective of the UNCITRAL Legislative Guide on Secured Transactions. See Discussion Paper Appendix A.

² For after-acquired property, registration would be a pre-requisite for creation but the right would not be created until the property was acquired. See paras 23.22–23.27 below.

³ See *SME Reissue Banking, Money and Commercial Paper* (2000) para 143 (L D Crerar).

⁴ Sale of Goods Act 1979 s 61(1).

⁵ *SME Reissue Banking, Money and Commercial Paper* para 145.

⁶ See eg NZ PPSA 1999 s 16(1) (definition of "personal property").

consider it highly unlikely that there would be practical benefit in facilitating security over coins and banknotes, when money is now typically held in other ways such as in bank accounts. We recommend:

- 89. For the purposes of the new legislative scheme in relation to pledge, the definition of “corporeal moveable property” should not include money.**

(Draft Bill, s 116(1))

Ships

21.7 There is a statutory form of security right for ships, known as a ship mortgage and governed by the Merchant Shipping Act 1995.⁷ Ship mortgages require to be registered in the UK Ship Register⁸ to have third party effect. The common law also recognises two hypothecs (non-possessory security rights), which are now obsolete in practice, namely the bond of bottomry (over the ship itself) and the bond of respondentia (over the cargo).⁹

21.8 In the Discussion Paper we expressed the view that the project should not deal with shipping law.¹⁰ Our reasons were as follows. First, the existence of the mature system of ship mortgages would cause considerable complexity if a new competing type of security right were to be added, side by side with the existing law. Secondly, the subject-matter of the 1995 Act is reserved to the UK Parliament.¹¹ We considered that any reform of the law in this area, including for instance the abolition of the obsolete bonds of bottomry and respondentia, would best be done at UK level.

21.9 We suggested that the new security right could be used for vessels in respect of which a ship mortgage is not available and we sought the views of consultees in relation to this. Those who responded to the question all agreed, except for the Faculty of Advocates which said that it had “no particular comment”. The WS Society said:

“We agree with this, but with an important qualification. A ship mortgage can only be granted over a ship registered in part 1 of the Register of Ships (or a fishing boat in part 2). Any ship can be registered in part 1 but smaller ones are not because of the cost and the detailed rules. Therefore we suggest that the new charge should be capable of being granted in relation to a ship which is not registered in parts 1 and 2 of the register.”

21.10 We accept this suggestion. It would facilitate the use of small yachts and other minor craft for security purposes, without the need to trouble with registration in the UK Ship Register. It is necessary to provide a little more detail. The UK Ship Register has four parts.¹² Part I is for ships owned by qualifying persons,¹³ which are not fishing vessels or small ships. Part II is for fishing vessels, which can be the subject of “simple” or “full

⁷ See G L Gretton, “Ships as a Branch of Property Law” in A R C Simpson, S C Styles, E West and A L M Wilson (eds), *Continuity, Change and Pragmatism in the Law: Essays in Honour of Professor Angelo Forte* (2016) 367 at 394–396.

⁸ See <https://www.gov.uk/uk-ship-register-for-merchant-ship-and-bareboat-charter-100qt>.

⁹ See Gloag and Irvine, *Rights in Security* ch 19.

¹⁰ Discussion Paper, para 17.1.

¹¹ Scotland Act 1998 Sch 5 Part II Head E3.

¹² Merchant Shipping (Registration of Ships) Regulations 1993 (SI 1993/3138).

¹³ On the meaning of “qualifying persons”, see the 1993 Regulations Part III.

registration”.¹⁴ Part III is for small ships.¹⁵ Part IV is for ships registered under the 1995 Act section 7 (“bareboat charter ships”).¹⁶ It is not possible for a ship mortgage to be granted over a fishing vessel which is the subject of a simple registration¹⁷ or over a small ship¹⁸ or over a bareboat charter ship.¹⁹ We recommend that:

- 90. It should not be competent to create a statutory pledge over a ship (or a share of a ship) in respect of which it is competent to register a mortgage in the UK Ship Register.**

(Draft Bill, s 47(1)(c))

21.11 This recommendation creates the possibility, albeit a remote one, of a statutory pledge being granted over a yacht, that yacht being subsequently registered in the UK Ship Register and a ship mortgage being granted over it. In this event the usual ranking rule that the security right created earlier ranks first would apply.²⁰

Aircraft

21.12 An aircraft mortgage can be created under the Mortgaging of Aircraft Order 1972.²¹ Third party effect is dependent on registration in the Register of Aircraft Mortgages.²² Under the 1972 Order only aircraft registered in the United Kingdom nationality register can be the subject of an aircraft mortgage.²³ We asked consultees whether they agreed that any new security right over corporeal moveable property should not extend to aircraft over which an aircraft mortgage can be granted. All consultees who answered this question agreed, except for the Civil Aviation Authority (CAA) and Faculty of Advocates, both of whom said that they had no comment. We recommend that:

- 91. It should not be competent to create a statutory pledge over an aircraft in respect of which an aircraft mortgage can be created.**

(Draft Bill, s 47(1)(a))

21.13 We do not think it appropriate to undertake a general review of the law of aircraft mortgages, which is UK-wide and reserved to the Westminster Parliament. Nevertheless, the 1972 Order has some specifically Scottish provisions and one of the members of our advisory group, Bruce Wood, drew two difficulties to our attention.

21.14 The first is that there is a style deed for Scottish law but not for English law.²⁴ Mr Wood advised us that experience has shown that the Scottish style can be awkward to use, and that if no prescribed style is needed in England, none should be needed in

¹⁴ See the 1993 Regulations reg 3.

¹⁵ A “small ship” is a ship which is less than 24 metres in overall length and which is, or is applying to be registered in Pt III of the UK Ship Register. See 1993 Regulations reg 1(2).

¹⁶ Merchant Shipping Act 1995 s 17. Such ships are registered abroad.

¹⁷ 1993 Regulations reg 3(a).

¹⁸ 1993 Regulations reg 91.

¹⁹ Merchant Shipping Act 1995 s 17(7).

²⁰ See Chapter 26 below.

²¹ SI 1972/1268.

²² 1972 Order art 14. In correspondence with us in July 2012, the Civil Aviation Authority advised that in the previous three years only eight Scottish aircraft mortgages were registered.

²³ 1972 Order art 3.

²⁴ 1972 Order art 19 and Sch 2 Part 1 para 2.

Scotland. We asked consultees whether the style should be deleted. Most agreed or had no objection. The Law Society of Scotland and several law firms disagreed, but their responses suggested that they believed that deletion of the style would endanger or indeed end the competence of aircraft mortgages in Scotland. We consider that this concern is misplaced. The style is provided for in Schedule 2 of the 1972 Order, which deals with Scottish aircraft mortgages. The rest of the Schedule would remain. We recommend that:

92. The prescribed style for Scottish aircraft mortgages should be deleted from the Mortgaging of Aircraft Order 1972.

This would require Westminster legislation.²⁵

21.15 The second issue identified by Mr Wood was doubt over whether priority notices for aircraft mortgages are competent in Scotland.²⁶ We asked consultees whether the 1972 Order should be amended to make it clear that this is the case. With one exception, consultees agreed. The exception was the CAA, which is responsible for the Register of Aircraft Mortgages. It was of the view that no amendment is necessary on the basis that article 14 of the 1972 Order, which deals with priority notices, is not restricted to England and Wales. In subsequent correspondence with us, it noted that while Schedule 2 of the 1972 Order amends other articles of the Order in relation to Scotland, it does not amend article 14. Further, in practice the CAA accepts priority notices in respect of Scottish aircraft mortgages. We now accept on general principles of statutory interpretation, as we understand does Mr Wood, that article 14 applies to Scotland. Nevertheless, the 1972 Order could be clearer on the issue. More generally, given that it is now over forty years old, we consider that it would be useful for it to be reviewed. This is true even although its importance is likely to be diminished by the implementation of the Cape Town Convention discussed next.

93. The Mortgaging of Aircraft Order 1972 should be the subject of a UK-wide review.

The Cape Town Convention

21.16 The Cape Town Convention on International Interests in Mobile Equipment covers security interests in “(a) airframes, aircraft engines and helicopters; (b) railway rolling stock; and (c) space assets.”²⁷ The Convention itself is a framework convention, which works with its protocols. Three protocols exist, for the three separate classes of asset.²⁸ Work has commenced on a fourth protocol in relation to agricultural, construction and mining equipment (the “MAC Protocol”). The reason for the Convention is that the equipment it covers very commonly moves between different countries and therefore there is much to be

²⁵ More precisely an Order in Council under the Civil Aviation Act 1982 s 102 and Sch 13 Part II subject to the negative resolution procedure).

²⁶ W A Wilson, *Scottish Law of Debt* (2nd edn, 1991) para 7.6 states that they are.

²⁷ UNIDROIT Cape Town Convention art 2(3). See <http://www.unidroit.org/instruments/security-interests/cape-town-convention>.

²⁸ The First Protocol is for airframes, aircraft engines and helicopters.

See <http://www.unidroit.org/english/conventions/mobile-equipment/aircraftprotocol.pdf>.

The Second Protocol is for railway rolling stock.

See <http://www.unidroit.org/instruments/security-interests/rail-protocol>.

The Third Protocol is for space assets.

See <http://www.unidroit.org/instruments/security-interests/space-protocol>.

said for an internationally recognised form of security interest, known as an “international interest”.

21.17 The Convention is heavily influenced by UCC–9.²⁹ It is asset-specific, so that (in contrast to UCC–9 and the PPSAs) the possibility of security over generic future assets does not exist.³⁰ The international registry which it created for aircraft is based in Dublin.³¹ When the Discussion Paper was published in 2011, the position was that the UK had signed the Convention but not ratified it.

21.18 Article 52 of the Convention enables contracting States to ratify it for the whole State or part of it. We asked consultees whether they considered that the UK Government should accede to the Convention (either for the whole UK or for Scotland only). Consultees were generally supportive of accession on a UK-wide basis or had no opinion. No consultee supported Scotland-only accession.

21.19 Prior to the publication of the Discussion Paper, the then Department for Business Innovation and Skills (DBIS)³² had issued a call for evidence in relation to UK-wide ratification of the First Protocol on airframes, aircraft engines and helicopters (known collectively as “aircraft objects”). In December 2013 it announced that it had decided to proceed with ratification.³³ In June 2014 DBIS published a consultation document on options for implementation.³⁴ This led to the promulgation of the International Interests in Aircraft Equipment (Cape Town Convention) Regulations 2015.³⁵ On 27 July 2015 the UK instruments of ratification were deposited with UNIDROIT and the Convention came into force in the UK on 1 November 2015.³⁶ As we have seen, the consultees to our Discussion Paper mainly favoured UK-wide accession and we therefore welcome this. None of our consultees made specific comments on accession to the Second and Third Protocols (respectively railway rolling stock and space assets).

21.20 In cases where it is competent to create an international interest in airframes, aircraft engines and helicopters under the 2015 Regulations, we do not think that the statutory pledge should be used. We recommend that:

94. It should not be competent to create a statutory pledge over an aircraft object in respect of which an international security interest can be created under the International Interests in Aircraft Equipment (Cape Town Convention) Regulations 2015.

(Draft Bill, s 47(1)(b))

²⁹ The standard text is R M Goode, *Official Commentary on the Convention on International Interests in Mobile Equipment* (2nd edn, 2008). See also Discussion Paper, Appendix A.

³⁰ But the Protocol to the Convention on International Interests in Mobile Equipment on Matters specific to Railway Rolling Stock (2007) says that the description of railway rolling stock can be “a statement that the agreement covers all present and future railway rolling stock” (art V(1)).

³¹ See <https://www.internationalregistry.aero/irWeb/Controller.jpf>.

³² Since July 2016, the Department for Business, Energy and Industrial Strategy.

³³ See DBIS, Ratification of the Convention on International Interests in Mobile Equipment and Protocol thereto on Matters Specific to Aircraft Equipment (June 2014) p 3, available at https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/320482/bis-14-452-ratification-of-convention-on-international-interests-in-mobile-equipment-aircraft-equipment-protocol-consultation.pdf.

³⁴ See the previous footnote.

³⁵ SI 2015/912.

³⁶ See generally M Bisset, “Ratification of the Cape Town Convention by the United Kingdom” (2016) 49 Air & Space Law 49.

Motor vehicles

21.21 In the Discussion Paper we noted that in some countries the registration of motor vehicles is a system of title registration and that security can happen as part of that register.³⁷ In the UK the registration system operated by the Driver and Vehicle Licensing Agency (DVLA) is administrative. It is separate from private law. Thus, for example, registration with the DVLA is not necessary for the transfer of ownership of a vehicle.³⁸

21.22 The statutory pledge could be granted over motor vehicles by registration in the Register of Statutory Pledges. If the experience in PPSA systems is repeated then motor vehicles are likely to be frequently the subject of the new statutory pledge, not least in relation to private individuals. The statutory pledge would offer an alternative to arrangements such as hire-purchase and conditional sale, and allow the debtor to have ownership of the vehicle rather than this being held by a finance company.

21.23 As we have mentioned elsewhere,³⁹ arrangements such as hire-purchase are no good where the debtor already has ownership but wishes to use the vehicle as collateral. Here the introduction of the statutory pledge has the potential to make a significant difference to the availability of vehicles for security purposes.

21.24 Later in this Report we recommend similar protections for good faith private purchasers of motor vehicles as currently exist where such a vehicle is the subject of a hire-purchase agreement.⁴⁰

21.25 A final issue about motor vehicles is that their unique vehicle identification number (VIN) enables them to be traced, where the owner has transferred the vehicle to a third party without the secured creditor's permission. Later in this Report we recommend that it should be possible for VINs to be registered in the RSP and be capable of being searched against.⁴¹ We recommend also that the protection for good faith acquirers where there is a supervening inaccuracy in relation to the provider's details should not apply where property has a unique number (being a class of property prescribed in RSP Rules) and that number is in the entry.⁴² We have VINs in mind here. Thus imagine that Alan grants a statutory pledge to the Ballindalloch Bank over his car and the bank registers the VIN in the entry in the RSP. Alan then sells the car to C Ltd without the bank's permission. C Ltd then sells to D Ltd. D Ltd would be unable to find the statutory pledge by a search against C Ltd because the statutory pledge is registered against Alan and it should in principle be protected if it is in good faith. But here the statutory pledge could be found by a search against the VIN.

³⁷ Discussion Paper, para 17.4.

³⁸ See Gretton and Steven, *Property, Trusts and Succession* para 5.20.

³⁹ See para 17.21 above.

⁴⁰ See paras 24.34–24.43 below.

⁴¹ See paras 30.7–30.8 and 34.6 below.

⁴² See Chapter 32 below.

Chapter 22 Incorporeal moveable property

Introduction

22.1 This chapter considers security over incorporeal moveable property. In the Discussion Paper we divided this type of property into (a) claims, monetary and otherwise and (b) other types of incorporeal moveable property.¹ Within (b) we listed intellectual property, company securities² (shares and bonds), public sector bonds, intermediated securities and negotiable instruments.³

22.2 For incorporeal moveable property there simply exists no “true” (or “proper”)⁴ security right. Under the current law only functional security can be achieved, by transferring the asset to the creditor by means of assignation. Thus taking security over financial instruments or intellectual property requires transfer of the asset to the creditor. As discussed elsewhere, the result is to give the creditor a more extensive right than is needed, resulting in problems in practice.⁵ For example, security can only be taken once. It is thus not possible to have multiple securities over the same asset.

22.3 We asked consultees whether the concept of a “proper” security over incorporeal moveable property should be introduced into Scots law. All the consultees who answered this question agreed, with the exception of Jim McLean who had in mind an alternative scheme based on assignation. Two law firm consultees argued that such a reform would be “useful and desirable”.⁶ Alisdair MacPherson commended it as “positive”, adding that there are “obvious commercial advantages offered by the fact that more than one security could be granted over the asset and the ability of the debtor to transfer the right to another party subject to the security.” We agree therefore that the statutory pledge should be available in respect of incorporeal moveable property.

22.4 The question then arises as to the types of that property which could be the subject of the new security right. Prior to the publication of the Discussion Paper, our advisory group took the view that it should be available for all types of incorporeal moveable property. This indeed is the general position under UCC–9, the PPSAs, the DCFR and the UNCITRAL Model Law.⁷ This was also supported by many of the consultees who responded to the Discussion Paper. Nevertheless, for the reasons which we set out below and after much consideration, we recommend that the statutory pledge should, at least initially, only be available in respect of incorporeal moveable property for certain asset classes.

¹ Discussion Paper para 19.1. In comparison in Chapter 7 of the Discussion Paper in relation to the current law, we distinguished between (a) personal rights as collateral and (b) intellectual property.

² The word “securities” of course here has a different meaning from security rights.

³ For an overview of the special types of incorporeal moveable property, see Discussion Paper, Chapter 7.

⁴ In other words a subordinate right. See para 17.2 above.

⁵ See paras 17.12–17.16 above.

⁶ Dundas & Wilson, and McGrigors.

⁷ See, for example, Drobnig and Böger, *Proprietary Security in Movable Assets* 214.

Claims

General

22.5 In the Discussion Paper we asked whether the new security right should apply to all types of claim,⁸ and not just some types, such as receivables. Consultees generally agreed. ABFA and the WS Society said: “It seems generally undesirable to distinguish the types of security right which can apply to anything falling within the brocard of incorporeal moveable property unless there is good reason to do so – otherwise why have the brocard.” Scott Wortley, however, noted that “whether such securities should be created over all claims is tricky as it is dependent in part on the reforms to the general law of assignments.”

22.6 We consider now that there are two major difficulties in permitting a statutory pledge to be created over claims.

Difficulty (a): inter-relationship with assignment in security of claims

22.7 The first difficulty is that alluded to by Mr Wortley, namely how a statutory pledge over claims would interface with an assignment in security over claims. We noted in the Discussion Paper that if a new form of security right over claims were to be introduced an assignment in security would arguably then no longer be necessary.⁹ Thus when the standard security was introduced it ceased to be competent to transfer heritable property for the purpose of security.¹⁰ Nevertheless, a counter-argument is that distinguishing outright assignment from assignment for the purpose of security is extremely difficult.¹¹

22.8 The approach under UCC–9, the PPSAs, the DCFR and the UNCITRAL Model Law is not to prohibit assignments in security but rather to recharacterise them as security rights.¹² This was also the position under the new Belgian Pledge Act of 11 July 2013, as originally passed, for the assignment in security of receivables,¹³ although the legislation was amended in 2016 to remove security over receivables from the new scheme.¹⁴ In contrast, the Dutch Civil Code debars transfers for security purposes, but the impact of the relevant provision has been restricted by case law.¹⁵ Prohibiting assignment in security, and recharacterising assignment in security as a proper security right are similar in substantive effect. The former says “assignment in security is void” and the other says “assignment in security is valid, but takes effect not as an assignment but as a proper security right”. Under

⁸ That is to say claims which are moveable. Our recommendations on assignment of claims extend to certain heritable claims. See paras 4.12–4.16 above.

⁹ Discussion Paper, para 18.33.

¹⁰ Conveyancing and Feudal Reform (Scotland) Act 1970 s 9.

¹¹ Although the same may in principle be said of transfers of other types of property. Note the Sale of Goods Act 1979 s 62(4).

¹² On recharacterisation, see para 18.8 above.

¹³ Belgian Pledge Act of 11 July 2013 art 73 (which provided for art 62 of the new Book III title XVII of the Civil Code).

¹⁴ See <http://www.cms-lawnow.com/ealerts/2016/12/belgian-reform-of-security-interests-over-movable-assets-postponed-further-and-slightly-amended>.

¹⁵ Dutch Civil Code art 3:84(3): “*Een rechtshandeling die ten doel heeft een goed over te dragen tot zekerheid ... is geen geldige titel van overdracht van dat goed.*” (“A juridical act that is intended to transfer property for the purpose of security ... does not constitute a valid title for the transfer of that property.”) See in particular *Keereweer v Sogelease BV* (HR 19-05-1995, NJ 1996, 119), discussed in S van Erp and B Akkermans (eds), *Cases, Materials and Text on Property Law* (2012) 513–515. The rule also does not apply to financial collateral arrangements. See Dutch Civil Code art 7:55. See also R G Anderson and J W A Biemans, “Reform of Assignment in Security: Lessons from the Netherlands” (2012) 16 *EdinLR* 24 at 39–41.

both approaches the effective result is no assignments in security, but only proper security rights.

22.9 Where the Financial Collateral Arrangements (No. 2) Regulations 2003 (FCARs)¹⁶ apply an assignment in security must be given effect according to its terms. Therefore prohibiting or recharacterising such an assignment is not possible.¹⁷

22.10 We asked consultees whether, if a new type of moveable security right were introduced, assignment in security should cease to be competent. A clear majority of consultees including ABFA, the Judges of the Court of Session, the Law Society of Scotland and several law firm consultees favoured retention of assignment in security. The Law Society observed that “since assignment in security must remain competent for certain cases (financial collateral) it makes more sense for the assignment in security to continue to be available across the board.” David Cabrelli, Chris Dun and the Faculty of Advocates, however, disagreed. Professor Eric Dirix favoured recharacterisation.

22.11 It seems to us that recommending a prohibition on assignment in security even where this would be permissible because the FCARs are not applicable, would attract significant opposition. It would no doubt require existing practices to be rethought, which would increase transaction costs. But if assignment in security is to be (i) retained in respect of claims and (ii) made far more commercially viable by being completed by registration in the Register of Assignations rather than intimation, it may be questioned how strong the case is for allowing the statutory pledge in respect of claims.

Difficulty (b): control

22.12 The second major difficulty in relation to the statutory pledge where claims are the encumbered property concerns the fact that this would be a fixed security. It would in effect be the Scottish counterpart of the English fixed charge. If the provider were a company or LLP, it would be subject to the same legislation in the event of insolvency, that is to say the Insolvency Act 1986. For the statutory pledge to be treated as a fixed security in relation to claims such as receivables would therefore seem to necessitate trying to imitate the English law rules on “control” of the *proceeds* of the claims. These rules, which we discuss elsewhere,¹⁸ are fiendishly difficult and unclear. In the broadest terms what seems to be needed is for the proceeds to be paid into a blocked bank account from which the secured creditor must give specific permission for any money to be released.

22.13 This issue previously attracted attention in 1994 when the Murray Report seemingly proposed a fixed security over receivables but without requiring control over proceeds.¹⁹ This resulted in a careful and detailed submission from this Commission, principally authored by Professor Niall Whitty. It stated:

“We suspect that a fixed moveable security over future book debts would be very popular with both secured creditors and borrower incumbrancers in Scotland. The secured creditors would be attracted inter alia by the priority over preferential

¹⁶ SI 2003/3226. See Chapter 14 above.

¹⁷ See para 14.19 above.

¹⁸ See paras 20.27–20.33 above and para 22.16 below.

¹⁹ The draft Floating Charges and Moveables Securities (Scotland) Bill appended to the Murray Report in clause 9 provides that the “moveable security” can be granted over receivables, but there are no provisions on control of proceeds.

creditors. The borrowers would be attracted by the freedom of management over the proceeds of the receivables. ...

We find it very difficult however to support the notion of a fixed security over receivables which gives the debtor freedom of disposal of the proceeds. ...

In Scots law a fixed security may be broadly defined as a real right in the property of another which secures the performance of an obligation. In the case of an assignation in security of a future incorporeal debt to become due by an identifiable debtor, intimation creates the assignee's real right under Scots law and subsequent attempts by the assignor at collection will be refused by the debtor unless the assignee consents. The assignation plus intimation creates a genuine real right which is in stark contrast to the purported or sham real right [proposed]."²⁰

22.14 The comments in the final paragraph are rather echoed by Lord Hope of Craighead in the subsequent landmark English decision of *National Westminster Bank plc v Spectrum Plus Ltd*²¹ where he states:

"[S]ubjecting book debts to a security which will be effective as a fixed charge in Scots law . . . is far less convenient [than a floating charge] in practice. This is because the law of Scotland still insists that a fixed charge can be created only by delivery of the property which is to be subjected to it in the hands of the creditor or by the equivalent of delivery. The only way in which this can be done in the case of book debts is by obtaining an assignation in security of the right to receive payment of the debt, which is then intimated to the party who is liable to pay the debt to the company."

22.15 We discussed the arguments made by Professor Whitty in some detail with our advisory group. We also explored the issue of control with insolvency experts with whom we held a meeting. Some were supportive of the position that control over proceeds is necessary to achieve a fixed security over claims. Others dissented. A cautious approach therefore is that control of proceeds is required.

22.16 In England and Wales, the rules distinguishing fixed and floating charges, and on the level of control of proceeds necessary to achieve a fixed charge, rest in equity.²² They are not statutory. As we recounted above,²³ the case law on receivables and their proceeds has ebbed and flowed from *Siebe Gorman & Co v Barclays Bank*²⁴ to *Spectrum Plus* (above) and it is difficult to know exactly what the law is. There is widespread agreement that this is one of the most unsatisfactory areas of English commercial law and in 2014 the Financial Law Committee of the City of London Law Society published a Discussion Paper on the matter.²⁵

²⁰ Comments by Scottish Law Commission on Consultation Paper by Department of Trade and Industry on Security over Moveable Property in Scotland (November 1994), 16 March 1995 paras 3.45–3.47.

²¹ [2005] UKHL 41.

²² See generally Beale, Bridge, Gullifer and Lomnicka, *The Law of Security and Title-Based Financing* paras 6.106–6.139 and Calnan, *Taking Security* paras 4.79–4.125.

²³ See paras 20.31–20.33 above.

²⁴ [1979] 2 Lloyd's Rep 142.

²⁵ The Discussion Paper is available at

<http://www.citysolicitors.org.uk/attachments/article/121/20140219%20Secured%20Transactions%20Reform%20Discussion%20Paper%20%20Fixed%20and%20floating%20charges%20v2.pdf>. It sets out three options: (1) to clarify the distinction between fixed and floating charges; (2) to identify particular assets out of which a levy in favour of certain preferential claims should be paid; and (3) to pay the levy as a small percentage of all charged assets subject to a cap.

In 2017 the Secured Transactions Law Reform Project also published a Discussion Paper.²⁶ English law may well be reformed in the coming years. Therefore attempting to put such unsatisfactory and difficult rules into our draft Bill is undesirable.

22.17 Nevertheless, without control provisions a statutory pledge over claims could distort the balance between secured and unsecured creditors in corporate insolvencies. As we have noted elsewhere,²⁷ insolvency law is in principle outwith the scope of this project. We cannot, however, ignore the fact that the two areas are closely related and that facilitating more security potentially has an adverse effect on unsecured creditors. Several consultees, notably the Faculty of Advocates and Scott Wortley, commented on this, as did the insolvency specialists with whom we met.

Conclusion

22.18 It therefore seems to us, particularly given the availability of assignation in security in respect of claims, that permitting the statutory pledge to be granted over claims, especially without control provisions, cannot presently be justified. We say this with some hesitation given that it is one of the key objectives of the UNCITRAL Legislative Guide on Secured Transactions that security should be facilitated over all types of asset,²⁸ but we have concluded that local circumstances require a deviation from this. The position may of course change in the future not least if there are developments in England and Wales, and corporate insolvency law is reformed, but for the moment we are of the view that claims should be outwith the scope of the statutory pledge.²⁹

Assignations in security and control of proceeds

22.19 There remains another difficult question. Where claims are assigned in security, should it be a requirement that the assignee has control over the proceeds? Thus, Professor Whitty and Lord Hope in the statements quoted above say that the “control” requirement in English law is replicated in Scottish law by the requirement for intimation to the (account) debtor. Earlier in this Report we recommend that registration in the new Register of Assignations should be an alternative to intimation.³⁰ This is especially to facilitate the assignation of future claims. Where the assignation is in security it may, however, be argued that registration alone should be insufficient and that there should also require to be control of proceeds.

22.20 We have also found this matter highly challenging, but ultimately we have concluded against including provisions in our draft Bill on control of proceeds for assignations in security of claims. Our reasons are as follows. First, an assignation is not a proper security right.³¹ It is a transfer.³² To be more exact, it is a transfer in security. In England and Wales

²⁶ The Discussion Paper is available at: <https://stlrp.files.wordpress.com/2017/01/paterson-fixed-and-floating-charges.pdf>. The author is Professor Sarah Paterson. It canvases possibilities for reform.

²⁷ See para 1.26 above. See also paras 18.69–18.71 above.

²⁸ UNCITRAL Legislative Guide on Secured Transactions at 21 (key objective (e)).

²⁹ Below at paras 22.30–22.34 we set out an exception for claims which fall within the definition of “financial instrument”.

³⁰ See Chapter 5 above.

³¹ Compare with the position in South Africa where an assignation in security of a claim (*cession in securitatem debiti*) can be characterised as a pledge. See P Nienaber and G Gretton, “Assignment/Cession” in R Zimmermann, D Visser and K Reid (eds), *Mixed Legal Systems in Comparative Perspective: Property and Obligations in Scotland and South Africa* (2004) 787 at 814–818.

³² For a detailed analysis, see A D J MacPherson, *The Attachment of the Floating Charge in Scots Law* (PhD Thesis, University of Edinburgh, 2017) 238–264.

equitable assignments for security purposes are commonly treated synonymously with fixed or floating charges and characterised as such.³³ The idea of an assignation being characterised as a floating charge is at odds with property law in Scotland where floating charges are not recognised under our common law.³⁴

22.21 Secondly, leaving aside their inherent complexity in English law, proceeds rules would be very difficult to operate in the context of an assignation as a transfer. Imagine that an assignation in security requires proceeds to be held in a blocked bank account. X Ltd assigns certain future invoices to Y Ltd. X Ltd arranges for the account debtors to make payment into a blocked account. The account is subsequently “unblocked”. What is to be the effect? The notion that the assignation is thereby invalidated and the right to the claims and therefore the proceeds is automatically revested in X Ltd is unattractive. And if the account is blocked again? Does that revalidate the assignation? There would have to be recharacterisation, which again would run counter to our property law and the views of our consultees.

22.22 Thirdly, assignation in security is an existing part of the law in Scotland. Our recommendations are to reform how it may be completed. This may be contrasted with the statutory pledge which would be an innovation.

22.23 Fourthly, at a practical level, even without a statutory requirement the assignee will want to assert a measure of control over the proceeds, otherwise it will be unprotected in the event of the assignor’s insolvency. Thus the assignee may insist that the proceeds are held in trust for it and paid over to it at regular intervals. An assignation in security of claims is of little value if the assignor is able to dissipate the proceeds. Another form of protection is for the assignee to intimate and require payment from the account debtor. When this is done in South Africa the sums recovered are applied in satisfaction of the secured debt and any surplus held to the order of the assignor.³⁵

22.24 Fifthly, if it is considered necessary for the purposes of corporate insolvency law to recharacterise an assignation in security as a floating charge where there is a lack of control of proceeds, this could be taken forward by reform of the corporate insolvency legislation. As we have mentioned above, there is already pressure in England and Wales for the different treatment of fixed and floating charges in an insolvency to be reviewed.

Financial instruments

General

22.25 In the Discussion Paper we saw particular advantages resulting from the availability of the new security right for financial instruments, such as shares in a company.³⁶ This is because under the current law security can only be achieved by transfer, even although

³³ See G Tolhurst, *The Assignment of Contractual Rights* (2nd edn, 2016) para 3.17. See also Beale, Bridge, Gullifer and Lomnicka, *The Law of Security and Title-Based Financing* paras 4-13–4.37.

³⁴ *Carse v Coppen* 1951 SC 233 at 239 per Lord President Cooper. See also R Anderson, “Security over bank accounts” 2010 Law and Financial Markets Review 593 at 599 in relation to assignation of claims in respect of bank accounts (discussed below at para 22.57): “Because a Scottish pledge over account operates by way of title transfer, any concession of a right to the account holder to operate the account does not destroy the security. In other words, *Spectrum Plus* has no application to pledges of account.”

³⁵ Nienaber and Gretton, “Assignation/Cession” at 817.

³⁶ Discussion Paper, paras 19.4–19.5.

such a transaction is misleadingly named a “pledge of shares” or “shares pledge”.³⁷ Thus in the Supreme Court case of *Farstad Supply A/S v Enviroco Ltd*³⁸ a bank took a transfer of company shares in security. This resulted in unwelcome consequences, in that the company whose shares were being used as collateral thereby ceased, for the time being at least, to be the subsidiary of the debtor company. In general terms the drawbacks of security by transfer which we outlined earlier apply.³⁹ The secured creditor acquires greater rights than it actually needs. Thus as registered holder of the instrument it is entitled to dividends or interest and, in the case of shares, to vote at shareholder meetings.

22.26 Another issue in relation to Scottish shares pledges has arisen since 1 April 2016 because of the new requirement for companies and LLPs to maintain a “Person of Significant Control (PSC) Register”.⁴⁰ Registration is required of any individual or “relevant registerable legal entity”⁴¹ which exercises specified methods of significant control of the company or LLP, for example, holding (directly or indirectly) 25% or more of the shares in the company.⁴² Various criminal offences apply where there is failure to comply with the requirements.⁴³ The new legislation has a carve-out for security in respect of shares:

“Rights attached to shares held by way of security provided by a person are to be treated for the purposes of this Schedule as held by that person—

(a) where apart from the right to exercise them for the purpose of preserving the value of the security, or of realising it, the rights are exercisable only in accordance with that person's instructions, and

(b) where the shares are held in connection with the granting of loans as part of normal business activities and apart from the right to exercise them for the purpose of preserving the value of the security, or of realising it, the rights are exercisable only in that person's interests.”⁴⁴

22.27 A consensus has now been reached by major law firms that this carve-out does apply to Scottish share pledges although they involve the transfer of the shares rather than taking a security right in the shares. But this is another example of a complexity arising from the lack of a “proper” security over shares.

22.28 Under English law it is possible to use an equitable security right (charge), which leaves the provider company as the registered holder of the instrument.⁴⁵ This means that the various difficulties caused by transfer can be avoided.

22.29 There was strong support from our advisory group for the statutory pledge to be available in respect of financial instruments. The current Scottish law requiring transfer was regarded as comparing very badly with the position of England and Wales. In addition,

³⁷ See eg *Braithwaite v Bank of Scotland* 1999 SLT 25. See Steven, *Pledge and Lien* para 5-05.

³⁸ [2011] UKSC 16.

³⁹ See paras 17.12–17.16 above.

⁴⁰ Companies Act 2006 Part 21A and Sch 1A, inserted by the Small Business, Enterprise and Employment Act 2015 s 81 and Sch 3. We are grateful to Andrew Kinnes for drawing this to our attention and also to Gillian Frew for her assistance.

⁴¹ Companies Act 2006 s 790C(8).

⁴² Companies Act 2006 Sch 1A Part 1 para 2.

⁴³ Companies Act 2006 ss 790F, 790Q and 790R.

⁴⁴ Companies Act 2006 Sch 1A Part 3 para 23.

⁴⁵ See generally Beale, Bridge, Gullifer and Lomnicka, *The Law of Security and Title-Based Financing* paras 3.19–3.24.

Michael Royden, a consultee to the Discussion Paper, while noting that the availability of the new security would create additional issues in corporate transactions, thought that the lack of a formal pledge⁴⁶ over shares in Scots law was “a disadvantage” and that it would be “useful” to resolve the issue.

Definition

22.30 Clearly “financial instrument” requires definition. We have concluded in discussion with our advisory group that it would make sense to draw on the definition in the FCARs. This is because this definition, despite some uncertainties,⁴⁷ already has application in relation to creating security over financial instruments. Mapping on to it is therefore a simpler approach than trying to provide a bespoke definition which would nevertheless have to interact with it. We discuss the FCARs and their requirements in Chapter 14 above and Chapter 37 below. The definition of “financial instruments” is:

- “(a) shares in companies and other securities equivalent to shares in companies;
- (b) bonds and other forms of instruments giving rise to or acknowledging indebtedness if these are tradeable on the capital market; and
- (c) any other securities which are normally dealt in and which give the right to acquire any such shares, bonds, instruments or other securities by subscription, purchase or exchange or which give rise to cash settlement (excluding instruments of payment);

and includes units of a collective investment scheme within the meaning of the Financial Services and Markets Act 2000, eligible debt securities within the meaning of the Uncertificated Securities Regulations 2001, money market instruments, claims relating to or in respect of any of the financial instruments included in this definition and any rights, privileges or benefits attached to or arising from any such financial instruments”⁴⁸.

22.31 This definition effectively comes in four parts: (a), (b), (c) and express inclusions. Part (a) clearly includes shares in both limited and public limited companies. The expression “securities equivalent to shares in companies is less straightforward, but may include membership certificates and depositary receipts.⁴⁹ Part (b) includes public sector bonds, such as those issued by HM Government and local authorities. For a security to fall within part (c) it must be shown that there is normally a market for it, even though they do not have to be traded on an exchange and there could be times in which no market exists.⁵⁰

Intermediated securities

22.32 In relation to the express inclusions, it is the final “sweep up” wording that is particularly important. It refers to “claims relating to or in respect of” financial instruments and thus includes intermediated securities. An intermediated security is where, for

⁴⁶ While one talks of a pledge of shares under the current law this is actually a transfer. See Steven, *Pledge and Lien* para 5-05.

⁴⁷ See further Yeowart and Parsons, *The Law of Financial Collateral* paras 3.26–3.61. Professor Gretton has described it as “vague”. See G L Gretton, “Financial Collateral and the Fundamentals of Secured Transactions” (2006) 10 Edin LR 209 at 211.

⁴⁸ Financial Collateral Arrangements (No. 2) Regulations 2003 (SI 2003/3226) reg 3(1).

⁴⁹ Yeowart and Parsons, *The Law of Financial Collateral* paras 3.35–3.36.

⁵⁰ Yeowart and Parsons, *The Law of Financial Collateral* paras 3.52.

convenience, shares or bonds are not held directly but indirectly. For example, a company issues shares and an investor wishes to buy some of these. The investor could hold the shares directly, but alternatively the shares can be held by an intermediary, such as a member of the CREST system,⁵¹ on behalf of the investor. The intermediary receives the dividends and passes these to the investor. If the investor decides to sell the shares, the intermediary will sell them and give the proceeds to the investor.

22.33 The investment therefore consists of a claim (personal right) against the intermediary.⁵² That claim could be assigned in security under the current law. Earlier in this chapter we concluded that claims should in principle be excluded from the scope of the statutory pledge at least initially. We consider that an exception should be made for claims falling within the definition of “financial instrument” on which we are drawing from the FCARs in the interests of applying that definition consistently. Our advisory group supported the availability of the statutory pledge for intermediated securities because multiple statutory pledges are possible. In contrast, an assignation in security, as a transfer, can only be done once.

22.34 We recommend:

95. It should be possible to create a statutory pledge over financial instruments within the meaning of regulation 3(1) of the Financial Collateral Arrangements (No. 2) Regulations 2003.

(Draft Bill, ss 47(2)(c) and 116(1))

Intellectual property

General

22.35 Intellectual property (IP) has become an important type of incorporeal moveable property for the purposes of granting security because of the increasing value of this type of asset.⁵³ It is therefore detrimental to our legal system’s reputation that, in the words of an article published on the law firm Brodies’ website, Scottish law here is “stuck in the 19th century”.⁵⁴ In an important independent report commissioned by the Intellectual Property Office and published in 2013 it was concluded that more needed to be done to encourage SMEs to use their IP to access finance.⁵⁵ Facilitating the granting of security rights is an

⁵¹ The system for the holding of dematerialised securities. See the Uncertificated Securities Regulations 2001 (SI 2001/3755). See generally Beale, Bridge, Gullifer and Lomnicka, *The Law of Security and Title-Based Financing* para 3.23.

⁵² The position in English law and some other systems is more complicated. The position of the investor is regarded as a bundle of rights, some of these being contractual rights against the intermediary and others being “proprietary rights” in the underlying investments. See J Benjamin, *Interests in Securities* (2000) and Beale, Bridge, Gullifer and Lomnicka, *The Law of Security and Title-Based Financing* paras 3.25–3.26.

⁵³ See eg I Davies, “Technology-based small firms and the commodification of intellectual property rights” in De Lacy (ed), *The Reform of UK Personal Property Security Law* 308 and M Abraham, “Tapping the intangible: security interests and intellectual property” 2013 *Insolvency Intelligence* 113. In 2009 the World Intellectual Property Office estimated that global commerce in IP was worth US \$300 billion worldwide annually. See World Intellectual Property Office, *Information Paper on Intellectual Property Financing* (2009) 4, available at http://www.wipo.int/edocs/mdocs/copyright/en/wipo_ip_fin_ge_09/wipo_ip_fin_ge_09_7-main1.pdf.

⁵⁴ See <http://www.brodies.com/blog/security-over-ip-scots-law-stuck-in-the-19th-century/>.

⁵⁵ Intellectual Property Office, *Banking on IP? The role of intellectual property and intangible assets in facilitating business finance: Final Report* (2013) available at https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/312008/ipresearch-bankingip.pdf. The report was written by Martin Brassell and Kelvin King.

important part of this. Also in 2013 the Department for Business, Innovation and Skills⁵⁶ noted that: “Smaller and newer firms, which often have less security to use as collateral, or firms with intangible assets such as intellectual property, find it harder to raise finance.”⁵⁷

22.36 The principal difficulty in current Scottish law highlighted earlier in this Report is that the only way in which security can be achieved is by transfer (assignment).⁵⁸ This means that complex contractual arrangements have to be entered into to license the IP back to the party which is providing it as collateral. Further, an assignment, as a transfer, can only be granted in favour of one secured creditor. It is impossible to grant several effective assignments of the same IP.

22.37 In an exchange with us following consultation, Scottish Enterprise expressed particular support for the new security being available in respect of IP:

“Existing methods of taking security over IP (assignment in security with a licence back to the debtor) are fairly restrictive and the cost and management implications to the creditor of maintaining the IP registrations (patents, trademarks etc.) and ensuring that IP created by the debtor after the date of grant of the security is captured under the security can cause potential lenders to avoid advancing lending against IP assets. If the new security would allow the IP registrations to remain with the debtor whilst the creditor can obtain a registerable security interest in the IP then this may be a valuable addition to the suite of securities available to lenders in Scotland.”

22.38 But, in a very detailed submission, Dr Andreas Rahmatian set out what he saw as the potential difficulties with the proposed new security right being available for IP.⁵⁹ His starting point was the fact that IP law is reserved under the Scotland Act 1998.⁶⁰ It is therefore not possible for an Act of the Scottish Parliament on security rights to amend existing UK legislation to the extent that IP is reserved. Dr Rahmatian contended that the inter-relationship between the new security right and the existing method of achieving security, namely by assignment (or assignment), would be difficult. Thus while the new security right could be discovered by a search in the Register of Statutory Pledges (RSP), an assignment would not be. The RSP would therefore not be definitive. He also drew attention to international private law issues. He pointed out the complications that would result where Scottish IP subject to the new security right was assigned to someone in another jurisdiction such as England and the assignee then granted a further security right over it there.

22.39 We do not doubt that there are problems here. In particular there is a need to clarify international private law in relation to IP, not least between Scotland and England.⁶¹ As regards the issue of IP being reserved, our policy is that our draft Bill should work within the framework of the existing UK statutory regimes on IP, and we say more on this shortly.⁶² Our conclusion, however, is that the difficulties that exist do not justify precluding the

⁵⁶ Since July 2016 the Department for Business, Energy and Industrial Strategy.

⁵⁷ Department for Business, Innovation and Skills, *Building the Business Bank: Strategy Update March 2013* (2013) 10 available at https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/203148/bis-13-734-building-the-business-bank-strategy-march-2013.pdf.

⁵⁸ See paras 17.12–17.16 above. See also J Macfarlane and S Macpherson, “Securities over Intellectual Property in Scotland” 1993 *The In-House Lawyer* 18.

⁵⁹ We are also grateful to Dr Rahmatian and Mr Jim McLean for attending a special advisory group meeting on this issue in March 2014 and providing us with their expertise there.

⁶⁰ Scotland Act 1998 Sch 5 Part II Head C4. But some parts of the law of plant varieties are devolved.

⁶¹ See Chapter 39 below.

⁶² See also para 1.47 above.

statutory pledge being made available in respect of IP. We consider that the benefit of having a security right which does not necessitate transfer is a substantial one. It would be an important innovation at a time when IP is increasingly valuable as potential collateral.

22.40 There would also be benefit in facilitating security over applications for IP and for IP licences where possible.⁶³ Thus the Patents Act 1977 makes clear that any patent, or application for a patent, or right in or under a patent, is incorporeal property which may be the subject of a security right.⁶⁴

22.41 As regards licences of IP some may not be suitable for being the subject of the statutory pledge because they are provided to be non-transferable.⁶⁵ Moral rights would also be excluded for the same reason.⁶⁶

22.42 Allowing the statutory pledge over IP when an assignment in security continues to be available, while bringing Scottish law into line with the other parts of the UK, does of course create a level of duplication. There may be much to be said for more radical reform.⁶⁷ But for pragmatic reasons this is beyond the scope of this Report. In particular, provisions restricting the assignment of IP for security purposes would require UK legislation and are thus beyond the legislative competence of the Scottish Parliament.

22.43 We therefore recommend:

96. It should be possible to create a statutory pledge over:

- (a) intellectual property, and**
- (b) applications for, or licences over, intellectual property.**

(Draft Bill, s 47(2)(a) & (b))

Registration

22.44 The result of our recommendations would be to introduce an important new option for security over IP. Creditors would thus have a choice. They could achieve security by transfer as under the existing law. Alternatively, the statutory pledge could be used.

22.45 IP can be broadly divided into two categories: unregistered (such as copyright) and registered (such as patents). For unregistered IP, the choice would work in the following way. The parties could do what is done at present ie assign the copyright, by way of security, with the assignment not being registered (except, in cases where the provider is a company etc, under the company charges registration scheme). Or they could use the new

⁶³ The UK Intellectual Property Office “Fast Facts 2017” publication states that global trade in IP licences in 2014 was worth more than £220 billion (1.6% of global trade) and rising. See https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/581279/Fast-Facts-2017.pdf.

⁶⁴ Patents Act 1977 s 31(1) and (3). The provisions also apply to applications for a European patent (UK) by virtue of s 78 of that Act. See also the Registered Designs Act 1949 s 15B(6) and the Trade Marks Act 1994 ss 24(5) and 27.

⁶⁵ See paras 19.63–19.65 above. For provisions on licences, see eg the Patents Act 1977 s 31(4), the Trade Marks Act 1994 s 28(1), the Registered Designs Act 1949 s 15B(7) and the Copyright, Designs and Patents Act 1988 s 90(4).

⁶⁶ Copyright, Designs and Patents Act 1988 s 205L.

⁶⁷ See S Thomas, “Security Interests in Intellectual Property” 2017 Legal Studies 214.

statutory pledge, which would leave title to the copyright being held by the provider. The statutory pledge would be registered in the RSP.

22.46 For registered IP, the same choice would exist, but there would be a complicating factor. In the Discussion Paper⁶⁸ we concluded that the IP legislation leaves the question of security rights to general law, thus leaving Scots law able to develop an alternative to assignment in security. But we also concluded that in some cases such a security right would, because of the provisions of the relevant legislation, be precarious unless registered in the appropriate IP register. In other words, it would be vulnerable to third parties acquiring rights over the property which would trump the unregistered security right. Thus suppose that X held a patent and wished to grant a statutory pledge over it to Y. If the rule is to be that the statutory pledge must be registered in the RSP and that is indeed the rule which we now recommend in Chapter 23 below,⁶⁹ then Y might wish to ensure that the security right would not be precarious by registering it also in the Patents Register. That would be double registration. This could be criticised as being inconvenient and adding expense.

22.47 One possibility would be to amend the IP legislation so as to allow registration in the RSP to suffice. But this would require UK legislation. Another possibility would be to provide that registration in the relevant intellectual property register would suffice. So the statutory pledge by X to Y could be registered in the Patents Register, and that would be all that would be needed. Attractive though that solution would seem, it would not be without difficulty. We think it would place more weight on the intellectual property legislation than that legislation is designed to bear. The provisions about registered IP do not have a coherent set of ranking rules: they have a few specific rules, but no general scheme. Moreover, they seem to presuppose that a security right will exist *before* any registration⁷⁰ and that would be inconsistent with the policy behind the statutory pledge, which is that it should not come into existence without satisfying the publicity principle.

22.48 Given that registration in the RSP should be fairly easy and inexpensive, we inclined in the Discussion Paper to think that no exception should be made, so that even if a statutory pledge were being granted solely over IP, it should still be registrable in the RSP.

22.49 Most consultees who responded to this question agreed, including the Faculty of Advocates, the Judges of the Court of Session, the Keeper of the Registers of Scotland and several law firm consultees. Others, notably Dr Ross Anderson, the Law Society of Scotland and Dr Hamish Patrick favoured registration in the relevant specialist IP register only.

22.50 We explored the issues here with our advisory group. A rule whereby a statutory pledge over registered IP would require to be registered in the relevant specialist register alone would only reduce time and cost where the statutory pledge was restricted to the IP. Thus, where a small business granted the statutory pledge over a patent and over equipment, there would have to be registration in the RSP because of the equipment being part of the subject matter of the statutory pledge.

⁶⁸ Chapter 7.

⁶⁹ See paras 23.11–23.19 below.

⁷⁰ See, for example, Patents Act 1977 s 33(1) and Trade Marks Act 1994 s 25(3). But cf A Orr and T Guthrie, “Fixed Security Rights Over Intellectual Property in Scotland” [1996] 18 *European Intellectual Property Review* 596 at 597 and D P Sellar, “Rights in Security over ‘Scottish Patents’” (1996) 2 *Scottish Law and Practice Quarterly* 137.

22.51 We doubt that a rule that the statutory pledge over registered IP is created by registration only in the relevant specialist register could be given effect without amendment being made to intellectual property legislation such as the Patents Act 1977. As we noted above, this legislation is reserved to the UK Parliament. At the moment it seems to us that the existing registration provisions concern *priority* of security rights rather than *constitution* of security rights. We understand also that in practice floating charges are not registered in the specialist registers and this too supports the view that registration is not constitutive.

22.52 In addition it is probable that a provision in our draft Bill requiring the statutory pledge to be constituted in a different way for registered IP than for other types of property would require legislation by the UK Parliament because IP law is a reserved area.

22.53 Legal advisers are familiar with having to register security documentation in more than one place given the requirements of the company charges registration scheme. In Chapter 36 below we consider in relation to that scheme that the ideal way forward would be an information-sharing arrangement, although this may be difficult to achieve in the short term. Our advisory group also supported that consideration be given to this as regards the RSP and the specialist IP registers. Once again we are aware that there are calls for a more radical reform of security rights over IP in the UK, for example, to have a unitary register, but that is beyond our scope given that it would require UK-wide legislation.⁷¹

22.54 We recommend:

97. In the case of registered intellectual property, registration of the statutory pledge in the relevant intellectual property register should not displace the requirement for registration in the Register of Statutory Pledges, but consideration should be given to establishing information-sharing arrangements between the registers.

Transferability

22.55 The enforcement of a security right involves the realisation of an asset, usually by it being sold.⁷² Thus the asset requires to be transferable. We deal with the general requirement for transferability in Chapter 19 above, but the issue is particularly germane in the context of intellectual property. For example, “moral rights”, being non-transferable,⁷³ could not be the subject of a statutory pledge. Some intellectual property licences can only be transferred under certain restrictions. Such assets could be encumbered by a statutory pledge, although clearly any prospective secured creditor would want to look closely at the relevant restrictions.

Enforcement

22.56 We deal with special issues as regards enforcement of a statutory pledge against IP in Chapter 28 below.

⁷¹ See S Thomas, “Security Interests in Intellectual Property” 2017 Legal Studies 214.

⁷² See Chapter 28 below.

⁷³ Copyright, Designs and Patents Act 1988 s 94.

Other forms of incorporeal moveable property

Security over bank accounts

22.57 In England and Wales it is possible to create a charge over the credit balance in a bank account in favour of the bank with which the account is held.⁷⁴ This is known as a “chargeback”. Under current Scottish law, the nearest equivalent is a so-called “pledge over account”. Like the share pledge, this is misleadingly named, as it is actually an assignation.⁷⁵ The account holder is assigning its claim against the bank to the bank. Dr Anderson has noted that while in principle this creates the possibility of *confusio* (confusion),⁷⁶ there are good arguments that this doctrine is inapplicable, in particular because the assignation is only intended to be in security. He has also argued that an agreement providing for contractual set-off may have advantages over the pledge over account.⁷⁷

22.58 If the statutory pledge were to be made available in respect of bank accounts similar difficulties as those discussed in relation to receivables above would require to be faced.⁷⁸ In other words, for there to be a “fixed security” within the meaning of the corporate insolvency legislation would seem to necessitate the secured creditor having “control” of the account. Given that (a) security can be achieved by assignation of the claim against the bank; (b) under our recommendations made above this could be achieved by registration in the RoA; and (c) the alternative possibility of contractual set-off, we are not convinced that there is a sufficient case for the statutory pledge to apply to bank accounts at this time. Of course it would be possible for the matter to be reviewed in the future.

Negotiable instruments

22.59 Negotiable instruments raise special issues. Thus in their consultation responses Brodies and the Law Society of Scotland noted that the Consumer Credit Act 1974 imposes restrictions on negotiable instruments being given in security in relation to a transaction regulated by that Act.⁷⁹ Earlier in this Report we recommended that negotiable instruments should be excluded from our proposed new scheme in relation to assignation of claims.⁸⁰ We understand from our advisory group that these are rarely used as collateral. Therefore, at least at the present time, we think that they should be excluded from the scope of the statutory pledge.

22.60 There is authority to the effect that negotiable instruments may be made the subject of a possessory pledge.⁸¹ This whole area, however, is specialist and in our view it would add unnecessary complexity to our recommended new rules for possessory pledge to be

⁷⁴ The leading case is *Re Bank of Credit and Commerce International SA (In Liquidation) (No 8)* [1998] AC 214. For discussion, see R Calnan, “Security over Deposits Again: *BCCI (No 8)* in the House of Lords” 1998 *Journal of International Banking and Financial Law* 125.

⁷⁵ See R G Anderson, “Security over bank accounts in Scots law” 2010 *Law and Financial Markets Review* 593 at 598.

⁷⁶ The doctrine that a person cannot hold a right against itself. See R G Anderson, “A Whimsical Doctrine: *Confusio*” in A J M Steven, R G Anderson and J MacLeod (eds), *Nothing so Practical as a Good Theory: Festschrift for George L Gretton* (2017) 31–45.

⁷⁷ Anderson, “Security over bank accounts in Scots Law” at 594–595 and 599–600.

⁷⁸ See paras 22.12–22.17 above.

⁷⁹ Consumer Credit Act 1974 s 123.

⁸⁰ See para 4.15 above.

⁸¹ See Steven, *Pledge and Lien* paras 5-07 to 5-09.

made to apply to negotiable instruments. Further, this was not a subject on which we consulted. Therefore the provisions on possessory pledge in our draft Bill should apply to corporeal moveables (excluding money) only. We recommend:

98. Any rule of law in relation to a pledge over a negotiable instrument should be unaffected by the reforms recommended in this Report.

(Draft Bill, s 43(6))

Summary

22.61 In the table below we set out the possibilities for taking security over incorporeal moveable property if our recommendations are implemented.

Asset Type	Statutory pledge	Security by transfer
Claims (general)	No	Yes (by assignation)
Financial instruments (general)	Yes (with FCARs adaptations if appropriate)	Yes (by assignation with FCARs adaptations if appropriate or other form of transfer eg under the Stock Transfer Act 1963)
Intermediated securities	Yes (with FCARs adaptations if appropriate)	Yes (by assignation with FCARs adaptations if appropriate)
Intellectual property	Yes	Yes (by assignation, with registration in IP registers for registered IP)
Bank accounts	No	Yes (by assignation)
Negotiable instruments	No	Yes (by negotiation)

The future

22.62 The reasons why we recommend that the statutory pledge is restricted initially to financial instruments (including intermediated securities) and IP are set out above and are entirely pragmatic. We accept that the optimum position is for all incorporeal moveable property to be capable of being encumbered. But we consider that this must await future developments, in particular the review of corporate insolvency law. It would be sensible, however, to empower the Scottish Ministers to widen the classes of incorporeal property as and when they consider it appropriate to do so. We recommend:

- 99. The Scottish Ministers should have the power to prescribe other kinds of incorporeal moveable property over which a statutory pledge may be created.**

(Draft Bill, s 47(2)(d))

Chapter 23 Statutory pledge: creation, amendment, transfer, restriction and discharge

Introduction

23.1 In this chapter we consider what is necessary for effective legal (juridical) acts in relation to a statutory pledge. First, we look at how this security right would be created. Secondly, we consider amendment and in particular adding property to the encumbered property and varying the secured obligation. Thirdly, we discuss transfer of statutory pledges by means of assignation. Finally, we consider how statutory pledges would be extinguished, in part by restriction, and in whole by discharge.

Creation

23.2 The creation of a statutory pledge, like the creation (or indeed transfer) of other rights in property in Scotland, would normally have three stages. First, there would be the contract between the prospective provider and the prospective secured creditor, known in most jurisdictions as the “security contract”. Secondly, there would be the actual grant of the statutory pledge by the provider in favour of the secured creditor. Thirdly, there would be the creation of the real right in favour of the secured creditor. Only then would the statutory pledge be enforceable against third parties and in insolvency. In other words, only then would it truly be created. This contrasts with the attachment/perfection approach of UCC–9 and the PPSAs under which a security right is created on attachment but only has third party effect on registration. As discussed earlier in this Report,¹ consultees did not favour such an approach.

(1) *Security contract*

23.3 A security contract sets out the details of the security transaction including the rights and obligations of the parties, particularly in relation to when the security can be enforced. Strictly, there is no requirement for a contract prior to the grant of a right in security, in the same way as property can be transferred without a preceding contract of sale. But of course in commercial practice there is invariably a security contract. Such a contract will be in writing. We see no need for writing to be mandatory as the law generally only insists on writing for contracts relating to real rights in land rather than moveable property.²

¹ See paras 18.44–18.49 above.

² Requirements of Writing (Scotland) Act 1995 s 1(2)(a)(i).

(2) *Grant of statutory pledge by means of constitutive document*

23.4 The statutory pledge, like other non-possessory rights in security, should require a constitutive document.³ There are a number of reasons why. The first is evidential. Possessory rights in security are evidenced by the secured creditor having possession of the encumbered property. With non-possessory rights in security the encumbered property remains with the provider and other evidence is needed to prove the existence of the right. The second reason is connected to the first. In the Discussion Paper we proposed that the new security right would be created in a similar way to a standard security, namely by the registration of a constitutive document.⁴ As we shall see below,⁵ this proposal was generally supported by consultees. Registration of a constitutive document obviously means that such a document is required. It would not be possible for a statutory pledge to be granted orally. Thirdly, where the provider of a statutory pledge is a company or LLP, Part 25 of the Companies Act 2006 means that the statutory pledge as a right in security would need to be registered in the Companies Register. Since 1 April 2013 the method is document registration.⁶

23.5 The constitutive document would require to be granted by or on behalf of the provider. The provider could sign a hard copy of the document in ink, or, to put this more formally, execute it as a traditional document in terms of the Requirements of Writing (Scotland) Act 1995.⁷ Increasingly, of course, documents are signed electronically and this should also be possible. We think that the position should be the same as for assignation documents, discussed earlier in this Report,⁸ namely that the Scottish Ministers should have power to modify what is required for signature by pen and ink (execution) and electronic signature (authentication) so that it is different from that required under the 1995 Act if they consider this is appropriate.⁹

23.6 There requires to be an exception for the need to sign the constitutive document where the encumbered property is a financial instrument and the FCARs¹⁰ apply. We discuss this in Chapter 37 below.

23.7 The constitutive document would have to identify the encumbered property. That may be either property of, or property to be acquired by the provider, including property not yet in existence. As we saw in Chapter 20, consultees supported the ability of the statutory pledge to cover future assets.¹¹

23.8 The level of identification would have to satisfy the specificity principle of property law,¹² in other words it would have to be sufficiently clear to allow third parties to determine

³ For example, for standard securities, see the Conveyancing and Feudal Reform (Scotland) Act 1970 Sch 2. For floating charges a document is also necessary because of the requirement for registration under the Companies Act 2006 Part 25.

⁴ Discussion Paper, paras 20.15–20.20.

⁵ See Chapter 29 below.

⁶ See Chapter 36 below.

⁷ Requirements of Writing (Scotland) Act 1995 ss 1A and 2.

⁸ See para 4.23 above.

⁹ This should also be the case as regards authentication for amendment and assignation documents, which are also discussed in this chapter.

¹⁰ SI 2003/3226.

¹¹ As is the case in other jurisdictions. See eg the Belgian Pledge Act of 11 July 2013 art 13 (which provides for art 8 of the new Book III title XVII of the Civil Code).

¹² See Gretton and Steven, *Property, Trusts and Succession* paras 4.13–4.15.

which assets are covered. Whether the test is met would have to be determined on a case by case basis. Earlier we recommended, as a protective measure, that for consumer providers the asset should require to be specifically identified.¹³ But for other providers it should be possible for items of encumbered property to be described in terms of their constituting an identifiable class such as “my computers” or “my vehicles” or “the computers to be listed on schedules to be sent” from the provider to the secured creditor.

23.9 The constitutive document should also require to state the secured obligation. Under the accessoriness principle,¹⁴ without such an obligation there can be no security right.

23.10 We recommend:

- 100. (a) A statutory pledge should require a constitutive document.**
- (b) The constitutive document should require to:**
- (i) be executed or authenticated by the provider,**
 - (ii) identify the property which is to be encumbered property (which may be either property of, or property to be acquired by, the provider), and**
 - (iii) identify the secured obligation.**
- (c) If the encumbered property is to consist of more than one item the constitutive document should not have to identify each item separately provided that the document identifies the items in terms of their constituting an identifiable class.**

(Draft Bill, s 46)

(3) Creation of real right by means of registration

23.11 In the Discussion Paper we considered whether registration should be required for the proposed new right in security over moveable property.¹⁵ We noted that in different countries in the world there are both approaches, although registration is the commoner. Arguments against registration include that it adds expense and that if sales of moveable property do not require registration, neither should security rights over moveable property. A further argument is that a registration requirement adversely affects creditors who do not know about it. This argument, however, is much stronger where a UCC–9/PPSA approach is followed and any transaction functioning as a security right must be registered. This is not the approach of our recommended scheme. Moreover, secured creditors will normally be banks and other financial institutions who are invariably well-informed about the law of credit and security rights.

23.12 There are, in contrast, strong arguments in favour of registration. It helps third parties, in particular future potential lenders, to know the position. The transparency brought

¹³ See paras 19.50–19.51 above.

¹⁴ See paras 19.27–19.30 above.

¹⁵ Discussion Paper, paras 16.13–16.17.

about by registration also reduces the scope for disputes. It thus facilitates non-possessory security, while at the same time protecting third parties.¹⁶ In addition it reduces the scope for fraud. A debtor's statement that certain assets are unencumbered can be checked by inspecting the register. In the event of insolvency, registration makes it easier to ascertain what rights the various creditors have. The general effect is to promote economic efficiency. Furthermore, because of the digital revolution, registration can be done quickly and cheaply.

23.13 In the Discussion Paper we asked consultees whether they agreed that, if a new non-possessory security right were introduced, it should be on the basis of some type of public registration.¹⁷ In the chapter entitled "Security over ordinary incorporeal moveable property (reform options)" we asked a similar question. This was whether consultees agreed that, if a new security right over claims is introduced, it should be created by registration.¹⁸ While this second question is in principle superseded following our recommendation in Chapter 22 to limit the statutory pledge as regards incorporeal moveable property to financial instruments and intellectual property, the views of consultees at a general level continue to be of interest. The Discussion Paper did not ask for their views as regards financial instruments, but in relation to IP, as discussed above in Chapter 22, the approach was in favour of registration. There was, as we saw in that chapter, a question about registered IP as to whether the new security right should be registered in the RSP as well as the specialist IP register.¹⁹

23.14 With the exception of Chris Dun, all consultees who answered the question in relation to corporeal moveables agreed that registration should be required. Mr Dun stated that he did not favour public registration. In contrast, Brodies and the Law Society of Scotland believed that there were "advantages in a registration-based non-possessory security arrangement". Magdalena Raczynska stated that "a mechanism enabling third parties [to know] that security has been taken is necessary". Scott Wortley said: "If a new moveable security is introduced it should require publicity in order to give notice to third party purchasers and creditors in accordance with the publicity principle. The most effective way to give publicity is through registration."

23.15 A number of consultees made further helpful comments. The Law Society of Scotland mentioned the need to comply with the rules on financial collateral arrangements. This is discussed in Chapter 37 below. It expressed concern about any disruption of existing practices as regards financing of cars and security rights over IP. But such concerns seem predicated on a UCC-9/PPSA functional approach which is not the approach that we are taking. The Law Society of Scotland and several law firm consultees all raised the issue of the extent to which third party purchasers should take the encumbered property free of the security right notwithstanding the registration. We address that matter in Chapter 24.

23.16 The consultee responses to the question about registration of the new security right in respect of claims followed a similar pattern, with overwhelming support. An exception was Jim McLean who did not favour a new security right and instead proposed a new scheme based on reform of the law of assignation.

¹⁶ See A Duggan, "A PPSA Primer" (2011) 35 Melbourne University Law Review 865 at 867.

¹⁷ Discussion Paper, para 16.17.

¹⁸ Discussion Paper, para 18.17.

¹⁹ See paras 22.44–22.54 above.

23.17 The predominant approach internationally now is for possession or registration to be required for rights in security over moveables to have third party effect. This is typified by the UCC–9/PPSA jurisdictions, as well by the DCFR and the UNCITRAL Model law. The new Belgian Pledge Act of 11 July 2013 takes a similar approach.²⁰ So too do the Law Commission for England and Wales in their recommendations in 2016 for new “goods mortgages”.²¹ We note also that one of the key objectives of the UNCITRAL Legislative Guide on Secured Transactions is “to enhance certainty and transparency by providing for registration of a notice of a security right in a general security registry.”²²

23.18 The jurisdictions which are perhaps most well-known for having laws of rights in security over moveable property which reject registration are Germany and the Netherlands. But these laws are increasingly coming under critical scrutiny. Alexander Morell and Frederic Helsen have argued that moving in the direction of the new Belgian register-based system would “be beneficial for the German system of non-possessory security interests. The higher the transparency in the system, the lower the cost of extending secured credit.”²³ Dewi Hamwijk has compared Dutch law with the UCC–9 approach.²⁴ While she concludes that in practice Dutch law works reasonably well because of the low incidence of fraud, she sees benefit in a future European Register for Proprietary Security based on the DCFR Book IX if this can meet certain economic efficiency standards.²⁵

23.19 We have concluded that registration should be required to create a statutory pledge.²⁶ In Chapter 29 below we discuss what exactly should be registered. We recommend:

101. Registration in the Register of Statutory Pledges should be a pre-requisite for the creation of a statutory pledge.

(Draft Bill, ss 48 to 49)

Creation and present assets

23.20 Where the statutory pledge is granted over property belonging to the provider, the secured creditor would obtain a real right on registration provided that the property is identifiable as encumbered property at time. This would be the moment that the statutory pledge is created over the property. For example, Eilish grants a statutory pledge in favour of Frederick over her Reubens painting. The statutory pledge is created on registration. It may be, however, that the encumbered property is not identifiable at the moment of

²⁰ Belgian Pledge Act of 11 July 2013 art 20 (which provides for art 15 of the new Book III title XVII of the Civil Code). See F Helsen, “Security in Movables Revisited: Belgium’s Rethinking of the Article 9 UCC System” (2015) 23 *European Review of Private Law* 959.

²¹ Law Commission, *Bills of Sale* (Law Com No 369, 2016) ch 6.

²² Available at https://www.uncitral.org/pdf/english/texts/security-ig/e/09-82670_Ebook-Guide_09-04-10English.pdf. See p 21.

²³ A Morell and F Helsen, “The Interrelation of Transparency and Availability of Collateral: German and Belgian Laws of Non-possessory Security Interests” (2014) 22 *European Review of Private Law* 393 at 437. In addition the authors refer at 436 to research that the introduction of a register-based system for security over movable property improves access to finance for businesses. See I Love, M S Martinez Peria and S Singh, “Collateral Registries for Moveable Assets: Does Their Introduction Spur Firms’ Access to Bank Finance”, World Bank Policy Research Working Paper (2013) available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2278093.

²⁴ Hamwijk, *Publicity in Secured Transactions Law*.

²⁵ Hamwijk, *Publicity in Secured Transactions Law* 372–374.

²⁶ Subject to an exception in respect of financial instruments because of the need to comply with the Financial Collateral Arrangements (No. 2) Regulations 2003 (SI 2003/3226) discussed in Chapter 37 below.

registration. If this is the case the statutory pledge would only be created on becoming so identifiable. For example, Vibrant Vehicles Ltd grants a statutory pledge in favour of Fochabers Funding Ltd over such of its vehicles as are set out in schedules to be delivered periodically to Fochabers Funding. The statutory pledge is duly registered but would only be created over a particular vehicle once it is identified in a schedule which is delivered. Thus the same statutory pledge would have different ranking points for different vehicles depending on when it was created over them. We discuss the issue of multiple ranking points further in the next section.

23.21 We recommend:

102. (a) A statutory pledge over property which, at the time the statutory pledge is registered, is the provider’s and is identifiable as property to which the constitutive document relates, is created over that property on registration.

(b) If the property is not yet so identifiable, the statutory pledge is created over that property on it becoming so identifiable.

(Draft Bill, s 48(1) & (2))

Creation and after-acquired assets: general

23.22 A statutory pledge could be granted over future assets.²⁷ Imagine that in May 2020 George grants a statutory pledge over “any motor vehicles present and future”. The statutory pledge is registered in the RSP. In May 2021 George acquires a vintage Rolls Royce. At what point should the statutory pledge be created in respect of this vehicle?

23.23 Under the property law principle of *nemo plus*,²⁸ someone cannot give an effective right over property which is not theirs. On this approach the statutory pledge cannot be created in relation to the vehicle until George acquires it in May 2021. Thus the one statutory pledge may have several ranking points depending on when property is acquired.

23.24 The UCC–9/PPSA rules, however, are different and there is typically one ranking point: the moment of registration of the financing statement.²⁹ No distinction is therefore made between present and after-acquired property for this purpose. But, to achieve this, the registration requires to have retroactive effect (effect *ex tunc* as opposed to *ex nunc*). Other rules then have to be imposed to protect secured creditors who had security rights over the asset prior to it being acquired by the provider, but which post-date the registration.³⁰

²⁷ See para 23.7 above.

²⁸ In full, this is *nemo plus juris ad alium transferre quam ipse haberet* (nobody can transfer a better right than they have in the first place). It is also known by the shorter *nemo dat quod non habet*.

²⁹ Eg NZ PPSA 1999 s 66. For commentary, see Gedye, Cuming and Wood, *Personal Property Securities in New Zealand* 257–262.

³⁰ For example, X Ltd grants a security right over its vehicles present and future in favour of Bank B. This is registered in 2020. In 2025 it acquires a van from W Ltd. In 2022 W Ltd had granted a security right in favour of Bank A which was registered that same year. That security right is not extinguished (for example by a good faith acquisition rule) when the van is transferred to X Ltd. Bank A’s security right was registered in 2022, but Bank B’s security was registered before that in 2020. Nevertheless, Bank B clearly should have priority. Under the PPSAs a special rule is needed to achieve this. See eg the NZ PPSA 1999 s 88.

Registration may also precede the creation of the security right, but the priority point is registration.³¹ The same is true under the DCFR Book IX.³²

23.25 We are not persuaded to adopt the UCC–9/PPSA rules. While a traditional property law approach leads to different ranking points for the same statutory pledge, questions of priority would often be straightforward to resolve. Imagine that James, a sole trader, grants a statutory pledge over his van and any future vans to Bank A. This is registered in the RSP in 2020. He grants a second statutory pledge over the same assets to Bank B, which is registered in the RSP in 2021. Each year between 2021 and 2025 he acquires a new van. In 2026 he becomes insolvent. Bank A should have priority over Bank B in respect of all the vans, although the statutory pledges were only created in respect of the vans as they were acquired. In Chapter 26 we recommend a ranking rule to this effect, although it may well already be a general rule of rights in security law in Scotland.³³

23.26 Thus we conclude that the statutory pledge should be created in respect of after-acquired property on that property being acquired, provided that the property is identifiable from the constitutive document or an amendment document³⁴ which has been registered. If the property is not so identifiable at that time then creation of the statutory pledge would not occur until it does become so identifiable. We gave the example above of Vibrant Vehicles Ltd granting a statutory pledge in favour of Fochabers Funding Ltd over such of its vehicles as are set out in schedules to be delivered periodically to Fochabers Funding. Imagine that a schedule is delivered which identifies a BMW that Vibrant Vehicles is about to acquire. On the acquisition subsequently taking place the statutory pledge is created over the BMW. But imagine that an Audi is acquired at the same time. It is only listed in a subsequent schedule. It is only on that subsequent schedule being delivered that the statutory pledge is created over the Audi.

23.27 We recommend:

- 103. A statutory pledge should be created over after-acquired property when that property becomes the provider’s property, provided that the property is identifiable at that time as property which is to be encumbered property. If it is not so identifiable at that time then the pledge should not be created until such time as it does become so identifiable.**

(Draft Bill, s 48(1) & (2))

Creation and after-acquired assets: insolvency of the provider

23.28 We consider that there should be a qualification to the general rule that a statutory pledge can extend to after-acquired assets. This is where the provider becomes insolvent after the statutory pledge is granted and the assets are acquired after that. Similar policy issues arise here as those discussed in Chapter 5 above in relation to assignation of future

³¹ Eg NZ PPSA 1999 s 146. For commentary, see Gedye, Cuming and Wood, *Personal Property Securities in New Zealand* 465–466.

³² DCFR IX.–3:305(2) and 4:101(2)(a).

³³ Discussion Paper, para 16.53.

³⁴ We deal with amendment documents at paras 23.33–23.40 below.

claims.³⁵ Providers who have become insolvent should be entitled to a fresh start and not have new assets acquired by them taken away to satisfy pre-insolvency secured creditors. For assignation of subsequently arising claims we recommend a rule whereby an assignation is ineffective for claims arising after the commencement of an insolvency, except for claims in respect of income from assets. This enables assignations of income streams such as assignations of rents to remain valid.

23.29 For the statutory pledge we recommend a simpler rule that property acquired after the commencement of insolvency is not covered. In practice, we doubt that providers would acquire new corporeal moveables or financial instruments or intellectual property after they become insolvent because they would not have funds to do so. And of course while the insolvency is ongoing such assets would fall into the estate managed by the insolvency official. In a commercial context goods are typically sold subject to retention of title clauses and the provider will never become the owner if they cannot pay for them.

23.30 The same issues apply here as for assignation of future claims with regard to defining “insolvency”.³⁶ Once again we have not had the advantage of formal consultation on the matter. We have therefore included in our draft Bill the same processes. We consider here too that the Scottish Ministers should have the power to amend the provisions by secondary legislation and we would expect the Scottish Government to consult on this matter as part of any future consultation on this Report.

23.31 In its response to our draft Bill consultation of July 2017 ICAS argued that we should recommend also a general rule that a statutory pledge is ineffective where it is created after the provider has become insolvent. It pointed to section 245 of the Insolvency Act 1986 but this provision is aimed principally at floating charges created within a certain period prior to the commencement of an insolvency.³⁷ Our view, however, is that this is a broader matter for insolvency law as to how the grant of a real right over moveable property owned by the grantor is affected where the real right is not acquired by the grantee before the insolvency commences. Thus the same question arises as regards the transfer of ownership of the property, or the grant of a liferent or a possessory pledge over it. We therefore do not favour a provision specific to statutory pledge. In contrast, we think that it should be put beyond doubt that although a statutory pledge is registered prior to the commencement of an insolvency it cannot extend to future assets acquired by the provider after that time.

23.32 We recommend:

104. (a) A statutory pledge granted prior to the provider becoming insolvent should not be able to encumber property acquired after that time.

(b) A provider who is an individual, or the estate of which may be sequestrated, becomes insolvent when:

³⁵ See paras 5.105–5.109 above.

³⁶ See para 5.108 above.

³⁷ It also mentioned the Insolvency Act 1986 s 127, which is limited to windings up by a court and which provides that “any disposition of the company’s property . . . made after the commencement of the winding up is, unless the court otherwise orders, void.” It suggested that the provision is unlikely to apply because a statutory pledge is unlikely to be a “disposition”. But in our Discussion Paper on *Sharp v Thomson* (SLC DP No 114, 2001) para 4.17 under reference to *Site Preparations Ltd v Buchan Development Co Ltd* 1983 SLT 317 we took the view that “disposition” should be interpreted broadly and would include the grant of security rights.

- (i) the provider’s estate is sequestrated,
 - (ii) the provider grants a trust deed for creditors or makes a composition or arrangement with creditors,
 - (iii) a voluntary arrangement proposed by the provider is approved, or
 - (iv) the provider’s application for a debt payment programme is approved under section 2 of the Debt Arrangement and Attachment (Scotland) Act 2002.
- (c) A provider which is not an individual becomes insolvent when:
- (i) a decision approving a voluntary arrangement entered into by the provider has effect under section 4A of the Insolvency Act 1986,
 - (ii) the provider is wound up under Part 4 or 5 of the 1986 Act or under section 367 of the Financial Services and Markets Act 2000,
 - (iii) an administrative receiver is appointed over all or part of the property of the provider including the encumbered property, or
 - (iv) the assignor enters administration, (“enters administration” being construed in accordance with paragraph 1(1) and (2) of schedule B1 of the 1986 Act).
- (d) The Scottish Ministers should have power to amend the definition of “insolvent”.

(Draft Bill, s 51)

Amendment of statutory pledge

23.33 It may be that the provider and the secured creditor wish to vary the terms of the statutory pledge. Take the following example. Andrew grants a statutory pledge over a valuable painting in favour of Bronwyn in return for a loan. A few months later Bronwyn agrees to make a further advance in return for the scope of the statutory pledge being extended to include a second painting. Here is a second example. Inverdeveron Innovations Ltd grants a statutory pledge over its patents in favour of the Boyndie Bank. The constitutive document sets out that the bank may not enforce its security by means of granting licences of the patents. The parties subsequently agree to depart from this restriction. In both examples the statutory pledge requires to be amended.

23.34 We consider that in principle the amendment of a statutory pledge should require the same form of writing as the constitutive document itself. That is to say there should be an amendment document executed (signed with pen and ink) or authenticated (signed electronically) by the secured creditor and the provider.

23.35 In general we do not think that such a document should require to be registered, except where it adds property to the encumbered property or it varies the secured obligation to increase its scope, where the current scope is apparent from the entry.³⁸ A third party looking at the RSP should be entitled to see that the scope of the statutory pledge has been extended. Without registration being required in such circumstances the third party would be misled. In contrast where the secured obligation is defined by reference to other documents which are not registered there seems no benefit to be gained by requiring the register to be updated if the obligation is varied.

23.36 Where property is being added the situation is similar to a grant of the statutory pledge in respect of that property. The amendment document should require to describe the property to be added. That property might be present or future property of the provider.

23.37 As for the constitutive document of a statutory pledge we consider it essential only that the amendment document is executed or authenticated by the provider, rather than both parties. The secured creditor's assent to the extension of the statutory pledge would be given by it taking delivery of the document and registering it in the RSP.

23.38 Where property is being added the creation (and thus priority) point in respect of that property would be the time of registration of the amendment document provided that the property is then identifiable as being encumbered property. If it is not identifiable at that point then the statutory pledge would be created in respect of it when it becomes identifiable.³⁹ As regards after-acquired property the priority point would be the time of acquisition provided it is identifiable as encumbered property at that time. If it is not so identifiable at that time, then it would only be created on becoming so identifiable. We give an example of how this would work above.⁴⁰

23.39 There should be separate rules on amendment where the FCARs apply and these are discussed in Chapter 37 below.

23.40 We recommend:

105. (a) The secured creditor and the provider should be entitled to amend a statutory pledge by means of an executed or authenticated amendment document.

(b) An amendment document which relates to the addition of property to the encumbered property must identify the property to be added. That property may either be property of, or property to be acquired by the provider.

(c) An amendment document by virtue of which only an amendment adding property to the encumbered property is made need not be executed or authenticated by the secured creditor.

(d) Where an amendment document relates to (either or both):

³⁸ See also paras 29.15–29.21 below.

³⁹ See paras 23.20–23.21 above.

⁴⁰ See para 23.26 above.

- (i) the addition of property to the encumbered property,**
- (ii) variation of the secured obligation, where the extent of that obligation is to be increased and its current extent is determinable from the entry alone**

the statutory pledge should be amended only on registration of that document.

(e) On the amendment being registered in respect of additional property, the statutory pledge is created over that property provided that it:

- (i) is identifiable as property which is to be encumbered property, and**
- (ii) is the property of the provider.**

(Draft Bill, ss 49 and 60)

Transfer (assignment)

23.41 It should be possible for a statutory pledge to be transferred by the secured creditor to a third party. Such a transfer would be by assignment. Provisions on transfer of security rights over moveable property are typical in legislation or instruments elsewhere.⁴¹ They can also be found in Scotland for other types of security right.⁴² For example, a bank may wish to transfer its loans and security rights to one of its group companies.

23.42 We consider that an assignment should require a document executed or authenticated by or on behalf of the secured creditor. This is because a transfer is a significant act which changes the identity of the secured creditor.

23.43 Sometimes the parties to a statutory pledge may wish to restrict the possibility of assignment. We think that they should be able to do so by agreement.⁴³ In the interests of commercial flexibility, it is not necessary for writing to be insisted upon but we would expect in practice such an agreement to be evidenced by writing (including electronic documents).

23.44 For standard securities (which of course are over land) an assignment is ineffective without registration in the Land Register.⁴⁴ But assignment of a security right over moveables in other jurisdictions typically does not require registration. This is the position under UCC–9, the PPSAs and the DCFR Book IX where assignment takes place off-register. Where, however, there has been an assignment, the person identified as the secured creditor on the register is under a duty to tell enquirers who the assignee is.⁴⁵ To avoid receiving requests more generally for information in relation to the security right (discussed in Chapter 35 below), a secured creditor who has assigned may choose to update the

⁴¹ See eg DCFR IX.–3:328.

⁴² For standard securities, see the Conveyancing and Feudal Reform (Scotland) Act 1970 s 14.

⁴³ There is a parallel here with anti-assignment clauses in relation to claims. See paras 13.2–13.11 above.

⁴⁴ Conveyancing and Feudal Reform (Scotland) Act 1970 s 14(1).

⁴⁵ See eg DCFR IX.–3:320(3): “Where the security right has been transferred, the person registered as the secured creditor must disclose the name and contact details of the transferee”.

register by means of a correction.⁴⁶ Under the company charges registration rules,⁴⁷ assignments of security rights (“charges”) are not registrable.⁴⁸

23.45 We have concluded in the light of such comparative authority that it should not be necessary for an assignment of a statutory pledge to be registered for it to be effective. For third parties what is most important is to discover whether the person searched against has granted a statutory pledge. The third party can ascertain whether there has been an assignment by contacting the party named as the secured creditor. Elsewhere we set out duties of the person registered as secured creditor in relation to information requests.⁴⁹ Of course there are other arguments in favour of requiring registration, such as certainty and preventing fraudulent ante-dating in the event of the assignor becoming insolvent. Banks and financial institutions rarely, however, are the subject of insolvency. We are not persuaded that there is a strong enough case to insist on registration.

23.46 There is statutory provision in relation to standard securities that where enforcement has begun prior to the assignment that the assignee can “step into the shoes” of the assignor and continue with the procedure rather than having to restart it.⁵⁰ We think that this should be the case for the statutory pledge too, subject to the express provision of the parties.

23.47 Once again there should be separate rules on amendment where the FCARs apply and these are discussed in Chapter 37 below.

23.48 We recommend:

106. (a) Except in so far as the provider and the secured creditor otherwise agree, a statutory pledge should be transferable by means of an assignment document executed or authenticated by the secured creditor.

(b) Subject to the provisions of the assignment document, the assignment should convey to the assignee entitlement to the benefit of any noticed served, or enforcement procedure commenced, by the assignor in respect of the statutory pledge before assignment.

(Draft Bill, s 59(1) to (2))

Restriction or discharge of statutory pledge

23.49 Where a statutory pledge covers several items of property the provider and secured creditor should be able to agree that certain items should be released from it. Often this would be where part of the secured debt is being repaid. And if the whole debt is repaid

⁴⁶ See Chapter 33 below.

⁴⁷ See Chapter 36 below.

⁴⁸ See G L Gretton, “Registration of Company Charges” (2002) 6 EdinLR 146 at 172. The changes made to the rules with effect from 1 April 2013 have not altered the position.

⁴⁹ See Chapter 35 below.

⁵⁰ Conveyancing and Feudal Reform (Scotland) Act 1970 s 14(2)(c). Section 14(2)(a) and (b) give the assignee the full benefit of all corroborative or substitutional obligations for the debt or any part thereof and the right to recover payment from the debtor of all expenses properly incurred by the creditor in connection with the security. We are of the view that these would automatically transfer under a general principle of the law of assignment: *accessorium sequitur principale* (accessory rights follow the principal). But as regards enforcement we think that the position should be stated expressly.

what would be desired is that the statutory pledge is extinguished. We have already set out one way in which a statutory pledge can be extinguished in part or in whole and that is by the secured creditor consenting in writing to the transfer of the property.⁵¹ Clearly, it should also be possible for the statutory pledge to be extinguished in part or whole even where property is not being transferred. As per the legislation on standard securities, we refer to extinction in part as “restriction” and in whole as “discharge”.⁵²

23.50 We consider that both restrictions and discharges should require writing. This could be by means of a hard copy document signed in ink.⁵³ But an electronic communication should also be permissible. In the interests of commerce there should not be a requirement for an electronic signature of the standard set down for authentication of electronic documents by the Requirements of Writing (Scotland) Act 1995 and which we recommend for the constitutive document of a statutory pledge.⁵⁴ That standard protects the provider whereas release of the property from the statutory pledge is in the provider’s interest.

23.51 In line with the position in other jurisdictions we do not think that restrictions and discharges should require registration. The need to register before extinction would be a clog on commerce. Thus when we recommended earlier that the secured creditor could consent to a transfer and allow the transferee to take the property unencumbered we did not impose a registration requirement.⁵⁵ There are also several examples of circumstances where a registered security right can be extinguished off-register. The most important is where the security is for a fixed sum.⁵⁶ Another is where the encumbered property is destroyed, because clearly there can be no security right without property. Earlier we recommended that registration should be required for certain amendments which increased the extent of the secured obligation and encumbered property. Here the register needs to be updated to warn third parties taking rights over the provider’s property. But where there is a restriction or discharge such a third party is not prejudiced because the scope of the statutory pledge is being decreased.

23.52 It must be necessary for there to be ways of correcting the RSP to give effect to the restriction or discharge of the statutory pledge which has taken place off-register, particularly so as the provider is not prejudiced by a stale entry. We deal with this later.⁵⁷

23.53 Once more there should be separate rules on extinction where the FCARs apply and these are discussed in Chapter 37 below.

23.54 We recommend:

107. It should be possible to restrict a statutory pledge to part of the encumbered property or to discharge it by means of a written statement made by the secured creditor.

(Draft Bill, s 61(1))

⁵¹ See paras 20.37–20.45 above.

⁵² Conveyancing and Feudal Reform (Scotland) Act 1970 ss 15 and 17.

⁵³ In the language of the Requirements of Writing (Scotland) Act 1995 s 1A, a “traditional document”.

⁵⁴ And for amendments and assignments of statutory pledges. See paras 23.5, 23.34 and 23.42 above.

⁵⁵ See paras 20.37–20.45 above.

⁵⁶ *Cameron v Williamson* (1895) 22 R 393. For discussion, see A J M Steven, “Accessoriness and Security over Land” (2009) 13 Edin LR 387 at 410–413.

⁵⁷ See Chapter 33 below.

Summary of juridical acts and their interaction with the Register of Statutory Pledges

23.55 In this chapter we have set out how different juridical acts in relation to a statutory pledge are to be effected. We think that it would be helpful to summarise here how these interact with the RSP. Where a statutory pledge is created in the first place or its scope as to secured obligation or encumbered property is increased beyond what is set out in the constitutive document, there would require to be *registration*. This is because these acts have the potential to prejudice third parties and therefore require to be publicised. In contrast, there would be no requirement to register a juridical act which does not affect the scope of the statutory pledge (assignment) or which reduces its scope (restriction) or extinguishes it (discharge). These juridical acts would take place off-register. There must, however, be the facility to update the register so that it reflects reality. That is *correction*, which is described in Chapter 33. For example, if a business has granted a statutory pledge over its vehicles to a bank in security of a loan and the bank subsequently discharges the pledge because the loan is repaid, the business should be entitled to have the register cleared. This can be done by correction.

23.56 The following table sets out the respective routes for juridical acts in relation to a statutory pledge to enter the RSP.

	Registration	Correction
Creation	✓	x
Amendment (adding property or increasing secured obligation)	✓	x
Assignment	x	✓
Restriction	x	✓
Discharge	x	✓

Chapter 24 Statutory pledge: protection of third party acquirers of encumbered property

Introduction

24.1 Where a statutory pledge was created over the provider's property, the provider would remain owner of that property. This is because a statutory pledge would be a "true" security right.¹ The existence of such a security right does not prevent the provider from transferring the property to someone else, but the acquirer takes the property encumbered by the security right.

24.2 In the Discussion Paper, we considered the possessory pledge and gave the following example.² If Adam owns a bicycle and grants to Ella a possessory pledge, and he then sells it to Siegfried, Siegfried becomes owner, but subject to Ella's rights. In such a case there is no need to protect Siegfried, because Ella's possession provides the pledge with publicity. The law therefore does not give Siegfried protection.³ For non-possessory security rights, however, the facts are different. If Adam still holds the bicycle there is nothing to put Siegfried immediately on notice of the existence of the security right. Thus there is a strong argument that, at least in certain cases, Siegfried should be protected and take the bicycle free of the security right.

24.3 The argument has two main strands: (1) fairness to the acquirer; and (2) economic efficiency. In relation to (1), the argument is not conclusive as a purchaser of moveable property is generally at risk that the seller does not have title. The goods may be stolen. *Caveat emptor*. In contrast, for land the Land Register can be checked and the seller's right to sell verified with a very high level of certainty.⁴ But while there is no general register as to ownership of moveable property,⁵ statutory pledges would be registered in the Register of Statutory Pledges. An acquirer could eliminate the risk by carrying out a simple on-line search.

24.4 In relation to (2), commerce requires in certain situations that transfer of moveable property should not be hindered by having to take the time (no matter how short) and expense (no matter how small) to check a register. At a more general level the issue is an example of a classic property law dilemma of choosing between two innocent parties who have suffered from the actions of another party. Here the secured creditor and the good faith acquirer are the innocent parties and the provider is the party who has acted improperly by dealing with the encumbered property without the creditor's permission. In its 2016

¹ See para 19.1 above.

² Discussion Paper, para 16.30.

³ Other systems take the same approach. See eg UCC § 9-320(e).

⁴ Of course, there may still be risks such as the seller impersonating the true owner and forging that party's signature on the disposition (deed of transfer). In that case, however, a good faith acquirer is entitled to indemnity from the Keeper where the Register is rectified. See LR(S)A 2012 ss 74 and 77.

⁵ There are certain specialist registers, for example for intellectual property.

Report on Bills of Sale, the Law Commission for England and Wales recommend criminal liability in fraud for providers who sell assets subject to a proposed new “goods mortgage” who do not declare that the goods are mortgaged.⁶ We do not make a similar recommendation as we consider that the matter is a more general one for the law of rights in security as a whole rather than for the law of statutory pledges alone.

24.5 Good faith acquisition rules in relation to statutory pledge can be broadly categorised under two headings. The first is where the acquirer should not be expected to check the RSP because of the circumstances in which the property is being acquired. This is the subject matter of this chapter. The second is where, even if the acquirer does carry out a check of the RSP against the seller, the search would not reveal the existence of the statutory pledge.⁷ We consider this matter in Chapters 31 and 32 below.

When acquirers should not be expected to check the RSP: general

24.6 Legislation on security over moveable property in other legal systems generally protects buyers in certain cases on the basis that they should not be expected to check a register.⁸ Parties other than buyers are typically not so protected. Thus, in particular, prospective secured creditors are expected to consult the register to see whether the prospective provider has already encumbered the property. Donees tend not to be protected on the basis that they have not given value and therefore do not suffer a financial loss from the asset turning out to be subject to a security right.

When acquirers should not be expected to check the RSP: a broad good faith protection?

24.7 In the Discussion Paper we tested the views of consultees by asking a number of questions in relation to when good faith purchasers should be protected.⁹ The widest approach we suggested was based on that of the Murray Report.¹⁰ It recommended that a buyer would take free if the buyer “is not aware that the property is subject to a moveable security or is aware that the property is subject to such a security but is not aware that such [contract of sale] is made without the prior written consent of the holder of the security having been obtained.”¹¹ This had to be read with the proviso that “for the purposes of this section a third party shall not be held to be aware that property is subject to a moveable security by reason only that” it had been registered.¹² We noted that the overall effect of this would have been that a moveable security would have seldom affected good faith buyers.

24.8 This approach is wider than that taken under UCC–9 and the PPSAs where good faith buyers who acquire outwith the course of the seller’s business are generally not protected. Nevertheless, the Law Commission for England and Wales in its Report on Bills of Sale recommends for the proposed new “goods mortgage” that private purchasers who act in good faith and without actual notice of the mortgage should take the goods

⁶ Law Commission, Bills of Sale (Law Com No 369, 2016) paras 8.46–8.54.

⁷ We acknowledge the contribution of Dr John MacLeod in relation to this categorisation.

⁸ See later in this Chapter.

⁹ Discussion Paper, para 16.47.

¹⁰ See paras 18.18–18.22 above.

¹¹ Draft Floating Charges and Moveable Securities (Scotland) Bill, cl 11(4)(c).

¹² Draft Floating Charges and Moveable Securities (Scotland) Bill, cl 11(5).

unencumbered by it.¹³ This is narrower than the Murray Report because only private purchasers are protected.

24.9 Consultees generally did not support the wide approach of the Murray Report. Aberdeen Law School stated: “If all good faith buyers were protected, the eroding effect on any security right would be marked and this would affect the attractiveness of the system.” The Faculty of Advocates had similar concerns. Magdalena Raczynska commented that such an approach “would diminish the role of the register”. The Keeper said: “If it is considered that a security should be created by registration, then in the Keeper’s view there should be a general assumption that “good faith” requires searches of the register whenever it would be reasonable to expect an acquirer to search.”

24.10 In view of consultees’ comments and the general position in other jurisdictions we conclude that the approach taken in the Murray Report is too wide.

Sale in the ordinary course of a business

Introduction and comparator legislation

24.11 A standard feature of legislation in other jurisdictions and of international instruments is that purchasers are protected where the sale is in the ordinary course of the seller’s business. In the words of Drobnig and Böger:

“Transactions conducted in the ordinary course of the transferor’s business should be protected; it would constitute a major obstacle for commerce in general if parties could no longer have confidence in the possession of the goods by the transferor and if it were necessary to investigate whether any registered security rights . . . existed in these assets.”¹⁴

24.12 For example, UCC–9 provides:

“Except as otherwise provided in subsection (e), a buyer in ordinary course of business, other than a person buying farm products from a person engaged in farming operations, takes free of a security interest created by the buyer’s seller, even if the security interest is perfected and the buyer knows of its existence.”¹⁵

24.13 We note the following. First, subsection (e) is about security rights perfected by possession. Secondly, “buyer in ordinary course of business” is perhaps misleading, for what is meant is a person who buys in the ordinary course of the seller’s business. Thirdly, “farm products” is a limited category including crops and livestock.¹⁶ Fourthly, the protection is only against security interests created by the buyer’s seller and not that party’s predecessors. Fifthly, even although purchasers know about the security interest they are protected.

24.14 The relevant provision in the New Zealand PPSA is:

“A buyer of goods sold in the ordinary course of business of the seller, and a lessee of goods leased in the ordinary course of business of the lessor, takes the goods free

¹³ Law Commission, Bills of Sale (Law Com No 369, 2016) paras 8.23–8.33.

¹⁴ Drobnig and Böger, *Proprietary Security in Movable Assets* 689.

¹⁵ UCC § 9–320(a).

¹⁶ UCC § 9–102(34).

of a security interest that is given by the seller or lessor . . . unless the buyer or lessee knows that the sale or the lease constitutes a breach of the security agreement under which the security interest was created.”¹⁷

24.15 This provision protects lessees as well as purchasers, but under Scottish law a lease of moveable property is merely a contractual and not a property right. Like the UCC–9 provision, protection is limited to security rights created by the seller, but in contrast there is no protection where the purchaser knows that the sale is in breach of the security agreement. The Australian PPSA has a rule broadly equivalent to that of New Zealand.¹⁸ The approach in the EBRD Model Law is more complex but to similar effect.¹⁹ Likewise, the DCFR gives protection where “the transferor acts in the ordinary course of its business”.²⁰ In such circumstances the mere fact that the security right is registered does not prevent the acquirer being regarded as a good faith acquirer and thus being protected by the good faith acquisition rules in the DCFR Book VIII. The protection is not limited to security rights created by the transferor. The Belgium Pledge Act of 11 July 2013 protects transferees if the transfer takes place in the ordinary course of the seller’s business or where they acquire in good faith.²¹ But transferees which are businesses are expected to check the register if the acquisition is not in the ordinary course of the seller’s business and are not to be regarded as being in good faith if they fail to do so.²²

Consultation

24.16 We asked consultees whether they agreed that buyers in the ordinary course of the seller’s business should take free from the new registered non-possessory security right (the statutory pledge). Consultees generally agreed. For example, Professor Eric Dirix said: “The protection of buyers in the ordinary course of the seller’s business is universally accepted.” John MacLeod stated that “this should certainly be the case in respect of corporeal moveables. It is less clear that businesses which buy and sell incorporeals should be relieved of the obligation of checking the register. The case for ongoing commerce in incorporeals is much less clear than the case for ongoing commerce in corporeal moveables.” We agree. We think that the rule should not apply to intellectual property and we propose a separate rule below for financial instruments.

24.17 Several consultees, however, qualified their agreement by reference to the issue as to whether the new security right was to be fixed or floating. Scott Wortley said: “General rules on the protection of the buyer are sensible, but if they go too far do they risk rendering the new security a floating rather than a fixed security?” Two law firm consultees²³ stated: “We see this as a critical consequence of the classification of the security as fixed or floating. If the intention (as we believe it should be) is to create a fixed security, the value of such a security would be limited by this provision. Our preference would be that an effective properly registered fixed security should prevail over buyers in the ordinary course [of

¹⁷ NZ PPSA 1999 s 53(1). See Gedye, Cuming and Wood, *Personal Property Securities in New Zealand* 220–231.

¹⁸ Australian PPSA 2009 s 46. See C Wappett, *Essential Personal Property Securities Law in Australia* (2nd edn, 2013) 175–180.

¹⁹ EBRD Model Law arts 19–21.

²⁰ DCFR IX.–6:102. See Drobnig and Böger, *Proprietary Security in Movable Assets* 689–691.

²¹ See E Dirix, “The New Belgian Act on Security Interests in Movable Property” (2014) 23 *International Insolvency Review* 171 at 176.

²² Belgian Pledge Act of 11 July 2013 art 30 (which provides for art 25 of the new Book III title XVII of the Civil Code).

²³ Dundas & Wilson and McGrigors.

business] unless the security holder has agreed otherwise.” SCDI said: “For small and medium sized businesses, any requirement to have to search a register before carrying out a day to day commercial transaction would impose an additional burden on them which is unlikely to be helpful.”

The statutory pledge as a fixed security

24.18 The Discussion Paper contemplated the new security right being either fixed or floating, but for the reasons set out in Chapter 20 above the statutory pledge is to be fixed only. The general rule outlined in that chapter is that the provider requires to obtain the consent of the secured creditor to specific transfers or the transferee will take the property still encumbered by the statutory pledge. The practical effect is that the statutory pledge is not suitable for stock-in-trade (inventory) except for the case of higher-value items where it is practical to obtain creditor consent to individual disposals. We gave the example of sales of high-value agricultural machinery.²⁴

24.19 Thus because the statutory pledge is a fixed security and therefore not generally meant for stock-in-trade it might be concluded that there is no need for an “ordinary course of business” rule. It is instructive in this regard to look at the position in England and Wales. The current law is not entirely clear. A buyer for value and without notice will take free of an equitable security, such as a fixed charge.²⁵ The fact, however, that the charge is registered in the Companies Register could be argued to provide the buyer with constructive notice of it. Some take the view, however, that registration is only constructive notice to those who would be reasonably expected to check the register and this would not include buyers in the ordinary course of a business.²⁶

24.20 The Report of the Law Commission for England and Wales on Company Security Interests²⁷ recommended “that a transferee (other than a secured party) of collateral that is subject to a registered charge which is a fixed charge should take subject to a charge unless the chargee has authorised the sale or other disposition.”²⁸ This was on the basis that stock-in-trade would never be subject to a fixed charge. In its draft Secured Transactions Code of 2016, the Financial Law Committee of the City of London Law Society, following accounting terminology, draws a distinction between “current assets” (for floating charges) and “fixed assets” (for fixed charges).²⁹ Its proposed rule for fixed charges is that if these have been registered an acquirer does not take free of the charge.³⁰

24.21 The difficulty, however, is that in some cases in particular for high-value assets it may actually be practical to trade in a way that consent from the secured creditor can be sought for individual disposals. Should a purchaser of a high-value piece of equipment from an equipment supplier realistically be expected to check the RSP? Moreover, there may also be cases where the provider does sell assets without obtaining the creditor’s consent. Take the following example. A garage business grants the statutory pledge over its equipment for repairing vehicles. The business subsequently diversifies and becomes a supplier of such

²⁴ See para 20.49 above.

²⁵ Beale, Bridge, Gullifer and Lomnicka, *The Law of Security and Title-Based Financing* para 13.25.

²⁶ Beale, Bridge, Gullifer and Lomnicka, *The Law of Security and Title-Based Financing* para 12.05.

²⁷ Law Com No 296 (2005). See paras 4.25–4.31 above.

²⁸ Law Com No 296 para 3.218.

²⁹ City of London Law Society draft Secured Transactions Code, section 41.

³⁰ City of London Law Society draft Secured Transactions Code, section 43.1(b).

equipment. It does not obtain the secured creditor's consent to dispose of equipment subject to the statutory pledge. In these circumstances we consider that a good faith acquirer should be protected. We note too that the broad protection proposed by the Murray Report discussed above³¹ was in the context of a fixed security.

24.22 It should be stressed that this rule could not be used to enable the statutory pledge to act as a floating charge by the secured creditor acquiescing in sales by the provider without obtaining the appropriate consent first. This is because of the recommendation which we made earlier that the effect of such acquiescence would be to extinguish the statutory pledge.³²

Conclusion

24.23 We consider that there should be a general rule that a purchaser who takes corporeal property in the course of the seller's business should be protected despite the transfer being in breach of the requirement to obtain specific consent of the secured creditor, provided that the purchaser is in good faith. We think that the purchaser should take free of any statutory pledge granted by the seller, or the seller's predecessors, in line with the position under the DCFR and Belgian law.³³ Purchasers should not be in bad faith because they have not consulted the RSP.

24.24 We recommend:

108. (a) A person who purchases corporeal property which is encumbered property and which is, or has been transferred without the required consent of the secured creditor, should acquire it unencumbered by the statutory pledge if:

(i) the person from whom the property is acquired is acting in the ordinary course of that person's business, and

(ii) at the time of acquisition, the person is in good faith.

(b) A person should not be taken to be other than in good faith by reason only of the pledge having been registered.

(Draft Bill, s 54)

Lower-value goods

24.25 In the Discussion Paper we noted that some jurisdictions and international instruments have provisions protecting good faith acquirers of lower-value goods, even where these are not acquired in the course of the seller's business.³⁴ The EBRD Model Law has a general rule to this effect,³⁵ but the rules in the Australian and New Zealand PPSAs

³¹ See paras 24.7–24.10 above.

³² See paras 20.52–20.53 above. This was a concern of R3 in its response to our draft Bill consultation of July 2017.

³³ For the counter-argument that protection should only be in respect of a statutory pledge granted by the seller see M Gedye, "The New Zealand Perspective" in Gullifer and Akseli (eds), *Secured Transactions Law Reform* 115 at 122.

³⁴ Discussion Paper, paras 16.37 and 16.45.

³⁵ EBRD Model Law art 21.2.5.

are restricted to consumer purchases. Thus in Australia the goods must be bought “predominantly for personal, domestic or household purposes”.³⁶ The threshold figure is currently A\$5,000 (about £2,911). In New Zealand the provision applies to goods acquired as “consumer goods”³⁷ and this term is defined as “goods that are used or acquired for use primarily for personal, domestic, or household purposes”.³⁸ The threshold figure is currently NZ\$2000 (about £1,048) which is lower than the Australian figure. The New Zealand figure is based on the value of the goods at the time that the security right attached (in effect was created), whereas the Australian figure is based on the value given by the acquirer. Both provisions require “new value” to be given. The reason for that is because under these systems security rights extend to proceeds.³⁹ The New Zealand approach can be criticised for being based on a historic rather than current value of the goods.⁴⁰ Both provisions enable the acquirer to take free of all security interests, whether created by the seller or another party.

24.26 We asked consultees whether there should be a rule that a good faith buyer should always take free from the new security right where the price paid by the buyer is below a certain limit (to be adjusted from time to time by statutory instrument). We asked also what the limit should be. Consultees were divided on this matter, with a majority inclining against such a rule. Two law firm consultees⁴¹ stated: “We do not believe such a rule is appropriate: many transactions deal with a very large number of small value assets eg debts and a *de minimis* rule would require very careful consideration.” The Law Society of Scotland, in a response in similar terms to that of the law firm, Brodies, said: “As the advantage associated with this form of security will be in dealing with large portfolios of relatively small value assets [we are] not sure that such a *de minimis* rule would be helpful. Individual sales below the prescribed limit could quickly erode the value of such security.” On the other hand, the WS Society favoured a wider approach following the Murray Report⁴² that any good faith buyer should be protected.

24.27 We agree that there should be no rule of general application here. But we are persuaded that as in Australia and New Zealand good faith private purchasers (or acquirers otherwise giving value) should be protected in the case of lower-value goods where these are wholly or mainly acquired for personal, domestic or household purposes. This protection would only apply to corporeal moveables. Take the following example. John is a sole trader gardener. He owns five lawnmowers which he uses for varying types of lawns. He does not trade in lawnmowers. He grants a statutory pledge over his business equipment including the lawnmowers and therefore the protection rule outlined in the previous section would not apply. He subsequently sells one of the lawnmowers to Jean for £500 without the secured creditor’s permission. Jean is in good faith. We think that she should be protected.

24.28 There is then the issue of where the threshold should be set. In his response, John MacLeod argued that “it might be better if the test was not of the price paid by the buyer but the value of the goods to avoid complications where the price of the goods was deliberately set below the ceiling”. We agree.

³⁶ Australian PPSA 2009 s 47(2).

³⁷ NZ PPSA 1999 s 54.

³⁸ NZ PPSA 1999 s 16(1).

³⁹ See Australian Statutory Review 2015 para 7.6.1.1.

⁴⁰ See Gedye, Cuming and Wood, *Personal Property Securities in New Zealand* 232.

⁴¹ Dundas & Wilson, and McGrigors.

⁴² See paras 24.7–24.10 above.

24.29 The figure should be set by statutory instrument. Aberdeen Law School suggested £1,000. Dr Ross Anderson made an “arbitrary” suggestion of £5,000. These were the only two specific suggestions. We think that the figure should be at least £1,000. When setting it we think that the Scottish Ministers should have regard also to the threshold figure below which a corporeal asset owned by an individual not acting in the course of a business cannot be made the subject of a statutory pledge.⁴³ This would effectively prevent the rule recommended here operating in consumer-to-consumer sales. Thus if a private individual can only grant a statutory pledge over assets each worth more than £1,000 and the low-value goods acquisition protects goods with a value less than £1,000 then it cannot come into play as regards statutory pledges granted by private individuals.

24.30 We consider also that this rule should not apply to motor vehicles, for which we recommend a separate rule below.⁴⁴ We recommend:

109. (a) An individual who acquires corporeal property which is encumbered property and which is, or has been, transferred without the required consent of the secured creditor, should acquire it unencumbered by the statutory pledge if:

- (i) the value of all that is acquired does not, at the time of acquisition, exceed such amount (if any) as the Scottish Ministers may by regulations specify,**
- (ii) at the time of acquisition, the acquirer is in good faith,**
- (iii) the acquirer gives value for the property acquired, and**
- (iv) the property is wholly or mainly acquired for personal, domestic or household purposes.**

(b) This rule should not apply in respect of the acquisition of encumbered property (or any part of that property) which consists of a motor vehicle.

(c) A person should not be taken to be other than in good faith by reason only of the pledge having been registered.

(Draft Bill, s 55)

Relevance of delivery

24.31 Under sections 24 and 25 of the Sale of Goods Act 1979 (the rules on sellers and buyers in possession), a pre-condition for the protection of the buyer from the seller’s lack of title is that the goods have been delivered to the buyer. We noted in the Discussion Paper that this approach is not generally to be found in UCC–9 and the PPSAs but we asked consultees whether it should be a requirement for protection in Scotland.⁴⁵

⁴³ See paras 19.36–19.51 above.

⁴⁴ And motor vehicles would typically have a higher value than the threshold figure in any event.

⁴⁵ Discussion Paper, para 16.46.

24.32 The responses which we received generally did not favour delivery. For example, Aberdeen Law School, in a thoughtful response,⁴⁶ stated:

“The interaction with s 17 of the Sale of Goods Act 1979 (as amended) would need to be considered carefully. If delivery is the step at which security is purged, yet ownership is transferred earlier by agreement, a buyer would need to undertake two steps rather than one to acquire unencumbered ownership.

This two-step process is something that has been alien to Scots law since the Sale of Goods Act 1893. The case for delivery has not been made, and the analogy with sections 24 and 25 of the Sale of Goods Act 1979 is imperfect . . . when transfer can happen without delivery it would be bizarre to leave a security right attached after the seller has divested itself of the asset.”

24.33 Consultees including Dr Hamish Patrick, the Law Society of Scotland and several law firms suggested payment of the price as a pre-requisite for protection. We agree. Thus the “in the course of a business” and “lower-value goods” protections set out above both require payment to be made/value given but not delivery.

When acquirers should not be expected to check the RSP: motor vehicles

24.34 The current lack of a non-possessory security over moveable property in Scotland is one of the reasons why hire-purchase contracts are popular. Typically what happens is that a supplier sells the goods to a finance company which then enters into a hire-purchase contract with the customer. This is a contract of hire, but with a purchase option which the buyer can choose whether or not to exercise.⁴⁷ In contrast, in a conditional sale transaction the customer does acquire ownership on paying all the instalments.

24.35 Until the option is exercised, ownership of the goods remains with the finance company. Therefore if the customer sells the goods, the purchaser does not acquire ownership. The Hire-Purchase Act 1964, however, provides an exception for private purchasers who have acted in good faith, but only in relation to motor vehicles.⁴⁸ The protection also applies where the motor vehicle is the subject of a conditional sale.

24.36 A statutory pledge over a motor vehicle would be functionally similar to hire-purchase or conditional sale. The customer would have possession of the vehicle. But rather than it being owned by the finance company, the customer would grant a statutory pledge over it which would be registered in the RSP. We are of the view that good faith private purchasers should be protected under the same principles in the 1964 Act. Some of its provisions are not particularly easy to follow and we have therefore tried to take a simpler approach.⁴⁹

24.37 First, we think that the same definition of “motor vehicle” should be used, namely “any mechanically propelled vehicle intended or adapted for use on roads to which the public has access”.⁵⁰ Secondly, the vehicle should be the subject of a statutory pledge. Thirdly, there should be a sale agreement, conditional sale agreement or hire-purchase agreement made in respect of the vehicle.⁵¹ Fourthly, the purchaser or hirer, at the time of entering into

⁴⁶ Authored by the late Professor David Carey Miller.

⁴⁷ See the definition in the Consumer Rights Act 2015 s 7.

⁴⁸ Hire-Purchase Act 1964 s 27.

⁴⁹ We note also in this regard Law Commission, Bills of Sale (Law Com No 369, 2016) paras 8.55–8.58.

⁵⁰ Hire-Purchase Act 1964 s 29(1)(b).

⁵¹ This follows from the definition of “disposition” in the Hire-Purchase Act 1964 s 29(1).

the agreement should be in good faith.⁵² They should not have to check the RSP in order to satisfy this test. Fifthly, the purchaser or hirer should not be a person carrying on a business which is described in section 29(2) of the 1964 Act. In other words, the person must not be a trade or finance purchaser ie not someone who carries on a business involving trading in motor vehicles or providing finance for their hire-purchase or conditional-sale. The result is that many business purchasers (not being motor dealers) are protected.⁵³

24.38 On these conditions being satisfied the purchaser or hirer should obtain the motor vehicle unencumbered on it being transferred. In the case of conditional sale and hire-purchase, however, the transfer would not be immediate. It would only happen on the relevant conditions being satisfied or on the hirer exercising the option to acquire the property. In the meantime it should not be possible for the statutory pledge to be enforced against the vehicle.

24.39 We consider also that where the party who sells or hires the motor vehicle is a trade or finance purchaser they should be liable to the secured creditor for the lesser of the amount remaining due under the secured obligation and the amount received, or to be received in respect of the transfer. We have been influenced in this regard by section 59 of the NZ PPSA 1999, but section 27(6) of the 1964 Act rather more opaquely would seem to impose similar liability. The policy is that trade or finance purchasers should exercise a higher standard of care when dealing with vehicles. Take the following example. Louise grants a statutory pledge over her van in favour of the Ballantrae Bank. The security right is registered in the RSP. Without the consent of the bank she sells the van to a motor dealership. The motor dealership subsequently sells to Joshua, who is in good faith. He acquires the van unencumbered by the statutory pledge. The motor dealership then becomes liable to the bank for the price it received or Louise's outstanding debt if lower. The motor dealership should have searched against Louise in the RSP prior to buying her van.

24.40 Finally, we believe that the Scottish Ministers should have the power to specify motor vehicles or classes of motor vehicle which are not to benefit from the rule. Our thinking here is that the RSP might in the future become so easy to check electronically that acquirers or certain classes of acquirer could be expected to check it. This may depend on the extent to which the registration of VINs (vehicle identification numbers) becomes compulsory.

24.41 In New Zealand there is a text message system known as "TXTB4UBUY". The NZ Personal Property Securities Register website states: "Before you buy a second hand vehicle, text us to check if money could be owing on the vehicle. There are three basic steps to completing a TXTB4UBUY search. First you send us an SMS text. Next you will receive a reply containing information that you then use to complete your search online. It costs \$3 per submitted search (the fee is charged to your mobile phone) . . . You should receive an SMS reply within minutes."⁵⁴ In New Zealand good faith private purchasers from licensed motor dealerships are protected,⁵⁵ but purchasers from private individuals are expected to check the register.

⁵² See the Hire-Purchase Act 1964 s 27(2). This provision requires "good faith without notice" but we are not convinced that "without notice" adds anything.

⁵³ See W C H Ervine, *Consumer Law in Scotland* (5th edn, 2015) para 3-41.

⁵⁴ See <http://www.ppsr.govt.nz/cms/searching-the-ppsr/txtb4ubuy>.

⁵⁵ NZ PPSA 1999 s 58.

24.42 We note also that the Law Commission for England and Wales in its Report on Bills of Sale has recommended that new legislation introducing “goods mortgages” should contain a regulation-making power to repeal the protection which is to be given to good faith private purchasers of vehicles if vehicle provenance checks become free (or almost free) and a routine part of buying a second-hand vehicle.⁵⁶

24.43 We recommend:

110. (a) The following rule should apply where:

- (i) there is a sale agreement (or conditional sale agreement) or a hire-purchase agreement in respect of a motor vehicle,**
- (ii) the motor vehicle is encumbered property,**
- (iii) the purchaser or hirer is, at the time of entering into the agreement, in good faith, and**
- (iv) at that time the purchaser or hirer is not a person carrying on a business described in section 29(2) of the Hire-Purchase Act 1964.**

(b) On the motor vehicle being transferred to the purchaser or hirer in accordance with the agreement, that person should acquire it unencumbered by the statutory pledge.

(c) And the statutory pledge should not be able to be enforced against the motor vehicle while the agreement is extant, and before the vehicle is transferred to the purchaser or hirer.

(d) But if the transferor is, at the time the agreement is entered into, a person carrying on a business described in section 29(2) of the Hire-Purchase Act 1964, the secured creditor should be entitled to receive from the transferor the lesser of:

- (i) the amount outstanding in respect of the secured obligation, and**
- (ii) the amount received, or to be received, by the transferor in respect of the acquisition.**

(e) A purchaser should not be taken to be other than in good faith by reason only of the statutory pledge having been registered.

(f) “Conditional sale agreement”, “hire-purchase agreement” and “motor vehicle” should have the meanings given to those expressions by section 29(1) of the Hire-Purchase Act 1964.

⁵⁶ Law Com No 369, 2016 paras 8.37–8.45.

(g) The Scottish Ministers should have the power to make regulations specifying the motor vehicles, or classes of motor vehicle, to which these rules are not to apply.

(Draft Bill, s 56)

Financial instruments

24.44 In the Discussion Paper we said that it would be unacceptable if the new security right were to cause problems for the free marketability of shares.⁵⁷ This principle applies generally to financial instruments, such as corporate and public-sector bonds. We noted that there are different types of case. Dealers trading in shares on the London Stock Exchange cannot be expected to check the RSP. But if a member of a small private company sells shares in that company to another member, the position is arguably different and the buyer might be expected to check the register in those circumstances.

24.45 We canvassed two main options, with the second having sub-options. The first main option would be for good faith acquirers always to take free of a statutory pledge. The second would be to protect some good faith acquirers, but not others. For example, open-market buyers could be protected.

24.46 Consultees generally favoured protection for publicly tradeable financial instruments only. Thus Dr Ross Anderson argued: “There is no reason for protection to apply to shares in a company whose securities are not listed on a publicly traded exchange. In such cases, the buyer’s professional advisers can be expected to check the RSP.” The Law Society of Scotland and several law firm consultees doubted that the statutory pledge would be used for tradeable financial instruments because the need to protect good faith third party acquirers meant that the security right would be easily lost. It is worth remembering, however, that the statutory pledge would remain effective against transferees other than good faith buyers as well as against subsequent security rights and in the event of the provider’s insolvency.

24.47 Following discussion with our advisory group, we have concluded that a good faith acquisition rule should apply to financial instruments on financial markets specified by the Scottish Ministers in regulations. This would allow flexibility because the situation in practice may change. We consider that acquirers should be protected if they do not know about the statutory pledge and the acquisition takes place in accordance with the rules of the specified financial markets. This is more generous than the earlier rules outlined in this chapter to protect acquirers. First, only actual knowledge by the acquirer of the statutory pledge would preclude the rule applying, and not a lack of good faith. Second, there would be no requirement to give value. The reason for this approach is the need to ensure free trading of financial instruments in financial markets.

24.48 We recommend:

⁵⁷ Discussion Paper, para 19.6.

111. (a) The following rule should apply where:
- (i) a person, in the ordinary course of trading on a specified financial market, acquires a financial instrument of a specified kind, and
 - (ii) that financial instrument is encumbered property.
- (b) The person should acquire the instrument unencumbered by the statutory pledge provided that:
- (i) at the time of acquisition the person does not know of the statutory pledge, and
 - (ii) the acquisition takes place in accordance with the rules of the specified financial market.
- (c) “Specified” should mean specified, for these purposes, by the Scottish Ministers by regulations.
- (d) The regulations should be able to specify different markets or descriptions of market in relation to different kinds of financial instrument.

(Draft Bill, s 57)

Chapter 25 Possessory pledge

Introduction

25.1 This chapter considers reforms to possessory pledge, the consensual security over corporeal moveable property created by delivery which is recognised by the current law and also under our recommended new statutory regime. While, as we noted in the Discussion Paper,¹ there is more pressure for reform in relation to non-possessory security, we consider that some reform of possessory pledge is desirable. This was supported by consultees.

Delivery

25.2 Pledge under the current law is a possessory security.² The relevant property must be delivered to the secured creditor in order to satisfy the publicity principle³ and to restrict the provider's ability to deal with the property. Thus while in principle the provider can still sell the property to a third party, the third party is warned of the existence of the pledge by the fact that the provider does not have direct possession of the property.

25.3 A preliminary point is that the *nemo plus* rule applies in relation to the creation of a pledge as it does to creation of other real rights. If the provider of the pledge does not own the property being pledged then no real right will be acquired by the secured creditor. But if the provider subsequently becomes owner of the property, although there is an absence of authority on the matter, we think that the pledge would then be created.⁴ This would effectively be the same rule as for statutory pledge.⁵ We therefore recommend that provision is made on the matter, although we doubt that this situation would commonly arise. Under English law it is possible for a pledgee to re-pledge the property. This is known as a "sub-pledge".⁶ Scots law is otherwise.⁷

25.4 We noted earlier in this Report that the law recognises various types of delivery.⁸ For pledge, however, the case of *Hamilton v Western Bank*⁹ states that there must be actual delivery, in other words, the property has to be physically handed over to the creditor. The decision has been the subject of significant criticism and subsequent case authority casts doubt on it.¹⁰ A court would hopefully take a different approach if the matter were to come before it today. For, if *Hamilton* is correct, this means that other forms of delivery cannot be used to create a pledge. Thus goods in a warehouse belonging to an independent third

¹ Discussion Paper, para 15.2.

² See generally, Steven, *Pledge and Lien*. The present Report recommends the introduction of a new type of pledge, known as a "statutory pledge".

³ On the publicity principle, see Discussion Paper, Chapter 11.

⁴ This in effect is the doctrine of accretion.

⁵ See para 23.27 above.

⁶ The leading case is *Donald v Suckling* (1866) LR 1 QB 585.

⁷ See Steven, *Pledge and Lien* paras 6-52 to 6-64. And see also the Belgian Pledge Act of 11 July 2013 art 19 (which provides for art 14 of the new Book III title XVII of the Civil Code).

⁸ See para 17.18 above.

⁹ (1856) 19 D 152.

¹⁰ See para 17.18 above. In particular, *North-Western Bank Limited v Poynter, Son, & Macdonalds* (1894) 22 R (HL) 1, [1895] AC 56 and discussed below at para 25.11, is contrary to *Hamilton*.

party may be delivered constructively by intimation to the third party.¹¹ Goods aboard a ship may be delivered by means of handing over the bill of lading which represents them.¹² If such other methods of delivery are doubtful for possessory pledge, it makes the law unduly restrictive and puts barriers in the way of businesses wanting to use assets for security. For example, in Scotland whisky is kept in warehouses belonging to third parties, which makes it a suitable subject for security.

25.5 In English law it is clear that delivery is not limited to actual delivery. In *Sewell v Burdick*¹³ the House of Lords decided that a pledge of a bill of lading is valid, the reason being that a bill of lading represents the civil possession¹⁴ of the goods in question, but does not necessarily represent their ownership. In the Discussion Paper we stated our view that the English approach is clearly preferable. There is no reason why the transfer of possession of a bill of lading for the purpose merely of security should result in transfer of ownership, any more than when possession of a gold ring is transferred to a pawnbroker, ownership should pass. We considered that *Hamilton* represents an unjustifiable interference with the intentions of the parties and the commercial realities of the situation. We asked consultees whether legislation should bring Scots law into line with English law (as settled in *Sewell v Burdick*) by providing that the pledge of a bill of lading (or delivery order¹⁵) is a true pledge. All the consultees who responded to this question agreed, as did the Scotch Whisky Association when we informed them of our proposal.

25.6 We think that it would be helpful for the new legislation to set out the forms of delivery which are permissible. In the first place, it should clearly continue to be possible to pledge corporeal moveables by physically handing these over to the secured creditor or to a person authorised to accept delivery on that person's behalf. Larger items such as vehicles may not be physically handed over as such but rather control may be given to the secured creditor perhaps by means of keys.¹⁶ Secondly, it should be competent for goods in a particular location to be pledged by giving the secured creditor, or a person authorised to act for that party, control of the location. The usual way to do this would be to hand over the keys to the relevant location, such as a store.¹⁷ Thirdly, constructive delivery by instructing an independent third party holder of the property to hold it on behalf of the secured creditor, or that party's authorised representative, should also be possible. As mentioned above, the usual case is goods held in a warehouse. In English law this type of delivery (which is known as "attornment") requires the custodian to tell the secured creditor that the property is now being held for that party.¹⁸ But this is not necessary in Scotland.¹⁹ Fourthly, pledge by

¹¹ *Anderson v McCall* (1866) 4 M 765; *Inglis v Robertson & Baxter* (1898) 25 R (HL) 70.

¹² See Carey Miller with Irvine, *Corporeal Moveables* para 8.27.

¹³ (1884) LR 10 App Cas 74.

¹⁴ Civil possession, otherwise known as indirect possession, means possession through another party. For example, the owner of goods which are in a warehouse has civil possession of them through the warehouse owner.

¹⁵ In other words a delivery order issued by a custodian such as warehouse. There would require to be intimation to the custodian here for the pledge to be valid, contrary to the position with bills of lading.

¹⁶ A point made to us by Dr Craig Anderson.

¹⁷ Justinian, *Institutes* II,1,45. See too Reid, *Property* para 620 (W M Gordon). For English law, see Beale, Bridge, Gullifer and Lomnicka, *The Law of Security and Title-Based Financing* para 5.33.

¹⁸ Beale, Bridge, Gullifer and Lomnicka, *The Law of Security and Title-Based Financing* para 5.25.

¹⁹ Except under the Sale of Goods Act 1979 s 29(4). See Reid, *Property* para 620 (W M Gordon) and C Twigg-Flesner, R Canavan and H MacQueen (eds), *Atiyah and Adams' Sale of Goods* (13th edn, 2016) 103–104. See also C Anderson, "Delivery of Goods in the Custody of a Third Party: Operation and Basis" (2015) 19 EdinLR 165. Dr Anderson argues that delivery here can be analysed as the owner assigning its right against the holder, but this assignation is within a specific context. Thus the general rules of intimation discussed in Volume 1 of this Report seem inapplicable.

means of handing over a bill of lading²⁰ should be available, as it is under English law. Where the bill is an order bill of lading it would require to be endorsed in favour of the secured creditor.²¹

25.7 We do not favour allowing pledge by means of *constitutum possessorium* (delivery by act of mind alone whereby the property remains in the possession of the provider of the pledge).²² This gives insufficient publicity to third parties and does not adequately restrict the provider's ability to deal with the property.²³

25.8 Where the prospective encumbered property is already in the direct possession or custody of the secured creditor, the requirement for delivery is unnecessary.²⁴ Imagine that Neil has lent Olive his van. He then borrows £5,000 from her. Neil and Olive should be able to agree that the van can be pledged for the debt without it having to be redelivered back to Neil so that he can make a fresh delivery to Olive.

25.9 Finally, the new legislation requires to be made subject to section 2 of the Factors Act 1889,²⁵ which allows a mercantile agent to pledge goods in that party's possession. The 1889 Act goes on to provide that this may be done by means of a pledge of the "documents of title" to the goods.²⁶ "Documents of title" are provided to include any bill of lading, dock warrant, warehouse keeper's certificate, and warrant order for the delivery of the goods.²⁷ This seems to override the usual rule for constructive delivery that intimation to the warehouse is required.²⁸

25.10 Accordingly we recommend that:

112. (a) For a possessory pledge to be created the property delivered must be or become the property of the provider.

(b) The rule in *Hamilton v Western Bank*, that pledge is restricted to actual delivery of the property which is to be encumbered, should no longer have effect.

(c) Delivery of corporeal moveable property in order to pledge it should be effected by:

²⁰ The bill of lading is the only clear example of a document symbolising goods, so that delivery of it is equivalent to delivery of the goods. One of our advisory group members suggested an air waybill as another example, but while the position is not entirely clear it would seem that it is not. We considered widening the rule to cover "any document representing the property" but consultees to our draft Bill consultation of July 2017 criticised this approach on the basis that it was too uncertain.

²¹ R M Goode, *Commercial Law* (5th edn, by E McKendrick, 2016) para 32.53.

²² For discussion, see Carey Miller with Irvine, *Corporeal Moveables* paras 8.23–8.25.

²³ As has been noted in South Africa. See H Mostert and A Pope (eds), *The Principles of the Law of Property in South Africa* (2010) 317.

²⁴ The Romans referred to this as delivery *brevi manu*. See Reid, *Property* para 622 (W M Gordon).

²⁵ Applied in Scotland by the Factors (Scotland) Act 1890. See L J Macgregor, *The Law of Agency in Scotland* (2013) para 3-07.

²⁶ Factors Act 1889 s 3.

²⁷ Factors Act 1889 s 4.

²⁸ See Steven, *Pledge and Lien* para 9-34. See also Beale, Bridge, Gullifer and Lomnicka, *The Law of Security and Title-Based Financing* para 5.34.

- (i) physically handing over or giving control of the property to the secured creditor or to a person authorised to accept delivery on behalf of the secured creditor,
- (ii) giving control of the premises in which the property is located to the secured creditor or to a person so authorised,
- (iii) instructing an independent third party who has direct possession or custody of the property to hold the property on behalf of the secured creditor or of a person so authorised, or
- (iv) delivering a bill of lading to the secured creditor or to a person so authorised (and where that bill is to the order of a particular person, by effecting the endorsement of the bill in favour of the secured creditor).

(d) Property already in the direct possession or custody of the secured creditor or of a person authorised to hold the property on behalf of the secured creditor when agreement on the creation of the pledge is reached between the provider and the secured creditor is deemed to have been delivered to the secured creditor for the purpose of creating a pledge.

(e) These rules should be without prejudice to section 2 of the Factors Act 1889 (powers of mercantile agent with respect to disposition of goods).

(Draft Bill, ss 45 and 118(4))

Redelivery of pledged property for the purpose of sale

25.11 In *North-Western Bank Limited v Poynter, Son & Macdonalds*²⁹ a bill of lading was pledged to the bank, but returned to the pledger for the purposes of selling the goods. The provider of the pledge undertook to hold the goods in trust for the bank. The validity of this arrangement was challenged. The case proceeded in the Scottish courts and ended up in the House of Lords, where it was held to be subject to English law.³⁰ The decision was that the pledge survived the transfer back to the provider. It has come to form the legal basis of trust receipt financing. But what exactly is held in trust is not clear.³¹ Thus if A pledges a bill of lading to B and B then hands it back on trust, A is now the trustee and owner of the goods. This suggests that B, as the beneficiary of the trust, is no longer a pledgee. Perhaps the law is that the pledge remains over the goods not sold and the trust covers the proceeds of those sold.

²⁹ (1894) 22 R (HL) 1, [1895] AC 56. See also the earlier decision in *McDowal v Annand and Colhoun's Assignees* (1776) 2 Pat 387.

³⁰ Both the pursuers and the defenders were English, but the case arose because of the arrestment of sums owned by a Scottish buyer of the goods.

³¹ See G L Gretton, "Pledge, Bills of Lading, Trusts and Property Law" 1990 Juridical Review 23.

25.12 The wider notion of the property being returned to the provider for the purposes of sale while maintaining the pledge is viewed as advantageous practically because it is the provider who is likely to be better placed to sell than the creditor. A pledge of a bill of lading may also be a relatively short-term security.³² Over forty years ago, however, the decision in *Poynter* was criticised by Dr Alan Rodger, later Lord Rodger of Earlsferry, as being contrary to principle by allowing the pledge to persist after the return of the goods.³³ In the Discussion Paper we raised the possibility of departing from the decision by asking if legislation should make it clear that the redelivery of pledged goods (or a pledged bill of lading) extinguishes the pledge. This would be without prejudice to any new system allowing for non-possessory security.

25.13 There was unqualified support for this proposal from several consultees, including Dr Ross Anderson, David Cabrelli, Chris Dun, Jim McLean and Dr Hamish Patrick. John MacLeod considered that this should only be done if a general codification of the law of pledge is undertaken. Other consultees, while stating that they agreed, said that any reform should not affect the right to proceeds under trust receipt financing. These included the Law Society of Scotland and Scott Wortley. As discussed above, the difficulty with such an approach is that it is simply not clear under the current law where the law of pledge stops and the law of trusts starts. We are also aware that trust receipt financing works in the same way in England and Wales as it currently does in Scotland. There would doubtless be resistance to Scotland-only reform here. We consider that the question should be reconsidered if and when there are relevant developments south of the border such as a major reform of secured transactions law.

113. The rule in *North-Western Bank Limited v Poynter, Son & Macdonalds*, that pledged property can be redelivered to the provider on the basis of a trust receipt without extinguishing the pledge, should not at the present time be abolished.

Enforcement of pledge under the Consumer Credit Act 1974

25.14 Sections 114 to 122 of the 1974 Act amount essentially to a code for enforcement of pledge where the person pledging the property is a consumer and the pledgee is a pawnbroker. The usual remedy of the pawnbroker is sale. No court order is required to authorise this. If that sale results in a surplus, that surplus must be returned to the (ex) debtor.³⁴ This is fair and reasonable and merely follows the general rule for rights in security.³⁵ There is, however, an exception. If the debt is a small one (currently up to £75)³⁶ enforcement is by forfeiture instead of sale. The pawnbroker becomes owner of the property. In the Discussion Paper³⁷ we showed that this was a strange and unfair rule. We gave the example of a painting being pawned for £70 and it later transpiring that it is worth £10,000. If the debtor defaults, the pawnbroker obtains a windfall. We concluded that as the 1974 Act currently stands there is no requirement to account to the pledger for the

³² See Calnan, *Taking Security* para 2.49.

³³ A F Rodger, "Pledge of Bills of Lading" 1971 *Juridical Review* 193.

³⁴ Consumer Credit Act 1974 s 121.

³⁵ See eg Gretton and Steven, *Property, Trusts and Succession* para 21.24.

³⁶ 1974 Act s 120(1)(a).

³⁷ Discussion Paper, para 6.15.

£9,930 gain. The case of *Henderson v Wilson*³⁸ was decided on that basis (under predecessor legislation in similar terms).

25.15 We were also puzzled that there is no provision in the 1974 Act on reduction of the debt by the value of the article. For example, it is unclear when ownership of a £40 article is forfeited because a loan of £70 has not been repaid, whether the debt is now (a) zero; (b) £30; or (c) £70.³⁹

25.16 Therefore we made two proposals. The first was that where, under the pawnbroking provisions of the Consumer Credit Act 1974, ownership of the pledged item is lost because the loan is below the prescribed figure (currently £75), the debt (if more than the value of the item) should be reduced by the value of the item. Secondly, we proposed that where, under the pawnbroking provisions of the 1974 Act, ownership of the pledged item is lost because the loan is below the prescribed figure, but the value of the item exceeds the loan, the loan should be discharged, and the pawnbroker should be obliged to pay the customer the surplus value (subject always to deduction of administrative expenses etc).

25.17 These proposals received strong support from consultees. Several, however, noted an issue of which we were indeed aware. The subject matter of the 1974 Act is reserved to the UK Parliament.⁴⁰ This means that we make no provision for this in our draft Bill. We consider also that reform is justified on a UK rather than Scotland-only basis. We therefore recommend:

114. (a) Where, under the pawnbroking provisions of the Consumer Credit Act 1974, ownership of the pledged item is lost because the loan is below the prescribed figure (currently £75), the debt (if more than the value of the item) should be reduced by the value of the item.

(b) Where, under the pawnbroking provisions of the Consumer Credit Act 1974, ownership of the pledged item is lost because the loan is below the prescribed figure (currently £75), but the value of the item exceeds the loan, the loan should be discharged, and the pawnbroker should be obliged to pay the customer the surplus value (subject always to deduction of administrative expenses etc).

Enforcement of pledge outwith the Consumer Credit Act 1974

Power of sale

25.18 Under the common law, which applies in non-consumer cases, the pledgee requires court permission to sell the pledged property on default.⁴¹ It is, however, permissible for the pledge agreement to authorise a sale without the need for a court order.⁴² This is known technically as *parata executie*.⁴³ But having a requirement to go to court where there is no

³⁸ (1834) 12 S 313.

³⁹ *McMillan v Conrad* (1914) 30 Sh Ct Rep 275, decided under predecessor legislation, suggests (a).

⁴⁰ Scotland Act 1998 Sch 5 Part II Head C7. See also para 1.39 above.

⁴¹ See Steven, *Pledge and Lien* para 8-06.

⁴² See eg *Moore v Gledden* (1869) 7 M 1016 at 1020 per Lord Neaves.

⁴³ See Steven, *Pledge and Lien* para 8-12. In South Africa the validity of *parata executie* clauses in terms of the right of access to the courts under the Constitution was successfully challenged in *Findevco (Pty) Ltd v Faceformat SA (Pty) Ltd* 2001 (1) SA 251 (E), but the Supreme Court subsequently departed from that

such agreement is perhaps odd in that the law seems more protective of the debtor in non-consumer cases than it is in consumer cases.⁴⁴ We noted in the Discussion Paper⁴⁵ that many European systems make a power of sale an implied term of a pledge. Given that application to the court increases enforcement costs and takes up court time, there is a case for reform here. It can, however, be argued that because an express clause is common in practice, there is no compelling need for reform.

25.19 We asked consultees whether the common law on a pledgee's power of sale is satisfactory and, if not, what changes are needed. Those who responded to this question all favoured an implied power of sale, but with different degrees of enthusiasm as to how necessary this was as a law reform exercise. Scott Wortley noted: "If experience is that the vast majority of people contract for an express power of sale I think the law should develop to reflect the practice to ensure that any unsophisticated creditors should have similar benefits."

Forfeiture

25.20 Forfeiture was discussed above in relation to the Consumer Credit Act 1974.⁴⁶ What is objectionable about forfeiture is that the value of the asset may be in excess of the debt. In contrast, allowing the secured creditor to appropriate the asset provided that payment of the excess value is made to the security provider is a different proposition and, increasingly, this has become competent under more recent legislation in other countries.⁴⁷ This is the approach taken in the DCFR,⁴⁸ where the provision makes it clear that the secured creditor can "appropriate encumbered assets only for the value of their recognised or agreed market price."

25.21 We asked consultees whether they agreed that, in cases outwith the Consumer Credit Act 1974, there should be a provision dealing with forfeiture clauses along the lines proposed in the DCFR. Consultees were generally supportive of such a provision.

Discussion

25.22 We have formed the view that there is much to be said for taking a broader approach to the reform of possessory pledge remedies. The reality is that the possessory pledge and the new statutory pledge serve the same purpose. They enable satisfaction of a debt to be made from moveable property. They merely differ in how they satisfy the publicity principle. The possessory pledge satisfies it by delivery. The new statutory pledge satisfies it by registration. We believe that the remedies available for the statutory pledge should also be available for the possessory pledge. This is the position under comparator legislation such as UCC-9 and the PPSAs. Thus the secured creditor should have an implied power of sale and alternative remedies such as leasing out the property or appropriation should also in principle be available. It is unclear under the current law whether lease is a remedy and it is

conclusion in *Bock v Duburoro Investments* 2004 (2) SA 242 (SCA). For discussion, see A J M Steven, "Rights in Security" in E Reid and D Visser (eds), *Private Law and Human Rights: Bringing Home Rights in Scotland and South Africa* (2013) 418 at 423–428 and R Brits, *Real Security Law* (2016) 170–181.

⁴⁴ Although, pawnbrokers require to be licensed by the Financial Conduct Authority under the Financial Services and Markets Act 2000 ss 19 and 22, and Sch 2 para 23.

⁴⁵ Discussion Paper, para 15.9.

⁴⁶ See paras 25.14–25.17 above.

⁴⁷ Eg the French Civil Code art 2348 (as amended in 2006).

⁴⁸ DCFR IX.–7:105.

doubtful whether appropriation is possible.⁴⁹ We discuss the remedies in detail in Chapters 27 and 28 below. Of course, where property has been pledged by means of delivery there is no need to have rules on the taking of possession by the secured creditor, because that possession is already held. We recommend that:

115. Possessory pledge should have the same remedies as statutory pledge in non-Consumer Credit Act 1974 cases.

(Draft Bill, ss 67 to 84)

Codification

25.23 Finally, there is the question of whether the law of possessory pledge should be codified. This of course is the position in the European countries which have civil codes. It is also true in the UCC–9/PPSA jurisdictions because in effect there is a general code of security over moveable property in which pledge is included. In the Discussion Paper we expressed the view that the codification of the law of pledge would be less difficult than codification of the law of assignation.⁵⁰ The possibility of codification drew a mixed response from consultees. David Cabrelli, Jim McLean, John MacLeod, Professor Eric Dirix and Scott Wortley were in favour. The Faculty of Advocates and Dr Hamish Patrick were opponents, although gave no reason. Aberdeen Law School was also sceptical on the basis that the new statutory pledge would then be the primary option for creditors. Others, including Chris Dun and the Law Society of Scotland only saw a case for codification as part of a wider review and all, apart from Mr Dun, considered that such a review should include the Consumer Credit Act 1974. Brodies had no strong view.

25.24 We consider that a case for entire codification of pledge law at this time has not been made out. The relevance of the 1974 Act, the subject matter of which is reserved to the UK Parliament, would make this impossible to achieve in our draft Bill. There are also issues in the law of pledge which were not covered in the Discussion Paper and which would require consultation if we were to seek codification.⁵¹ But, as a result of our recommendation above, the remedies for enforcement in non-consumer cases would become codified and this would be a considerable improvement on the current law. Of course codification could be revisited at a future date and this would certainly be the position if there were support for a UCC–9/PPSA approach in the UK. We recommend that:

116. The law of possessory pledge should not be codified at the present time.

⁴⁹ See Steven, *Pledge and Lien* paras 8-04 to 8-18 as to the remedies for pledge.

⁵⁰ Discussion Paper, para 15.12.

⁵¹ Eg duties owed by the parties. See Steven, *Pledge and Lien* ch 7.

Chapter 26 Ranking of pledges

Introduction

26.1 In this chapter we deal with the issue of how pledges (both possessory and statutory pledges) rank with other rights in security and with diligence. Ranking, often also known as “priority”,¹ is an important issue for rights in security.² The facilitation of access to finance by modern secured transactions laws depends on their ability to enable competing creditors to know clearly what their ranking is.³

26.2 The basic rule, that an earlier security has priority over a subsequent security, is straightforward. There is potential for complexity, however, particularly in multi-party situations. The phenomenon of the priority circle is well documented,⁴ notably in the context of the floating charge. For reasons explained elsewhere,⁵ our general approach in this Report is to leave the floating charge as it is and therefore solving such priority circles must await a future more general review of security rights and insolvency law.

General

26.3 Pledge is a true security right.⁶ In other words, the secured creditor holds only a subordinate right in the encumbered property and the security provider retains ownership. Thus Anton could grant a statutory pledge over his car to Barry in respect of a loan from Barry. Under this arrangement, Anton is still owner of the vehicle. He could therefore grant a second statutory pledge over the same car to Catherine in respect of a separate loan from her. But in such circumstances, the question arises as to which security has priority. In other words, which security ranks first? This question is important because in the event of default the car may not be valuable enough to repay both loans.

26.4 Under the general law, ranking is by time of creation: *prior tempore potior jure* (prior in time stronger in right).⁷ In property law terms, this means by time of real right. For statutory pledges this would normally mean the time of registration.⁸ If Barry registers in the Register of Statutory Pledges on 1 November and Catherine on 2 November, Barry has the first ranking security and Catherine the second ranking security. Imagine that Anton defaults

¹ Particularly in the UCC–9 and PPSA systems. See eg DCFR Book IX chapter 4.

² Thus eg in the UNCITRAL Legislative Guide on Secured Transactions, key objective (g) of an effective and efficient secured transactions law is “to establish clear and predictable priority rules”.

³ N O Akseli, *International Secured Transactions Law: Facilitation of Credit and International Conventions and Instruments* (2011) 225.

⁴ A priority circle is where under ranking provisions creditor A ranks above creditor B, creditor B ranks above creditor C, but creditor C ranks above creditor A. See eg G Gilmore, *Security Interests in Personal Property* (1965) para 39.1; S Wortley, “Squaring the Circle: Revisiting the Receiver and ‘Effectually Executed Diligence’” 2000 *Juridical Review* 325; and A MacPherson, “A Vicious Circle: the ranking of floating charges and fixed securities” 2014 *Edinburgh Student Law Review* 67. See also http://www.law.ed.ac.uk/research/making_a_difference/research_in_a_nutshell_the_ranking_problem.

⁵ See Chapter 18 above and Chapter 38 below.

⁶ See para 17.17 above.

⁷ The rule is a familiar one in other jurisdictions. See eg Gullifer (ed), *Goode and Gullifer on Legal Problems of Credit and Security* para 5-26.

⁸ See Chapter 23 above. Except in financial collateral cases where the security is created by possession or control. See Chapter 37 below.

and the car is sold for £5,000. Both loans are for £3,000. Barry would receive £3,000 and Catherine £2,000. Catherine would be left as an unsecured creditor for the remaining £1,000 of her loan.

26.5 In the Discussion Paper we asked consultees whether priority of the new security right to be introduced in respect of corporeal moveable property should be by date of registration.⁹ There was strong support from consultees for this. There was similar support for our equivalent question in relation to incorporeal moveable property.¹⁰ While our question was framed in terms of “date” it is more precise to refer to “time”. As was seen in Chapter 6 above, modern security registers in other jurisdictions work on an electronic basis and record both the date and time of registration.

26.6 The time of registration would generally be the time of creation of a statutory pledge in respect of property owned by the provider. We deal with the issue of after-acquired property later in this chapter. We considered the issue of creation in relation to both current and after-acquired property in Chapter 23 above. That discussion is therefore of importance to the question of ranking too. In particular we concluded that a statutory pledge should be created at the time that the secured creditor obtains a real right and not back-dated to the time of registration. We recommended too that a statutory pledge should only be created when the relevant property became identifiable as encumbered property, perhaps by being identified in a schedule sent by the provider to the secured creditor. If a statutory pledge were to be set-up in this way it would be important for the parties to keep careful records.¹¹

26.7 The general *prior tempore potior jure* rule would also govern the priority as between a statutory pledge and a possessory pledge. Imagine that Darcey grants a statutory pledge over her painting to Edna on 1 June. On 2 June Edna registers the security in the RSP. On 3 June Darcey agrees to pledge the painting to Frank. On 4 June Darcey delivers the painting to Frank. This means that he obtains a real right, as possessory pledge of course requires delivery.¹² But Edna’s statutory pledge ranks above the possessory pledge, because she obtained her real right on 2 June.

26.8 A ranking issue is unlikely to arise between two possessory pledges. If a debtor has already pledged equipment to Bank A by handing it over to Bank A, the debtor cannot then hand over the equipment to Bank B to give it a pledge.¹³ Where a possessory pledge is effected by constructive delivery the third party custodian, such as a warehouse, could be asked to hold the goods firstly for Bank A and then secondly for Bank B. But whether this would be effective is unclear. In view of the fact that the current law may limit pledge to actual delivery it is perhaps unsurprising that there does not appear to be authority on the question.¹⁴

⁹ Discussion Paper, para 16.55.

¹⁰ Discussion Paper, para 18.28.

¹¹ As to the risk of fraudulent ante-dating it must be remembered that the earliest point from which a statutory pledge could rank is registration. Moreover, the secured creditor could have achieved a higher ranking by describing the encumbered property in the constitutive document as “all cars present and future” rather than “all cars to be identified in schedules”. An alternative approach, which we considered, but rejected in the interests of commercial flexibility, would be to require the encumbered property to be described within the four corners of the constitutive document.

¹² See para 25.2 above.

¹³ This is another reason why possessory pledge is restrictive.

¹⁴ See para 25.2 above.

26.9 *Prior tempore potior jure* is of course a general rule. In the remainder of this chapter we make further recommendations as to which other rules this should be subject. Clearly, as a general rule, it should also be subject to any other enactment. For example, certain provisions in statutes relative to intellectual property require registration of rights in security in the relevant specialist register for there to be third party effect and thus for a statutory pledge over such property to rank.¹⁵ Another example is the ranking rules for floating charges as regards any other right in security.¹⁶

26.10 We therefore recommend:

117. In general, the priority in ranking of any two pledges, or a pledge and a right in security other than a pledge, should be determined according to their creation, the earlier created having priority over the later.

(Draft Bill, s 64(1))

Future advances

26.11 Where security can cover future obligations, the following issue arises. Suppose that Suzanna grants to Tom an all-sums standard security over her house. At a time when the property is worth £1,000,000 and the loan from Tom is £700,000, Suzanna wants to borrow £100,000 from Ulrika, with Ulrika being granted a second-ranked standard security over the same property. Since there is £300,000 free “equity” in the property, it might seem that this deal is unproblematic.¹⁷ But since the security held by Tom is an all-sums security, if Tom makes further advances to Suzanna in future, that would eat up the equity and undermine the value of Ulrika’s security.

26.12 The same issue can arise with floating charges. Thus for both these types of security there is a rule whereby in this situation the priority of an earlier ranking security right can be frozen by means of a notice served on the holder of that security right.¹⁸ In the Discussion Paper, we asked whether a similar rule would be appropriate for the new security (the statutory pledge).¹⁹ We thought also that if the legislation were to be silent, then such a rule would probably be implied, on the basis that it is part of the common law of rights in security (though the point might be open to debate).²⁰ But we noted that there is no equivalent rule in UCC–9 and the PPSAs.²¹ The question of course would not arise if the new security was incapable of securing future advances. But elsewhere in this Report we recommend, in line with the position for standard securities and floating charges, that it should be capable of doing so.²²

¹⁵ See eg the Patents Act 1977 s 3 and the Trade Marks Act 1994 s 25(3)(a).

¹⁶ Companies Act 1985 s 464.

¹⁷ Though the contract between Suzanna and Tom might, and in practice commonly does, forbid Suzanna to grant any other security over the property without Tom’s consent.

¹⁸ Conveyancing and Feudal Reform (Scotland) Act 1970 s 13; Companies Act 1985 s 464(5).

¹⁹ Discussion Paper, para 16.27.

²⁰ See in particular *National Bank of Scotland Ltd v Union Bank of Scotland Ltd* (1886) 14 R (HL) 1. (This case is sometimes cited with the defender’s name, ie Union Bank, given first.)

²¹ The PPSA rules allow “the first ranking creditor [to] erode the value of the subordinate creditor’s security interest” and the only way to ensure this does not happen is for the second secured creditor to enter into a contractual priority arrangement with the first secured party. See Gedye, Cuming and Wood, *Personal Property Securities in New Zealand* para 72.2.

²² See paras 19.18–19.22 above.

26.13 Most consultees who responded to the question agreed that there should be a “freezing” provision for the new security. Chris Dun, however, dissented, writing: “This arrangement works poorly in practice in the context of standard securities and I would suggest should be avoided. In practice, it simply leads to expense in that there is a requirement for a ranking agreement to be entered into to maintain the “all sums” priority of the first ranking security – which in practice will invariably prohibit the grant of postponed security.” We think that Mr Dun’s point has much force. We are also struck by the fact that there is no “freezing” provision in UCC–9 and the PPSAs.

26.14 On reflection, we think that if there were to be such a provision secured creditors would invariably seek to exclude it by means of a “negative pledge” clause. Such clauses are typically found in floating charges and forbid the grant of further security rights. They are to be found in the legislation on floating charges and they make that legislation more complicated.²³ But without such a rule negative pledge clauses would not be required for that purpose because an earlier created statutory pledge would always rank above a subsequent statutory pledge unless there was a ranking agreement to the contrary.²⁴ We think that the same rule should apply to possessory pledges. We accordingly recommend:

118. The priority in ranking of a pledge should be the same irrespective of whether the secured obligation is an obligation owed or is an obligation which will or may become owed.

(Draft Bill, s 64(5))

After-acquired property

26.15 The general *prior tempore potior jure* rule requires to be carefully considered in relation to property which the provider has acquired after the grant of the statutory pledge. Earlier we recommended that a statutory pledge should be created on the secured creditor obtaining a real right in the asset, which in respect of after-acquired property means that this cannot happen until the provider has become owner.²⁵ We argued that this was preferable to back-dating the priority artificially to the time of registration. For possessory pledge, the need to deliver the assets means that the security is generally restricted to property which the provider currently owns and is thus able to deliver.²⁶

26.16 As we did in the Discussion Paper, we think that it is helpful to consider policy by reference to examples.²⁷ Imagine that Horace grants a statutory pledge in favour of Isabel over his present and future pianos. It is registered in the RSP on 1 June 2020. At that time Horace has one piano. Isabel duly acquires a real right in the piano. On 1 December 2022 Horace buys a second piano from John. Clearly Isabel did not acquire a real right in that piano two years previously on registration. At that point the piano did not belong to Horace.

²³ Under the Companies Act 1985 s 464(1) and (1A) a floating charge with a negative pledge clause will rank above a subsequent fixed security. The Bankruptcy and Diligence etc. (Scotland) Act 2007 Part 2 takes a more simple approach of floating charges generally ranking above subsequent fixed securities, although it still has a “freezing provision”. See 2007 Act s 40(5).

²⁴ On ranking agreements, see para 26.35–26.39 below.

²⁵ See paras 23.22–23.27 above. The property would also require to be identifiable as encumbered property.

²⁶ But cf para 25.3 above where we recommend that if the property is not the provider’s at the time of delivery, but subsequently becomes the provider’s the pledge would be created at that point. We doubt that this situation would be usual.

²⁷ Discussion Paper, paras 16.50–16.55.

Indeed it might not yet even have been manufactured. Isabel can only acquire her real right on Horace becoming owner.

26.17 This rule also has the following consequence. Imagine that John had granted a statutory pledge over his piano in favour of Quentin, which was registered in the RSP on 1 June 2021. When John subsequently transferred the piano to Horace on 1 December 2022, he did so without Quentin's permission. Therefore Quentin's statutory pledge subsists.²⁸ To say that Isabel's statutory pledge would rank above Quentin's security because it was registered a year earlier (on 1 June 2020) would be wrong. The piano was encumbered by Quentin's security before it ever entered into Horace's patrimony.

26.18 Let us develop the example further. As well as granting the statutory pledge in favour of Isabel registered on 1 June 2020, he grants a similar statutory pledge over his present and future pianos in favour of Jacqueline. This statutory pledge is registered on 1 May 2021. On 1 December 2022 Horace buys the second piano. Both Isabel and Jacqueline would acquire their real right in security at the same moment. In the Discussion Paper, we said that in such a situation Isabel's security right would nevertheless rank first and that this was a "twist" in the law of ranking.²⁹

26.19 We noted that under UCC–9 and the PPSAs, as well as the DCFR, a security right is deemed to be perfected at the time of registration, even although in respect of after-acquired assets the right cannot be created until the asset is acquired.³⁰ We criticised this on the basis that it is undesirable for a juridical act to have retroactive effect. For after-acquired assets, the real right should be obtained on acquisition of the property by the provider.³¹ We consider nevertheless that the "twist" mentioned in the previous paragraph should be provided for in the new legislation to make it clear that in the situation described Isabel's statutory pledge would rank first. In other words, ranking would be by date and time of registration.³²

26.20 We therefore recommend:

119. Where a provider grants two or more statutory pledges over property which, as at the time the pledges are granted, is not the provider's, the priority in ranking of any two of the pledges should be determined according to the dates on which they are registered, the earlier having priority over the later.

(Draft Bill, s 64(2) & (3))

²⁸ Assuming that it was not a low-value piano and the good faith acquisition rule which we recommended in Chapter 24 did not apply.

²⁹ Discussion Paper, para 16.53.

³⁰ Discussion Paper, para 16.52. See eg DCFR IX.–3:305(2) and 4:101(2)(a).

³¹ Subject to an exception in respect of property acquired after the commencement of insolvency. See paras 23.28–23.32 above.

³² Normally, this would mean the date and time of registration of the constitutive document, but if the pledge over the particular property was only granted by means of an amendment document it would be the date and time of its registration which would matter.

Ranking with floating charges

26.21 The ranking of floating charges is regulated by section 464 of the Companies Act 1985.³³ We consider that a statutory pledge created before a floating charge has attached should rank above the floating charge. This is in line with the existing rule found in section 464(4)(a): “a fixed security, the right to which has been constituted as a real right before a floating charge has attached to all or any part of the property of the company, has priority of ranking over the floating charge”. A statutory pledge would be created in particular assets when the secured creditor obtains a real right in these. Thus for after-acquired assets the real right would only be obtained when the provider becomes owner³⁴ and therefore the statutory pledge holder would not be preferred to the floating charge holder as regards assets acquired post-attachment.

26.22 We think that it would be helpful to amend the 1985 Act to make it clear that the statutory pledge is to be regarded as a “fixed security” for the purposes of the ranking rules in that Act. A similar amendment should be made to the Insolvency Act 1986.

26.23 We therefore recommend:

120. The definitions of “fixed security” in section 486(1) of the Companies Act 1985 and section 70(1) of the Insolvency Act 1986 should be amended to include a statutory pledge.

(Draft Bill, s 65)

Ranking with ship mortgages

26.24 Earlier in this Report we recommend that a statutory pledge should not be competent in respect of vessels over which it is competent to grant a ship mortgage.³⁵ This is to avoid undue proliferation of security types. The situation, however, is not entirely straightforward. Ship mortgages are only possible where a ship is registered in certain parts of the UK Ship Register.³⁶ As the WS Society noted in its response to the Discussion Paper, any UK ship can in principle be registered in Part 1 of the Register and therefore be the possible subject of a ship mortgage.

26.25 Hence the following situation, although probably unlikely in practice, could occur. An unregistered ship, perhaps a yacht, could have a statutory pledge granted over it. The owner might then subsequently register the yacht in Part 1 of the UK Ship Register and grant a ship mortgage. Here the usual ranking rule that the earlier-created security should rank first would apply.³⁷

³³ The provisions are applied to limited liability partnerships by the Limited Liability Partnerships (Scotland) Regulations 2001 (SSI 2001/128) reg 3 and Sch 1; European Economic Interest Groupings by the European Economic Interest Grouping Regulations (SI 1989/638) reg 18 and Sch 4; co-operative and community benefit societies by the Co-operative and Community Benefit Societies Act 2014 s 62 and building societies by the Financial Services (Banking Reform Act) 2013 Commencement (No. 8 and Consequential Provisions) Order 2015 (SI 2015/428) art 4.

³⁴ See paras 23.22–23.27 and 26.14–26.19 above.

³⁵ See paras 21.7–21.11 above.

³⁶ See para 21.11 above.

³⁷ See para 26.4 above.

Ranking with aircraft mortgages

26.26 Elsewhere in this Report we recommend that a statutory pledge should not be competent in respect of aircraft where an aircraft mortgage or international interest under the Cape Town Convention can be granted.³⁸ In the unlikely event that a statutory pledge were granted over assets which subsequently became subject to one of those types of security,³⁹ the relevant legislation has ranking rules which regulate the matter.⁴⁰

Ranking with tacit security rights

26.27 Certain security rights arise by operation of law rather than being granted. The leading examples are lien and the landlord's hypothec. The former allows someone to retain an article until a bill is paid. For example, a repairer may assert a lien for work done.⁴¹ The landlord's hypothec allows the landlord in a commercial lease to seize the tenant's goods for rent arrears.⁴² In the Discussion Paper,⁴³ we noted that floating charges rank behind "any fixed security arising by operation of law".⁴⁴ We said also that UCC-9 and the PPSAs had provisions under which tacit securities prevail over express securities.⁴⁵

26.28 We asked consultees two separate questions. The first was whether they agreed that any new security right should be without prejudice to the landlord's hypothec. The second was whether the new moveable security should be postponed, in terms of ranking, to security rights arising by operation of law. Perhaps unsurprisingly given that the landlord's hypothec is a security arising by operation of law consultees generally took a consistent approach here. Most of those who responded were of the view that tacit securities should have prior ranking. We agree that this should be the policy for the statutory pledge. But some also called for clarification of the general law relating to the landlord's hypothec, where there is some uncertainty following statutory reform in 2007.⁴⁶ Dr Hamish Patrick favoured abolition of the hypothec. Such matters must, however, be left for the future.

26.29 It is perhaps less likely that there will be a competition between a tacit security and a possessory pledge because of the need for the secured creditor to have possession. Thus if a business has handed over equipment to a bank, the business's landlord will not be able to use its hypothec in relation to the equipment as it will not be in the leased premises.⁴⁷ But in some cases there could be a competition. For example, goods in a warehouse might be pledged to a bank by means of constructive delivery (intimation to the warehouse) but the warehouse has a lien over them in respect of its charges.⁴⁸ We consider here that the lien should have priority.

26.30 We recommend that for both possessory and statutory pledges:

³⁸ See paras 21.12 and 21.16–21.20 above.

³⁹ Perhaps engines which were adapted to become aircraft engines to which the Cape Town Convention applies.

⁴⁰ Mortgaging of Aircraft Order 1972 (SI 1972/1268) art 14; International Interests in Aircraft Equipment (Cape Town Convention) Regulations 2015 (SI 2015/912) reg 16.

⁴¹ For example, *Tyne Dock Engineering Co Ltd v Royal Bank of Scotland Ltd* 1974 SLT 57.

⁴² Bankruptcy and Diligence etc. (Scotland) Act 2007 s 208. This right in security originated in Roman law.

⁴³ Discussion Paper, para 16.58.

⁴⁴ Companies Act 1985 s 464(2).

⁴⁵ UCC § 9–333; NZ PPSA 1999 s 92.

⁴⁶ See A McAllister, "The Landlord's Hypothec: Down but is it out?" 2010 Juridical Review 65; A J M Steven and S Skea, "The landlord's hypothec: difficulties in practice" 2010 SLT (News) 120.

⁴⁷ The landlord's hypothec affects goods in the leased subjects.

⁴⁸ See eg *Laurie & Co v Denny's Tr* (1853) 15 D 404.

- 121. Where property is subject both to a pledge and to a security arising by operation of law, the security arising by operation of law should have priority over the pledge.**

(Draft Bill, s 64(4))

Interaction with diligence

26.31 The statutory pledge would interact with diligence under the general law, as do possessory pledges at the present time. Once again the general rule is *prior tempore potior jure*. We consider that the law would be made more accessible here by restating it in statute.

26.32 For example, Kirsten is a sole trader who owns equipment. On 1 June she grants a statutory pledge over it to the Lothian Bank which is immediately registered in the RSP. On 15 June, Mike, a creditor of Kirsten, attaches the equipment. The attachment would be effective but would rank after the pledge. Conversely, if Mike had attached the equipment on 31 May the pledge would be effective when it was created on 1 June but it would rank after the diligence.

26.33 Consideration needs to be given to the situation where further advances are made in relation to an obligation secured by a pledge. For example, the pledge granted by Kirsten to the Lothian Bank is for all sums owed by Kirsten to the bank. The pledge is registered. Kirsten is immediately lent £10,000 by the bank. One month later Mike attaches the equipment. Three days later the bank lends Kirsten a further £5,000. Here we consider that the bank's priority should generally be limited to the £10,000 advanced before Mike attached the equipment. If, however, the bank is contractually obliged, or has undertaken, to lend the further £5,000 prior to Mike attaching then in that event it should have priority for the entire £15,000. This rule reflects the position in relation to standard securities where a further advance is made by a first ranking security holder who has received notice of a subsequent standard security,⁴⁹ as well as the better view of the ranking of inhibiting creditors as against standard security holders making further advances.⁵⁰ Secured creditors considering making further advances can protect themselves by ascertaining whether any diligence has been carried out prior to making the advance.

26.34 We recommend:

- 122. (a) Where diligence is executed in respect of property all or any part of which is encumbered by a pledge, the pledge has priority of ranking over the diligence, except as regards further advances made after the execution of the diligence which are not required to be made by a contractual agreement entered into or undertaking given before such execution.**

⁴⁹ Conveyancing and Feudal Reform (Scotland) Act 1970 s 13.

⁵⁰ G L Gretton, *The Law of Inhibition and Adjudication* (2nd edn, 1996) 150–154.

(b) Where a pledge is created over property in respect of all or any part of which diligence has been executed, the diligence has priority in ranking over the pledge.

(Draft Bill, s 66)

Ranking agreements

26.35 We consider again in line with the general law that it should be possible for a secured creditor holding a pledge to enter into a ranking agreement⁵¹ with the holder of another pledge, or indeed another security right such as a floating charge. We think that such an agreement should be in writing for evidential reasons.

26.36 The agreement should not affect third parties who have not consented to it.⁵² Thus imagine that there are three statutory pledges over the same asset in favour of Alan, Ben and Carol. Alan's security ranks first, then Ben's and then Carol's. Alan and Carol agree that Carol should rank before Alan. Unless Ben consents to the arrangement, Ben's priority should be unaffected.⁵³

26.37 On the other hand we think that a ranking agreement should bind the successors of the original parties. Where Alan has entered into a ranking agreement with Carol whereby Alan's statutory pledge ranks behind Carol's, Alan should not be able to defeat that by assigning his statutory pledge to David. Here David should also be bound by the agreement unless Carol agrees otherwise.

26.38 On the basis that ranking agreements should be personal to the parties and their successors we consider that ranking agreements in respect of statutory pledges should not be registrable in the RSP.⁵⁴

26.39 We recommend:

123. (a) The secured creditor and the holder of another pledge or other right in security should be able to set out in writing an agreement as to ranking.

(b) Such an agreement should have effect only as between the parties to the agreement and their successors and should not be registrable.

(Draft Bill, s 64(6) & (7))

⁵¹ Sometimes known as a "subordination agreement".

⁵² In England, see *Re Woodroffe's (Musical Instruments) Ltd* [1986] Ch 366. But cf *Re Portbase Clothing Ltd* [1993] Ch 388. For discussion, see Gullifer (ed), *Goode and Gullifer on Legal Problems of Credit and Security* para 5.62.

⁵³ In practice this may mean Alan continuing to enforce as Alan ranks above Ben. Alan would then pay over Alan's share (or other agreed amount) to Carol.

⁵⁴ Under the Companies Act 2006 s 859O(1)(b) it is possible but not mandatory to register a ranking agreement affecting a charge (security right) granted by a company, in the Companies Register. This only became possible in 2013 and it has been doubted whether the power to register will be exercised frequently. See Calnan, *Taking Security* paras 6.113–6.114.

Chapter 27 Enforcement of pledge (1)

Introduction

27.1 Where the debtor defaults on the secured obligation, the secured creditor will normally wish to recover what is due to it by enforcing the security right. This is the reason for taking the security right in the first place.¹ The secured creditor is able to proceed against the encumbered property rather than simply having to rely on its rights under the debt contract. Such contractual rights are of little avail if the debtor has become insolvent or indeed has disappeared without leaving a forwarding address.

27.2 In the Discussion Paper we expressed the view that, so far as possible, enforcement of the new security right should be swift and inexpensive.² The longer it takes to enforce a security right and the more expensive that process is, the less effectively the security right works.³ Debtors themselves consequently suffer because delays in enforcement tend to result in more accumulated interest and the expenses of the process will usually fall on the debtor too.

27.3 Nevertheless, there need to be appropriate rules protecting debtors. The enforcement of the security right will mean that assets of the debtor⁴ will be used to recover the secured debt. Protection is particularly required in a consumer context. But it should also be remembered that we have already recommended safeguards by limiting the extent to which the security can be granted over non-business assets.⁵ In addition the protections in the Consumer Credit Act 1974, in relation to any grant of a security right by a consumer, would also apply.⁶ We say more about these later.⁷

27.4 We discussed enforcement only briefly in the Discussion Paper on the basis that for the most part enforcement involves issues of technique rather than questions of fundamental policy. We noted that there were several models for enforcement that could be consulted. These include UCC–9, the PPSAs, the DCFR, the EBRD Model Law and the Murray Report,⁸ as well as existing schemes in Scotland, such as the rules for enforcing standard securities contained in the Conveyancing and Feudal Reform (Scotland) Act 1970.⁹ We have drawn on these in the preparation of this Report. We have found the DCFR particularly helpful.

¹ See para 1.3 above.

² Discussion Paper, para 16.63. Thus for example one of the key objectives of the UNCITRAL Legislative Guide on Secured Transactions is “to facilitate efficient enforcement of a secured creditor’s rights”. See https://www.uncitral.org/pdf/english/texts/security-lg/e/09-82670_Ebook-Guide_09-04-10English.pdf at p 21.

³ See eg Calnan, *Taking Security* para 1.29.

⁴ Assuming, as is usually the case, that the debtor and the provider are the same person.

⁵ See paras 19.36–19.55 above.

⁶ See in particular Consumer Credit Act 1974 Parts 7, 8 and 9. See W C H Ervine, *Consumer Law in Scotland* (5th edn, 2015) paras 8-134 to 8-153.

⁷ See paras 27.14–27.26.

⁸ And now too the UNCITRAL Model Law on Secured Transactions of 2016.

⁹ Although, in relation to the 1970 Act, we were aware of the deficiencies in the current rules and the fact that this area will be reviewed as part of our forthcoming project on heritable securities. See Scottish Law Commission, Ninth Programme of Law Reform (Scot Law Com No 242, 2015) para 2.17.

27.5 In this chapter and the next one we set out the enforcement rules which we think should apply to pledges under the new statutory scheme. This chapter considers the circumstances in which a pledge can be enforced, when a court order should be required and, in the case of the statutory pledge, how possession of the encumbered property can be obtained. Chapter 28 focusses principally on realisation of the encumbered property and distribution of the proceeds.

Consultation: general

27.6 In the Discussion Paper we asked two broad questions on enforcement of the new security right (the statutory pledge). The first asked consultees for their views in general terms, but this question was located in the chapter on reform of security over corporeal moveable property.¹⁰ The other question asked for views on enforcement in so far as the collateral consisted of personal rights.¹¹ But as discussed in Chapter 22 above we recommend at least initially that these should not be the subject of a statutory pledge.

27.7 Generally, the questions unsurprisingly drew broad responses from consultees. Dr Ross Anderson agreed “that enforcement should be as easy as possible”. ABFA argued that enforcement procedures “should be kept simple”. Aberdeen Law School said that: “it seems desirable that recourse to the courts is not necessary in all instances”. ICAS/R3 commented that “[t]he methodology of enforcement has to be given careful consideration”. We agree.

27.8 In Chapter 25 we considered the questions in the Discussion Paper on the enforcement of possessory pledges.¹² We say more about this below.

Consultation: statutory pledges and receivership

27.9 The Discussion Paper also considered the specific issue of whether the statutory pledge should be enforceable (if so desired by the creditor) by a form of receivership.¹³ This type of enforcement mechanism for security rights is recognised under English law but has also been made available in Scotland for enforcement of floating charges.¹⁴ In England and Wales the type of receiver appointed by a floating charge holder under the Insolvency Act 1986 is known as an “administrative receiver”.¹⁵ In addition there are so-called “LPA receivers” who can be appointed under mortgages or charges to receive the income from the encumbered property (typically rents).¹⁶

27.10 We expressed doubt about statutory pledges being enforceable by receivership. We noted that if the debtor became insolvent, the security right would be enforceable through liquidation or administration or alternatively, sequestration because the general law of insolvency gives security rights their due ranking. Outwith insolvency, a creditor could appoint an agent to act, a matter to which we return below.¹⁷ We noted also that

¹⁰ Discussion Paper, para 16.71.

¹¹ Discussion Paper, para 18.32.

¹² See paras 25.18–25.22 above.

¹³ Discussion Paper, para 16.70.

¹⁴ Originally by the Companies (Floating Charges and Receivership) (Scotland) Act 1972. See now the Insolvency Act 1986 ss 50–71. See generally J H Greene and I M Fletcher, *The Law and Practice of Receivership in Scotland* (3rd edn, by I M Fletcher and R Roxburgh, 2005).

¹⁵ Insolvency Act 1986 s 29(2).

¹⁶ The “LPA” comes from the authorising statute: Law of Property Act 1925 s 101.

¹⁷ See paras 27.29–27.31 below.

receivership is a problematic concept, under which the receiver is nominally the debtor's agent, when in substance he or she is really acting for the creditor.¹⁸ And when a receiver is appointed by a floating charge holder, the receivership goes beyond a mere mechanism for enforcing security. There is, for example, the power to hire and dismiss employees.¹⁹ Receivership is therefore to some extent a concept of insolvency law. The Enterprise Act 2002 now greatly limits the extent to which it is available for enforcement of floating charges.²⁰

27.11 Consultees who commented on the issue generally agreed that receivership should not be used to enforce the statutory pledge. This was the unqualified view of the Judges of the Court of Session. Brodies noted that the security would potentially be over a more limited class of assets than the floating charge and that Scotland has not, to date, followed the English position of allowing receivers to enforce fixed securities. They therefore agreed that the extension of enforcement through receivership should not be followed. Instead they suggested "a direct power of sale and additional or ancillary powers of enforcement" to be held by the holder of the statutory pledge. The Law Society of Scotland agreed. Scott Wortley stated: "Receivership is to me an unsophisticated tool which targets the management of the business and has knock on consequences for third party creditors as actions are carried out for the benefit of one creditor. The powers of the receiver are substantial. I think they extend beyond what is required in this case."

27.12 We therefore recommend:

124. The statutory pledge should not be enforceable by receivership.

A unitary approach to the enforcement of possessory pledges and statutory pledges

27.13 In Chapter 25 above we recommended that (a) possessory pledges not regulated by the Consumer Credit Act 1974, and (b) statutory pledges, should in principle have the same enforcement regime. This was because a possessory pledge and the new statutory pledge both serve the same purpose of enabling satisfaction of a debt to be made from assets. They simply differ in how they satisfy the publicity principle: the possessory pledge by delivery and the statutory pledge by registration. There require to be some minor differences in relation to enforcement. In particular for statutory pledges there needs to be a mechanism to take direct possession of the property. A unitary scheme for enforcement of security rights over moveable property is a feature of legislation in other countries, notably under UCC-9 and the PPSAs.

Consumer Credit Act 1974

Introduction

27.14 The Consumer Credit Act 1974 is one of the more complex pieces of legislation currently on the statute book. As we noted in Chapter 1, legislative competence to amend it

¹⁸ See Beale, Bridge, Gullifer and Lomnicka, *The Law of Security and Title-Based Financing* para 18.61.

¹⁹ Insolvency Act 1986 Sch 2 para 11.

²⁰ It amended the Insolvency Act 1986 inserting new sections 72A–72H.

is reserved to the UK Parliament.²¹ This means that our draft Bill, which is intended for implementation by the Scottish Parliament, requires to work within the terms of the 1974 Act.

General application

27.15 The provisions in the 1974 Act which regulate security rights granted by “consumers” within the meaning of the Act would automatically apply to the new statutory pledge.²² The 1974 Act has provisions which apply more generally to consumer credit agreements which it regulates. In particular a default notice must be served on the debtor at least 14 days before any enforcement steps can be taken.²³

27.16 We noted in Chapter 19 above that the 1974 Act uses the term “individual” to refer to consumers. That term is defined more widely than might be expected as including:

“(a) a partnership consisting of two or three persons not all of whom are bodies corporate; and

(b) an unincorporated body of persons which does not consist entirely of bodies corporate and is not a partnership.”²⁴

But certain credit agreements made with individuals are outwith the scope of the 1974 Act, notably loans of more than £25,000 taken out for business purposes and loans of more than £60,260 to “high net worth individuals”.²⁵

Pawn

27.17 The 1974 Act has an enforcement scheme for possessory pledges which are subject to it, in other words pawns²⁶ by individuals, small partnerships involving individuals and unincorporated bodies involving individuals. It follows that when the 1974 Act enforcement scheme is applicable our recommended scheme could not be applicable. This means that our scheme in relation to possessory pledges would be principally applicable where the provider of the statutory pledge is a company or LLP. We recommend:

125. In the scheme for the enforcement of pledges, the expression “pledge” should not include a pledge as defined in section 189(1) of the Consumer Credit Act 1974.

(Draft Bill, s 67)

Applicability of other protections

27.18 In the Discussion Paper we asked consultees if a new non-possessory security over corporeal moveable property were introduced, whether the pro-consumer protections in the Consumer Credit Act 1974 should be amended so as to extend to it (other than those

²¹ See paras 1.39–1.42 above.

²² See, for example, the Consumer Credit Act 1974 ss 105–113.

²³ Consumer Credit Act 1974 ss 87–89.

²⁴ Consumer Credit Act 1974 s 189(1). For discussion, see W C H Ervine, *Consumer Law in Scotland* (5th edn, 2015) para 8-35.

²⁵ See para 19.52 above.

²⁶ The historic inter-relationship between the words “pledge” and “pawn” is unclear but the latter seems to mean a pledge in favour of a pawnbroker or professional-pledge taker. See Steven, *Pledge and Lien* paras 2-15 to 2-16.

protections that would apply automatically).²⁷ But we did not elaborate which non-automatically applicable protections we particularly had in mind.

27.19 Consultees were generally supportive, although their answers tended to be non-specific. Dr Ross Anderson wondered if we meant amending the definition of “security” in section 189 of the 1974 Act. But the current definition seems wide enough to include the new statutory pledge.²⁸

27.20 The Law Society of Scotland and several law firm consultees all suggested that the new security right should have similar protections to hire-purchase. To put it another way, the statutory pledge should not be seen by creditors as a mechanism to evade the protections of hire-purchase law.

27.21 There is, however, a fundamental conceptual difference between hire-purchase and the statutory pledge. The former is a contract to hire goods with an option to purchase. It is necessarily restricted to acquisition finance. The latter is the grant of a security right by a person over that person’s property.²⁹ It is not limited to acquisition finance. Nevertheless, functionally the two can appear very similar.

27.22 We have considered the protections conferred on hire-purchasers in various parts of the 1974 Act. In our view, three are of particular significance.³⁰ It is worth, however, making a preliminary point. As a result of our earlier recommendation that the statutory pledge should only be available for consumer finance transactions where the property is above a certain value, the statutory pledge would be available for a narrower category of assets than hire-purchase.³¹

27.23 The first protection is that where the creditor wants to take possession of the property because the hirer is in default, a court order is required if the creditor requires to enter any premises to do so.³² We agree with this approach. Our recommendation below generally requiring a court order to enforce where the provider is an individual acting outwith the course of a business covers this situation.³³

27.24 The second protection can be referred to as the “one third” rule. Where the hirer has paid one third of the purchase price the creditor has to apply for a court order to be allowed to recover the goods.³⁴ The apparent policy here is to differentiate hirers who cannot pay and hirers who will not pay, because where a debtor has repaid less than one third of debt a court is likely to grant an enforcement order rather than allow any relief which the 1974 Act offers.³⁵ We set out below our recommendations as to the circumstances in which a court

²⁷ Discussion Paper, para 16.78.

²⁸ The definition refers to “a mortgage, charge, pledge, bond, debenture, indemnity, guarantee, bill, note or other right provided by the debtor or hirer, or at his request (express or implied), to secure the carrying out of the obligations of the debtor or hirer under the agreement” (our emphasis).

²⁹ Although this could include future property.

³⁰ These typically apply to conditional sale as well as hire-purchase.

³¹ See paras 19.36–19.51 above.

³² Consumer Credit Act 1974 s 92. Goods will almost always be within premises. An exception would be a motor vehicle on the street.

³³ See paras 27.46–27.54 below.

³⁴ Consumer Credit Act 1974 s 90.

³⁵ Law Commission, Bills of Sale (Law Com No 369, 2016) paras 7.72 and 7.77.

order should be required before enforcement can take place,³⁶ but we are not persuaded that they should be tied to cases where a certain amount of the secured debt has been repaid.

27.25 The third protection is known as the “one half” rule. Where the hirer has paid half the purchase price, he or she is entitled to return the property and have no further personal liability.³⁷ In other words, the remaining debt is cancelled. This is controversial in the case of motor vehicles because the speed at which new cars depreciate means that the finance company can suffer a loss as a result of it. Under the Consumer Credit Trade Association Code, which operates in relation to bills of sale and motor vehicles in England and Wales, the rule is a broader one. The borrower is entitled to surrender the motor vehicle to the lender and be discharged of personal liability at any time prior to repossession agents being instructed even if no repayments have been made.³⁸ The Law Commission for England and Wales has recommended that this wider rule becomes the law in relation to its proposed new “goods mortgage”.³⁹

27.26 For our part, we consider that conceptually such a rule sits more easily with the situation where the creditor has ownership of the asset. This is certainly the position for hire-purchase and bills of sale, but for the new goods mortgage the creditor would not acquire ownership.⁴⁰ With the statutory pledge the provider has ownership. We are therefore not persuaded that the “one half” rule is appropriate for statutory pledges. Moreover, it is essentially a rule about personal liability for a debt being cancelled, which is in principle outwith the scope of this Report. In some cases it may also disadvantage the provider because the asset is worth more than the remaining debt. Nevertheless, if the statutory pledge was deliberately used to defeat the operation of the “one half” rule applicable in hire-purchase the position would clearly need to be reviewed, notwithstanding the conceptual difficulties and the fact that the subject matter of the Consumer Credit Act 1974 is reserved to the UK Parliament.

Only prescribed remedies

27.27 We consider that the secured creditor should be limited to the remedies set out in statute for the enforcement of a pledge. This provides certainty, as well as protecting the provider of the statutory pledge (normally the debtor). We recommend:

126. A pledge should be enforceable in no other way than in accordance with the remedies set out in statute.

(Draft Bill, s 68(1))

³⁶ See paras 27.46–27.54 below.

³⁷ Consumer Credit Act 1974 ss 99 and 100.

³⁸ Law Com No 369, 2016 para 7.106. Bills of sale tend to be granted over older vehicles where depreciation is less of an issue.

³⁹ Law Com No 369 paras 7.108–7.112.

⁴⁰ Law Com No 369 para 4.42 recommended that “a goods mortgage should continue to take effect by transferring ownership to the lender unless the parties agree that it should take effect as a charge”. But in its *Replacing bills of sale: a new Goods Mortgages Bill, Consultation on draft clauses* (2017) Appendix 2 the Law Commission announced a change in policy and proposed that the goods mortgage should be a type of charge. The main reasons given are set out in para 2.5 of that Appendix and include the fact that transfers of ownership by way of security have mainly become obsolete.

Enforcement: when?

27.28 The circumstances in which a pledge can be enforced should be set out. We consider that there should be two.⁴¹ The first is where there is failure to perform the secured obligation. Thus if the security right secures repayment of a loan by B Ltd to a bank which is due on 1 April and B Ltd fails to pay on that date the bank should be entitled to enforce, subject to any agreement between the parties on the matter. The second is in such other circumstances as are agreed between the provider and the secured creditor. For example, the secured creditor may wish to stipulate that the security becomes enforceable immediately on the appointment of a trustee in sequestration or liquidator. We think that an agreement between the provider and secured creditor as to the relevant circumstances should require to be in writing. We recommend:

- 127. (a) A statutory pledge should be enforceable:**
- (i) where there is failure to perform the secured obligation, or**
 - (ii) in such other circumstances, if any, as are agreed between the provider and the secured creditor.**
- (b) Any such agreement should require to be set out in writing.**

(Draft Bill, s 68(2) & (3))

Enforcement: by whom?

27.29 We concluded above that it would not be appropriate for enforcement to proceed by way of receivership.⁴² Nevertheless, the secured creditor rather than acting directly may wish to appoint an agent to enforce the pledge. For example, insolvency practitioners and law firms are commonly involved in enforcement of security rights. In principle we think that it should be possible for the secured creditor to enforce through the agency of others.

27.30 A number of our consultees expressly supported this approach. One law firm⁴³ commented: "We suggest that the best solution is to confer powers on the security holder but give the security holder express statutory power to appoint agents to act on its behalf and entitled to exercise all the relevant powers etc."

27.31 Floating charges are enforced by insolvency practitioners but enforcement involves taking over the running of the company or other corporate body. In contrast a pledge (possessory or statutory) will be over a more limited class of assets, so requiring an insolvency practitioner always to act seems unnecessary. In relation, however, to taking possession of encumbered property, we consider that for protective reasons only prescribed categories of person should be able to act for the secured creditor. We discuss this below.⁴⁴ In general we recommend:

⁴¹ This follows the definition of default in the DCFR IX.-1:201(5).

⁴² See paras 27.9–27.12 above.

⁴³ Dundas & Wilson.

⁴⁴ See paras 27.64–27.81 below.

128. A statutory pledge should be enforceable by or on behalf of the secured creditor.

(Draft Bill, ss 68 and 118(4))

Duties of secured creditor

27.32 In order to protect the provider it is necessary to make the secured creditor subject to certain duties. Comparator legislation in numerous other jurisdictions places a duty on the secured creditor to act in accordance with reasonable standards of commercial practice.⁴⁵ Thus, for example, there should be no harassment of the provider, or action or non-action by the secured creditor which leads to the devaluation of the encumbered property.⁴⁶ Such a duty is sometimes imposed on the secured creditor generally, or specifically in relation to enforcement, the latter being the approach of the DCFR. There is a difference between our recommended legislation and most comparators in that our approach is less codal. Enforcement of pledges would be subject to the general law, such as the rules on catholic and secondary security rights,⁴⁷ like enforcement of existing security rights.⁴⁸ It may be that the common law would impose a duty to act in accordance with reasonable standards of commercial practice. But, as the position is not certain, we consider that there would be value in having a statutory rule in relation to enforcement. Given that so many other jurisdictions have a similar rule, indeed wider where not limited to enforcement, we are not persuaded by the submission made by R3 to our draft Bill consultation of July 2017 that this would be “a rogue’s charter to resist and challenge as invalid any enforcement on the allegation of a failure to follow an unspecified standard practice.”

27.33 We accordingly adopt the approach of the DCFR. The result would be that where a security provider or other party with an interest⁴⁹ could show that the duty was (set to be) breached usual court remedies such as interdict and damages would be available.

27.34 Some comparator legislation also places a duty on the secured creditor to act in good faith.⁵⁰ The role of good faith in Scottish private law is controversial,⁵¹ not least in relation to rights in security.⁵² We are therefore not persuaded of the case to have it as an express statutory requirement in this case.⁵³

⁴⁵ For example, Saskatchewan PPSA 1993 s 65(3); NZ PPSA 1999 s 25(1); Australian PPSA 2009 s 111; Malawi PPSA 2013 s 5(1); DCFR IX.–7:103(4) and UNCITRAL Model Law on Secured Transactions art 4.

⁴⁶ See Drobnič and Böger, *Proprietary Security in Movable Assets* 717.

⁴⁷ Gloag and Irvine, *Law of Rights in Security* 58–65. In essence the doctrine of catholic and secondary security rights is that where Creditor 1 has a security right over several assets and Creditor 2 has a lower ranking security right over some of these assets, Creditor 1 must enforce its security right in the way least prejudicial to Creditor 2.

⁴⁸ With the exception of the floating charge. See *Forth & Clyde Construction Co Ltd v Trinity Timber & Plywood Co Ltd* 1984 SLT 94.

⁴⁹ For example, the debtor (if a separate person).

⁵⁰ For example, NZ PPSA 1999 s 25(1). For discussion, see Gedye, Cuming and Wood, *Personal Property Securities in New Zealand* 116–118. Good faith is also a general principle of the DCFR. See DCFR I.–1:102(3)(b) and I.–1:103.

⁵¹ See A D M Forte (ed), *Good Faith in Contract and Property Law* (1999).

⁵² See *Smith v Bank of Scotland* 1997 SC (HL) 111 (duty of security holder to act in good faith). Rights in security here includes cautionary obligations. See G L Gretton, “Sexually Transmitted Debt” 1997 SLT (News) 195 and K G C Reid and G L Gretton, *Conveyancing 2014* (2015) 184–189. Another area of doubt is whether the so-called offside goals rule applies as between holders of rights in security. See Reid, *Property* para 697.

⁵³ See also M Raczynska, “A new model law of secured transactions: worldwide modernisation in the making?” 2014 *Journal of International Finance and Banking Law* 697 at 699–700 criticising the use of the term “good faith” in the then draft UNCITRAL Model Law on Secured Transactions.

27.35 Later we deal with the more specific duty of the secured creditor to obtain the best price (or equivalent) reasonably obtainable when realising the encumbered property.⁵⁴

27.36 We recommend:

129. In enforcing a pledge a secured creditor should have a duty to conform with reasonable standards of commercial practice. This duty should be to the provider and third parties with an interest in how the pledge is enforced.

(Draft Bill, s 68(4))

Pledge Enforcement Notice

General

27.37 In the Discussion Paper we expressed the view that the secured creditor would require to serve some form of formal notice on the provider before being allowed to enforce the new security right over moveable property.⁵⁵ Such notices are familiar in Scotland because of their use in relation to standard securities.⁵⁶ We suggested also that the notice would require to be registered.⁵⁷ On reflection we do not think that such notices should be registered. This is the general position under UCC–9, the PPSAs, the DCFR, the UNCITRAL Model Law on Secured Transactions and indeed for standard securities. While the Keeper favoured registration, it was opposed by another of our consultees, Dr Hamish Patrick.

27.38 We think that the enforcement notice should be known as a “Pledge Enforcement Notice”. But in consumer cases it would not be the only notice which would be required.

Consumers

27.39 As mentioned above,⁵⁸ the Consumer Credit Act 1974 has protections which apply to the grant of any security right by a consumer. In addition, there are requirements in the Financial Conduct Authority’s source book dealing with consumer credit (known as “CONC”).⁵⁹ These would automatically apply to statutory pledges. As noted above the enforcement of possessory pledges subject to the 1974 Act is regulated by specific provisions in that Act and therefore is outwith the scope of our enforcement provisions.⁶⁰

27.40 The approach of the 1974 Act is to regulate certain consumer credit agreements, namely those between an “individual (“the debtor”) and any other person (“the creditor”).⁶¹ Such an agreement is known as a “regulated agreement”.⁶² An “individual” includes a partnership consisting of two or three persons, not all of whom are bodies corporate; and an

⁵⁴ See para 28.5 below.

⁵⁵ Discussion Paper, para 16.66.

⁵⁶ Conveyancing and Feudal Reform (Scotland) Act 1970, ss 19–23A.

⁵⁷ Following the precedent of the EBRD Model Law art 22.

⁵⁸ See para 27.15 above.

⁵⁹ The sourcebook is available at <https://www.handbook.fca.org.uk/handbook/CONC/2/>.

⁶⁰ See para 27.17 above.

⁶¹ Consumer Credit Act 1974 s 8(1).

⁶² Consumer Credit Act 1974 s 8(3).

unincorporated association which does not entirely consist of bodies corporate.⁶³ Therefore, importantly, business loans to sole traders and small partnerships are regulated agreements.

27.41 But certain categories of agreement are exempted. Two are perhaps most relevant for present purposes. The first is business loans of more than £25,000.⁶⁴ The second is loans to “high net worth” individuals of more than £60,260.⁶⁵ Broadly speaking, individuals are of “high net worth” if they have a net income of £150,000 or more, or assets of £500,000 or more (excluding a home or pension). For this exception to apply, debtors must make a declaration to waive the usual protections and obtain a statement from an accountant giving details of their income or assets.

27.42 In respect of a regulated agreement which is not exempt, there is a requirement for a default notice to be served on the debtor⁶⁶ at least 14 days prior to taking any enforcement steps.⁶⁷ This requirement would apply to the statutory pledge, in the same way as it applies to other security.⁶⁸ This means that for such statutory pledges there is a delay prior to enforcement in the interests of debtor protection. In other cases, enforcement can proceed immediately on the notice being served.

Other persons to be notified

27.43 We consider that an enforcement notice should also be served on holders of other rights in security in the encumbered property or creditors who have executed diligence against it, to let them know that enforcement is to take place. But this duty should only apply in so far as the secured creditor knows or can be reasonably be expected to know of the other right in security or the diligence. Other security rights would often be discoverable from either the RSP or Companies Register. But the fact that someone has executed diligence may be less apparent. Finally, we consider that it should also be necessary to send the notice to any persons with statutory duties in relation to the provider’s property who are prescribed for this purpose. We have in mind insolvency officials.

Forms of notice

27.44 We consider that the Scottish Ministers should have the power to prescribe different forms of Pledge Enforcement Notice for different types of provider. We expect that the notice would have more extensive wording in consumer cases, advising the provider of the statutory pledge with information about obtaining advice in relation to the notice.⁶⁹ The form for use in non-consumer cases is likely to be briefer. The secured creditor should be required to use the statutory form with only minor deviation.

27.45 We therefore recommend:

130. (a) Before taking any steps to enforce a pledge the secured creditor should require to serve a notice on:

⁶³ Consumer Credit Act 1974 s 189(1).

⁶⁴ Financial Services and Markets Act 2000 (Regulated Activities) Order 2001 (SI 2001/544) art 60C(3).

⁶⁵ Financial Services and Markets Act 2000 (Regulated Activities) Order 2001 (SI 2001/544) art 60H.

⁶⁶ In most cases the debtor and the provider of the statutory pledge would be the same person.

⁶⁷ Consumer Credit Act 1974 ss 87 and 88.

⁶⁸ For the definition of “security” see the 1974 Act s 189(1).

⁶⁹ The width of the definition of “consumer” would be a matter for the Scottish Ministers to consider. As we have noted, the 1974 Act definition is wider than that under the Consumer Rights Act 2015.

- (i) the provider,**
- (ii) the holder of any right in security over all or part of the encumbered property,**
- (iii) any creditor who has executed diligence against all or part of the encumbered property, and**
- (iv) any prescribed person who has statutory duties in relation to the provider's estate.**

(b) But the duty in cases (ii) and (iii) is to be waived if the secured creditor does not know and cannot reasonably be expected to know of the right in security or diligence.

(c) Such a notice is to be known as a "Pledge Enforcement Notice" in, or as nearly as may be in, such form as may be prescribed.

(d) The Scottish Ministers should have the power to prescribe different forms for different categories of provider.

(e) If by virtue of the Consumer Credit Act 1974, a default notice must be served on the provider, the requirements of that Act in relation to such a notice should require to be satisfied before a Pledge Enforcement Notice can be served.

(Draft Bill, s 69)

Whether court order required for enforcement

27.46 The question of whether a court order should be required to enforce a pledge is one of balance. On the one hand, requiring judicial involvement increases costs and lengthens the enforcement process. On the other hand, the involvement of the court protects the provider from a secured creditor who in fact is enforcing illegitimately.

27.47 In the case of standard securities, the position since the Home Owner and Debtor Protection (Scotland) Act 2010 came into force is that a court order is normally required for enforcement in respect of residential properties.⁷⁰ In contrast a court order is not required for non-residential properties. Further, in residential cases the court can only allow enforcement if certain pre-action requirements are complied with and it is reasonable in the circumstances of the case to do so.⁷¹

27.48 Under the Consumer Credit Act 1974 the rule, as mentioned earlier, for regulated hire-purchase and conditional sale agreements is that a court order is required to recover the goods where there has been default under the agreement, provided that the debtor has paid at least one third of the price.⁷² This rule has been carefully reviewed by the Law Commission for England and Wales as part of its Report on Bills of Sale, in which it

⁷⁰ Conveyancing and Feudal Reform (Scotland) Act 1970, ss 20(2A) and 23(4). See K G C Reid and G L Gretton, *Conveyancing 2010* (2011) 150–155.

⁷¹ Conveyancing and Feudal Reform (Scotland) Act 1970 s 24(5).

⁷² Consumer Credit Act 1974 s 90. See para 27.23 above.

recommends the replacement of bills of sale with “goods mortgages”. Its recommendation is that there should be an “opt-in procedure” under which debtors who have repaid one third of their loan could require the secured creditor to obtain court permission to enforce. If the debtor did not opt in no court authorisation would be required. The Commission concluded: “On balance, we have reached the conclusion that court oversight is beneficial, but only to those who actively engage with the process by opting in.”⁷³

27.49 For possessory pledges regulated by the 1974 Act, which are outwith our scope here, there is a statutory power of sale without the need for court involvement.⁷⁴ For other possessory pledges, as we noted in Chapter 25 above, the default position currently is that a court order is required but the parties can agree an express power of sale.

27.50 We believe that the general rule should be that court authorisation should not be required to enforce a pledge. Of course it would always be open to a provider to seek the assistance of the court, for example by seeking an interdict, if the secured creditor acts unlawfully.

27.51 For private individuals, however, we consider that a court order should be required. But we think that “individual” should be defined more narrowly than in the 1974 Act and exclude businesses. Thus a court order should not be required where the provider is a sole trader and the enforcement is against assets used wholly or mainly for the purposes of the provider’s business. Our view also is that there should not be a threshold such as less than one third of the debt having been paid where no court order is required. There may be legitimate circumstances of personal hardship where little has been repaid and the provider/debtor could take advantage of their rights under the 1974 Act⁷⁵ if the matter requires to go to court. In its response to our draft Bill consultation of July 2017 the Faculty of Advocates questioned the need for a court order if this was a “mere formality”. However, in addition to the possibility of exercising rights under the 1974 Act, the need for court involvement would ensure that there was only enforcement in the case of genuine default on the secured obligation.

27.52 We have given careful consideration as to whether providers should require to “opt in” for a court order to be required. On balance, we have decided in the interests of debtor protection that it would be preferable for there to be the ability for the provider to “opt out”.⁷⁶ After the pledge becomes enforceable the provider should be able to agree in writing that court authorisation is not required.⁷⁷ In practice this rule would normally be encountered in relation to statutory pledges, as enforcement of possessory pledges by individuals will usually be regulated by the 1974 Act. Furthermore, given the restrictions which we recommended earlier in relation to the grant of statutory pledges,⁷⁸ the asset most likely to be involved is a motor vehicle.

⁷³ Law Commission, Bills of Sale (Law Com No 369, 2016) para 7.48.

⁷⁴ Consumer Credit Act 1974 s 121 and the Consumer Credit (Realisation of Pawn) Regulations 1983 (SI 1983/1568).

⁷⁵ Such as seeking a time order under s 129. This provision gives sheriffs wide powers to alter the rate and time of payments. See further W C H Irvine, *Consumer Law in Scotland* (5th edn, 2015) paras 8-151 to 8-153.

⁷⁶ This was the view of those representing consumer groups who responded to the Law Commission’s Bills of Sale consultation. See Law Com No 369 para 7.47.

⁷⁷ This is the position under the DCFR Book IX.–7:103(2).

⁷⁸ See paras 19.36–19.51 above.

27.53 There is of course a strong argument that those who fail to opt out may be very unlikely to engage with the court.⁷⁹ It would therefore be crucial that the form of Pledge Enforcement Notice prescribed for individuals should set out as clearly as possible the provider's rights. The notice might also include the possibility for consent to extra-judicial enforcement being given by returning part of the form to the creditor duly signed. This would enable enforcement to be carried out cheaply. Before prescribing the forms we would expect the Scottish Ministers to discuss drafts of these with consumer groups.

27.54 We recommend:

- 131. (a) A court order should not generally be required to enforce a pledge.**
- (b) Such an order should be required where the provider of a pledge is an individual unless:**
- (i) after the pledge becomes enforceable, the provider and the secured creditor agree in writing that it may be enforced without such an order, or**
 - (ii) the provider being a sole trader, enforcement is against property used wholly or mainly for the purposes of the provider's business.**

(Draft Bill, s 70(1))

Residential moveable property

General

27.55 Occasionally a statutory pledge might be granted over a large item of corporeal moveable property which is someone's home. The main examples would be boats and caravans. As a matter of law, it is likely that static caravans would be regarded as heritable and therefore could not be the subject of a statutory pledge.⁸⁰

Occupancy rights

27.56 The Matrimonial Homes (Family Protection) (Scotland) Act 1981 and the Civil Partnership Act 2004 provide that where the home of spouses or partners is owned solely by one of them, the other has occupancy rights in it.⁸¹ Under the 1981 Act the home is referred to as a "matrimonial home" and under the 2004 Act it is referred to as a "family home".⁸² These definitions include caravans (including those which are mobile) and houseboats.

27.57 The legislation protects the spouse or partner who does not have ownership from any "dealing" in relation to the property, including the grant of a heritable security.⁸³ Such spouses or partners are referred to as being "non-entitled". Their occupancy rights are

⁷⁹ Law Com No 369 para 7.48.

⁸⁰ Cf *Christie v Smith's Executrix* 1949 SC 572.

⁸¹ Matrimonial Homes (Family Protection) (Scotland) Act 1981 s 1; Civil Partnership Act 2004 s 135(1).

⁸² Matrimonial Homes (Family Protection) (Scotland) Act 1981 s 22; Civil Partnership Act 2004 s 101.

⁸³ Matrimonial Homes (Family Protection) (Scotland) Act 1981 s 6; Civil Partnership Act 2004 s 106.

unaffected unless they have consented to the dealing. We think that the legislation should be amended to make it clear that the definition of “dealing” includes the grant of a statutory pledge. Further, in the interests of consistency, the provisions protecting heritable creditors who have acted in good faith and have received false documentation in relation to occupancy rights, such as a forged consent, should apply. These enable the creditor to seek a court order requiring a non-entitled spouse or partner who is in occupation of the home to make any payment due by the other spouse or partner in respect of the loan.⁸⁴

27.58 We recommend:

132. (a) The definitions of “dealing” in the Matrimonial Homes (Family Protection) (Scotland) Act 1981 and the Civil Partnership Act 2004 should be amended so as to include the grant of a statutory pledge.

(b) The protections conferred by the Matrimonial Homes (Family Protection) (Scotland) Act 1981 and the Civil Partnership Act 2004 on heritable creditors who have acted in good faith should be amended so as to apply to secured creditors of statutory pledges.

(Draft Bill, s 58(1) & (7) to (12))

Special rules for enforcement

27.59 In general terms we think that the same broad policies should apply to enforcement of a statutory pledge as in the case of a standard security over someone’s home.⁸⁵ But the legislative scheme for enforcement under the standard security legislation is complex. We will be reviewing this as part of our forthcoming project on heritable securities. The likelihood of a corporeal moveable being someone’s home is small. A wealthy individual who owns a boat and falls on hard times is far more likely to sell the boat than move into it. We consider therefore that the scheme for moveable property can be less complex.⁸⁶

27.60 Our view is that a special form of Pledge Enforcement Notice should have to be served on any occupier of the encumbered property. The Scottish Ministers would have power to prescribe different forms for different occupiers. For example, a boat might be rented out to a business merely to provide storage facilities.

27.61 We consider that a court order should normally be required where the property is someone’s sole or main residence.⁸⁷ The Pledge Enforcement Notice would explain the occupier their rights in relation to this.

27.62 In our view there should be an exception to the need for a court order when, after the security becomes enforceable, the relevant parties agree in writing that such an order is not required. These parties would be (a) the person whose sole or main residence the property is; (b) the provider, if different from that person; and (c) the secured creditor.

⁸⁴ Matrimonial Homes (Family Protection) (Scotland) Act 1981 s 8; Civil Partnership Act 2004 s 108.

⁸⁵ On which, see generally G L Gretton and K G C Reid, *Conveyancing* (4th edn, 2011) para 22-35.

⁸⁶ According to the Scottish edition of *The Times*, 29 April 2017 in 2016 there were 111 houseboats with residential moorings in Scotland.

⁸⁷ Cf Conveyancing and Feudal Reform (Scotland) Act 1970 s 20A(2A)(a) and 23(4)(a)(i).

27.63 The court would require to be satisfied that enforcement is reasonable in all the circumstances of the case before it could grant an order.⁸⁸ These circumstances should include those which are specified in the standard security legislation.⁸⁹ We recommend:

- 133. (a) Before taking any steps to enforce a statutory pledge the secured creditor should be required to serve a special form of Pledge Enforcement Notice on any occupier of the encumbered property or part of it.**
- (b) A court order should be required for enforcing a statutory pledge as regards encumbered property which is the sole or main residence of an individual (whether or not the individual is the provider of the security) unless:**
- (i) after the statutory pledge becomes enforceable the secured creditor, the provider and (if the individual is not the provider) the individual agree otherwise, and**
 - (ii) the agreement is a written agreement.**
- (c) The court should not grant an order unless satisfied that enforcement is reasonable in all the circumstances of the case.**
- (d) Those circumstances should include:**
- (i) the nature of, and reason for, the default by virtue of which authority to enforce is sought,**
 - (ii) whether the person in default has the ability to remedy the default within a reasonable time,**
 - (iii) whether the secured creditor has done anything to remedy the default,**
 - (iv) whether it is, or was, appropriate for the person in default to take part in a debt payment programme approved under Part 1 of the Debt Arrangement and Attachment (Scotland) Act 2002, whether the person in default is taking part, or has taken part, in such a programme, and**
 - (v) whether reasonable alternative accommodation is available for (or can be expected to be available for) the individual whose sole or main residence is the property.**

(Draft Bill, ss 69(1)(e) and 70(2), (4) & (5))

⁸⁸ Cf Conveyancing and Feudal Reform (Scotland) Act 1970 s 24(5)(b).

⁸⁹ Conveyancing and Feudal Reform (Scotland) Act 1970 s 24(7).

Protection of secured creditor in relation to occupancy rights of spouse or partner

27.64 We have thus far considered the Matrimonial Homes (Family Protection) (Scotland) Act 1981 and the Civil Partnership Act 2004 in the context of statutory pledges being granted over caravans and houseboats etc.⁹⁰ Here we discuss an issue in relation to where a statutory pledge has been granted over an item of moveable property within a matrimonial or family home.

27.65 The 1981 and 2004 Acts enable a spouse or partner with occupancy rights (the “non-entitled spouse or partner”) in such a home to apply to the court for an order granting them possession or use of any furniture and plenishings within the home. But such an order is not to prejudice any third party in relation to the non-performance of any obligation under a hire-purchase or conditional sale agreement in relation to that property.⁹¹ This is subject to another provision enabling the spouse or partner with occupancy rights to perform obligations due by the other spouse or partner (“entitled spouse or partner”).⁹² The policy is to enable creditors to enforce their rights under hire-purchase and conditional sales contracts. We consider that the same protection should apply to a secured creditor who has taken a statutory pledge over such furniture or plenishings. In practice, however, because of the value threshold which we recommend elsewhere for providers of statutory pledges who are individuals we do not expect that the provision would be frequently engaged.⁹³

27.66 It might also be asked whether non-entitled spouses and partners should not be prejudiced by the grant of a statutory pledge over furniture or plenishings unless they have consented to it. But the 1981 and 2004 legislation offers protections from dealings with the *home* without consent rather than with the *contents*. Thus under the current law the entitled spouse or partner could pawn an item of furniture without the consent of the non-entitled spouse or partner and the pawn would be effective against them.

27.67 We recommend:

- 134. The protections conferred by the Matrimonial Homes (Family Protection) (Scotland) Act 1981 and the Civil Partnership Act 2004 in relation to creditors under hire-purchase and conditional sale agreements in relation to furniture and plenishings should be extended to include secured creditors of statutory pledges.**

(Draft Bill, s 58(1) to (6))

Secured creditor’s right to take possession of or immobilise corporeal property

General

27.68 For a possessory pledge, as the name indicates, the secured creditor does not need to seize the property in order to realise it. Possession is already held. But for a statutory pledge it would be the provider who would normally be in possession. There requires to be a mechanism by which the secured provider can take hold of the asset. Here debtor

⁹⁰ See paras 27.55–27.58 above.

⁹¹ Matrimonial Homes (Family Protection) (Scotland) Act 1981 s 3(2); Civil Partnership Act 2004 s 103(2).

⁹² 1981 Act s 2; 2004 Act s 102.

⁹³ See paras 19.36–19.51 above.

protection is important. The circumstances under which possession can be taken require to be carefully regulated.

27.69 The general rule should be that once the secured creditor in a statutory pledge has served a Pledge Enforcement Notice there should be an entitlement to take possession of the encumbered property. For some assets such as boats or machinery it may be more convenient for the secured creditor to immobilise the property or take other reasonable steps to ensure that it is not disposed of or used in an unauthorised way.

27.70 We think that the secured creditor should be able personally (or through agents or employees) to take possession of or immobilise the property with the consent of the provider or of any third party such as a warehouse who is holding the property. But that consent should require to be given after default, otherwise the risk is that it is written into any security agreement that the provider will give consent. Where consent is not forthcoming the secured creditor should require to obtain a court order to take action personally in relation to the property. The court may wish to set down conditions as to how possession is to be taken or immobilisation carried out.

27.71 Obtaining a court order of course takes time and costs money. We therefore consider that possession might also be taken or immobilisation carried out by an “authorised person” acting on behalf of the secured creditor. In response to our consultation question on enforcement, Dundas & Wilson stated: “We believe that it may be desirable (from a public policy perspective) that . . . agents [appointed to enforce a statutory pledge should] be required to be [insolvency practitioners] to ensure standards of behaviour – the regulation of such persons is already onerous.”

27.72 In our view the case for regulation is a strong one, in particular in a non-corporate context, where the property of individuals is being seized on default. We consider that there should be three categories of authorised person. The first is messengers-at-arms and sheriff officers. These are officers of the court and therefore under judicial supervision.⁹⁴ They are experienced in enforcing debts against assets through their work in relation to diligence (the legal process used by unsecured creditors against assets). It is already possible for them to carry out extra-judicial debt collection subject to certain conditions.⁹⁵

27.73 The second is qualified insolvency practitioners. They are experienced in enforcing floating charges and more generally dealing with the assets of distressed companies. Importantly, they are also subject to detailed regulation.⁹⁶ We would anticipate that the secured creditor is more likely to appoint an insolvency practitioner in corporate cases where the same statutory pledge encumbers a range of assets.

27.74 Thirdly, we consider that the Scottish Ministers should be able to prescribe other persons who may act as agents. This would provide the legislation with some flexibility.

27.75 In the case of a large corporeal moveable such as a boat there may be a need to remove any individual present in the property. Under the recommendations which we make

⁹⁴ See S Cowan, *Scottish Debt Recovery: A Practical Guide* (2011) para 6-03. As the name implies, sheriff officers act under the supervision of the Sheriff Court. Their equivalent in the Court of Session are messengers-at-arms. It is common for individuals to hold both offices.

⁹⁵ Debtors (Scotland) Act 1987 s 75(1)(f). See Cowan, *Scottish Debt Recovery* para 6-05.

⁹⁶ Insolvency Act 1986 ss 388–398.

above a court order would be required first if the property is someone's sole or main residence. We consider that removing individuals should only be carried out by authorised persons.

27.76 We therefore recommend:

- 135. (a) The following rules should apply in relation to corporeal property in respect of which a secured creditor in a statutory pledge has served a Pledge Enforcement Notice.**
- (b) The secured creditor should be entitled:**
- (i) to take possession of the property, or**
 - (ii) to take any reasonable steps necessary to ensure, whether or not by immobilising the property, that it is not disposed of or used in an unauthorised way.**
- (c) The secured creditor should be able to take such possession, or such steps:**
- (i) personally if authorised to do so by the court but otherwise only with the consent of the provider given after default, and of any third party who is in direct possession of, or has custody of, the property, or**
 - (ii) through the agency of an authorised person.**
- (d) The secured creditor should be entitled, in taking possession of the encumbered property to remove any individual from it, but only through the agency of an authorised person.**
- (e) An "authorised person" should mean:**
- (i) a messenger-at-arms or sheriff officer,**
 - (ii) a person qualified to act as an insolvency practitioner, or**
 - (iii) such other person as the Scottish Ministers may by regulations specify.**

(Draft Bill, s 71(1) to (4) and (8) to (9))

Encumbered property in the possession of higher or equal ranking creditors

27.77 It is possible that the encumbered property may be in the possession of another secured creditor or a creditor who has carried out diligence against it. Thus for example, Carol, who is enforcing a statutory pledge over an asset owned by Andrew, may find that it is in the possession of Ben, the holder of a higher ranking statutory pledge who is also in the process of enforcing his security right.

27.78 Where the other creditor has a higher or equal ranking we consider in principle that it should not be possible for possession to be recovered from that other creditor.⁹⁷ This is because that creditor has a higher or equal entitlement to the property and should be entitled to realise the asset. It should of course be possible for possession to be taken with the consent of the other creditor. Alternatively, there should be a right to take possession of the property or immobilise it with the authorisation of the court (personally if the court authorises this or by means of an authorised person). Thus, depending on the precise circumstances, the court may be willing to authorise the taking of possession if the other creditor is unreasonably delaying in realising the property.

27.79 We recommend:

136. (a) The secured creditor should not have an entitlement to take possession of the encumbered property or to take the steps set out in the previous recommendation if the property is in the possession of a person:

- (i) who has a right in security over the property, or over any part of the property, being a right in security which has priority over, or ranks equally with, the pledge to which the Pledge Enforcement Notice relates, or**
- (ii) who has executed diligence against the property, or against any part of the property, and by virtue of that diligence has priority in ranking over, or ranks equally with, that pledge.**

(b) But in these circumstances the secured creditor may take possession or take these steps:

- (i) with the consent of the person who has the right in security over the property, or has executed diligence against it,**
- (ii) if authorised by the court, through the agency of an authorised person, or**
- (iii) personally, if authorised to do so by the court.**

(Draft Bill, s 71(6) & (7))

Secured creditor's right to take possession of certificate of financial instrument

27.80 The secured creditor may also need to obtain possession of financial instrument certificates. Similar rules should apply as for corporeal property, although clearly there is no need for powers of immobilisation. Possession should be able to be taken with consent, or through the agency of an authorised person, or personally where the court authorises this. There should be equivalent restrictions as for corporeal property where the instrument is in

⁹⁷ See the draft Floating Charges and Moveables Securities (Scotland) Bill, cl 17(1)(a).

the possession of a higher or equal ranking creditor. In practice, however, we understand that diligence against financial instruments is unusual.

27.81 We recommend:

137. The taking of possession of financial instrument certificates by the secured creditor should be subject to similar rules as the taking of possession of corporeal property.

(Draft Bill, s 72)

Chapter 28 Enforcement of pledge (2)

Introduction

28.1 This chapter considers further issues in relation to enforcement of pledges, in particular realisation of the encumbered property. We set out the remedies which we recommend should be available, namely sale, lease, licensing (in the case of intellectual property) and appropriation. Finally, we look at the secured creditor's liability for breach of duty in relation to enforcement.

Secured creditor's entitlement to sell

28.2 The standard method of realising encumbered assets is to sell them. Clearly an enforcing creditor should have the right to do this. Of course, as discussed in the previous chapter, first the enforcing creditor would require to have served a Pledge Enforcement Notice and, where applicable, obtained a court order authorising enforcement.

28.3 The sale could be by private agreement or by public auction. Requiring a court to supervise the sale would in our view unnecessarily increase costs. Under the standard security legislation there is a requirement to advertise before the sale.¹ We understand from our advisory group that because of this rule where land held by a company is subject to both a floating charge and a standard security, sale is effected under the floating charges legislation because it does not have a requirement for advertisement. This reduces time and costs, which ultimately would be borne by the provider. We note that legislation in other jurisdictions and the DCFR and UNCITRAL Model Law on Secured Transactions do not impose a specific duty to advertise.² We are not convinced that advertisement should be an express requirement for pledges under the new scheme, because the provider can be protected in other ways.

28.4 First, we recommended earlier that the secured creditor must conform with reasonable standards of commercial practice.³ This general duty would apply to how sale is effected.

28.5 Secondly, in common with the standard security legislation and comparator legislation on security over moveable property, the secured creditor in selling the property would require to take all reasonable steps to ensure that the price obtained is the best reasonably obtainable.⁴ This is a general rule of rights in security law and is required to protect providers. Imagine that David has granted a statutory pledge over a painting worth £100,000 in favour of Eric for a loan of £60,000. If Eric requires to enforce, his personal interest is only in obtaining the £60,000 owed to him. But it would not be fair to David for the painting to be sold for that amount when it is worth £100,000. He is entitled to receive the

¹ Conveyancing and Feudal Reform (Scotland) Act 1970 s 25.

² NZ PPSA 1999 ss 109 and 110; Australian PPSA 2009 s 128; DCFR IX.–7:211 (although private sale is only permitted by agreement with the provider); and UNCITRAL Model Law on Secured Transactions art 78.

³ See paras 27.32–27.36 above.

⁴ Conveyancing and Feudal Reform (Scotland) Act 1970 s 25; NZ PPSA 1999 s 110; Australian PPSA 2009 s 131. DCFR IX.–7:212 appears to have a slightly lower standard of a “commercially reasonable price”.

£40,000 of remaining value in the painting. Depending on the circumstances it may well be necessary for the secured creditor to advertise to fulfil the duty to obtain the best price reasonably obtainable.⁵ In other cases, where the asset has a clear market value (such as certain financial instruments) advertising may not be necessary.

28.6 It may be that the secured creditor wishes to buy the encumbered property or some of it. We think that this should be possible but only in restricted circumstances to ensure that proper value is achieved. We recommend a rule based on the Saskatchewan PPSA⁶ under which the secured creditor can only buy the property if the sale is by public auction and the price bears a reasonable relationship to market value.⁷ Alternatively, where the property is tradeable on a public market such as the Stock Exchange and its market value is verifiable the secured creditor should be able to purchase it at that value.

28.7 Once the sale has taken place the secured creditor should require to hold the proceeds in trust until these are applied towards the obligations secured on the property (whether by that statutory pledge or other security rights) and any surplus returned to the provider. This means that the proceeds would be protected if the secured creditor becomes insolvent as the proceeds would be outwith the secured creditor's ordinary patrimony.

28.8 We recommend:

138. (a) Where a pledge is being enforced, the secured creditor should be entitled to sell all or any of the encumbered property.

(b) The secured creditor, in selling the property, should require to take all reasonable steps to ensure that the price obtained is the best reasonably obtainable.

(c) The secured creditor should be entitled to purchase all or any of the property only if the sale is by public auction and if the price bears a reasonable relationship to market value.

(d) If the property is tradeable in a public market in which the current market value is verifiable the secured creditor should be entitled to purchase all or any of the property only in that market and for market value.

(e) Any proceeds derived from the sale should require to be held in trust until applied by the secured creditor.

(Draft Bill, s 73)

Effect of sale

28.9 Although the provider is not a party to the sale, the secured creditor requires to be enabled by the law to transfer the provider's title to the property to the purchaser. And the purchaser should acquire the property unencumbered by the pledge.

⁵ See Gedye, Cuming and Wood, *Personal Property Securities in New Zealand* 398–399.

⁶ Saskatchewan PPSA 1993 s 59(13).

⁷ A public auction will not necessarily achieve market value, for example, if few bidders attend.

28.10 It is a general principle of rights in security law that the purchaser also takes the property free of any lower ranking security rights or diligence.⁸ The lower ranking creditors are in principle compensated in respect of the loss of their rights by receiving a share of the proceeds of the sale. But that of course is only if there are sufficient proceeds. The lower-ranking secured creditors will, however, be aware of this risk when they take their security rights and have the opportunity to lower their exposure by charging higher interest on the debt.⁹

28.11 The position as regards equal ranking rights or diligence appears to be less clear internationally, but in line with the position for standard securities we consider that the purchaser should also take free of these.¹⁰

28.12 In contrast the purchaser would take the property subject to the rights of higher ranking creditors. The existence of such rights, however, may make sale of the property difficult as purchasers will naturally want to acquire unencumbered ownership. Therefore, following the approach of the DCFR,¹¹ we think that it should be possible for agreement to be made with the higher ranking creditor, the effect of which would be that it would receive its share of the proceeds according to its ranking and the purchaser would therefore take the property free of the pledge.

28.13 We recommend:

139. Where the secured creditor sells encumbered property on enforcement the purchaser should acquire the property unencumbered by:

- (a) the pledge,**
- (b) any right in security or any diligence ranking equally with, or postponed to, the pledge, and**
- (c) any right in security or any diligence which has priority in ranking over the pledge, but only if the holder of that right in security, or as the case may be the creditor who executed that diligence, consented to the sale.**

(Draft Bill, s 74)

Secured creditor's entitlement to let

28.14 We think that the secured creditor should in principle be entitled to recover the secured debt by means of letting (leasing) the property and receiving rent payments. The Murray Report recommended such a remedy.¹² It is also available under the Belgian Pledge

⁸ Conveyancing and Feudal Reform (Scotland) Act 1970 s 26(1); NZ PPSA 1999 s 115; Australian PPSA 2009 s 133; DCFR IX.-7:213.

⁹ Drobnig and Böger, *Proprietary Security in Movable Assets* 751–752.

¹⁰ Conveyancing and Feudal Reform (Scotland) Act 1970 s 26(1).

¹¹ DCFR IX.-7:213(2).

¹² Although it referred to it as “hire”. See the draft Floating Charges and Moveable Securities (Scotland) Bill, cl 17(3)(a) appended to the Murray Report. While “hire” is the traditional term for a lease of corporeal moveables, the word “lease” is commonly used nowadays too, not least in the context of finance leases.

Act, the DCFR, the UNCITRAL Model Law and some PPSAs.¹³ The approach sometimes taken is that letting is only permissible where the parties have agreed on this. In the interests of commercial flexibility we think that the default position should be that the secured creditor can let the property, but the parties should be able to exclude this by means of written agreement.

28.15 As for sale, the secured creditor should require to take all reasonable steps to ensure that the rental income obtained is the best reasonably obtainable. Thus a houseboat which could command a rental of £1,000 a month should not be leased for £100 per month. The greater the income generated the faster the secured debt will be recovered. Again, as for sale, the secured creditor should hold the income in trust until it is applied towards the obligations secured on the property. We recommend:

- 140. (a) Where a pledge is being enforced it should be competent for the secured creditor to let all or any of the encumbered property.**
- (b) The secured creditor in letting the property should require to take all reasonable steps to ensure that the rental income obtained is the best reasonably obtainable.**
- (c) The rental income obtained should be held in trust by the secured creditor until applied towards the satisfaction of the secured obligation.**
- (d) The provider and the secured creditor should be able to agree that the right to let is excluded in respect of all or any of the encumbered property. Such an agreement should require to be set out in writing.**

(Draft Bill, s 75)

Secured creditor's entitlement to grant licence over intellectual property

28.16 In our review of comparative legislation we noted that the Australian PPSA makes specific provision for enforcement in the case of intellectual property by allowing the secured creditor to grant a licence of this.¹⁴ Other comparators such as the DCFR do not have such a provision.¹⁵ On one view a licence is merely a form of lease and we have already recommended that the secured creditor should be entitled to grant a lease.¹⁶ The view of our advisory group, however, was that the best approach was to make express provision. There is a potential legislative competence issue here because the law on intellectual property is generally reserved to the UK Parliament. But as the purpose of the provision is to enable enforcement of a security right, we take the view that a provision would be within the competence of the Scottish Parliament.¹⁷

¹³ Belgian Pledge Act of 11 July 2013 art 55 (non-consumer cases) (which provides for art 47 of the new Book III title XVII of the Civil Code); DCFR IX.-7:207(1)(b); UNCITRAL Model Law on Secured Transactions art 78; Saskatchewan PPSA 1993 s 59(3)(d); Australian PPSA 2009 s 128(2)(b).

¹⁴ Australian PPSA 2009 s 128(2)(c).

¹⁵ But compare the UNCITRAL Model Law on Secured Transactions art 78, which expressly permits licensing.

¹⁶ See paras 28.14–28.15 above.

¹⁷ See para 1.47 above.

28.17 Our view is that the provision should work broadly in the same way as that on enforcement by leasing the encumbered property. It should be open to the parties to exclude licensing as a remedy by means of written agreement. The secured creditor should only be able to grant a licence to the extent that the provider was able to grant such a right.¹⁸ Where a licence is granted the secured creditor should be required to take all reasonable steps to ensure that the rental income obtained is the best reasonably obtainable. The income should then be held in trust until applied towards satisfaction of the secured obligation.

28.18 We recommend:

- 141. (a) Where a statutory pledge over intellectual property is being enforced it should be competent for the secured creditor to grant a licence over all or any of that property (but only if and to the extent that the provider is entitled to grant such a licence).**
- (b) The secured creditor in granting a licence should require to take all reasonable steps to ensure that the rental income obtained is the best reasonably obtainable.**
- (c) The income obtained should be held in trust by the secured creditor until applied towards the satisfaction of the secured obligation.**
- (d) The provider and the secured creditor should be able to agree that the right to grant a licence is excluded in respect of all or any of the intellectual property encumbered by the statutory pledge. Such an agreement should require to be set out in writing.**

(Draft Bill, s 76)

Secured creditor's entitlement to protect and maintain etc. the encumbered property

28.19 We consider that the secured creditor should be entitled to have management powers in relation to the encumbered property. There should be the right to protect, maintain and manage the property and to take steps to preserve its value. For example, certain assets would require to be stored under particular conditions pending realisation or they may deteriorate.

28.20 In our view it would also be helpful to set out in statute a non-exhaustive list of actions that might be taken by the secured creditor, such as exercising voting rights in relation to financial instruments which are encumbered property; insuring the encumbered property; or bringing, defending or continuing legal proceedings in relation to that property. We recommend:

- 142. (a) A secured creditor who is enforcing a pledge should be entitled to take reasonable steps to protect, maintain and manage the encumbered property and to preserve its value.**
- (b) Such steps could include:**

¹⁸ For example, the provider may have already granted an exclusive licence to another party.

- (i) exercising any voting rights in relation to a financial instrument which is encumbered property,
- (ii) effecting or maintaining an insurance policy in relation to the encumbered property,
- (iii) settling any liability in relation to that property,
- (iv) bringing, defending or continuing legal proceedings in relation to that property, and
- (v) taking such other steps as the provider, whether before or after the pledge has become enforceable, has agreed may be taken by the secured creditor.

(Draft Bill, s 77)

Application of proceeds from enforcement of pledge

General

28.21 Once the secured creditor has realised the encumbered property from sale, lease or licence, the proceeds obtained require to be applied. We consider now the rules that should apply in relation to this.¹⁹

Distribution: (a) expenses

28.22 The first thing which the proceeds should be used to meet is the expenses which the secured creditor has reasonably incurred in relation to enforcement. While the standard security legislation limits recovery to “properly incurred”²⁰ expenses, the Murray Report and comparator legislation allow “reasonable”²¹ expenses. We follow that latter approach here. Clearly, “expenses” should be interpreted broadly and include costs incurred in realising the property by sale or otherwise. We think that it would be helpful to make it clear that the secured creditors’ costs in taking possession of or immobilising the property, as well as managing it prior to realisation should also be covered.

28.23 After the expenses are paid the remaining proceeds require to be distributed in accordance with the rankings of the security rights or diligence affecting the property.

Distribution: (b) other secured creditors

28.24 As noted above,²² the default position should be that higher ranking creditors are unaffected by realisation and their rights continue to encumber the property. Accordingly they do not participate in the distribution. But again, as was discussed earlier, this may make realisation – particularly sale - difficult and therefore it should be possible for the

¹⁹ Broadly equivalent rules are found in comparator legislation or instruments. See eg Conveyancing and Feudal Reform (Scotland) Act 1970 s 27; draft Floating Charges and Moveable Securities (Scotland) Bill, cl 19; Australian PPSA 2009 s 140; and DCFR IX.–7:215.

²⁰ Conveyancing and Feudal Reform (Scotland) Act 1970 s 27(1)(a).

²¹ Draft Floating Charges and Moveable Securities (Scotland) Bill cl 19(1)(a); DCFR Book IX.–7:215(5); NZ PPSA 1999 s 16(1) (definition of “future advance”) and Australian PPSA 2009 s 18(5).

²² See para 28.12 above.

higher ranking creditor to agree to the realisation. The property can then be sold unencumbered. In that case the higher ranking creditor must be paid from the proceeds in priority to the secured creditor who is actually enforcing.

28.25 Example 1. Carol is enforcing a statutory pledge over a yacht owned by Ann. There is a prior ranking statutory pledge over it in favour of Bill. Carol is owed £20,000. Bill is owed £30,000. The boat is sold for £100,000. Bill consents to the sale. Carol's expenses are £1,000 and these are paid first, leaving £99,000.

28.26 Next comes Bill's £30,000. But if there were more than one higher ranking creditor who consented to the sale then payment should be in accordance with their respective rankings. The same principle applies to lower ranking creditors and we give an example in that regard below.

28.27 Next comes the secured creditor who is enforcing the pledge. Thus, to continue the example, Carol would receive her £20,000 (leaving £49,000 to be returned to Ann as we will confirm below.²³)

28.28 There may be a secured creditor with a right in security, or a creditor who has executed diligence, which ranks equally with the pledge being enforced. This situation, however, is admittedly unlikely, except in the context of a ranking agreement. But, if it were to arise, the other creditor would be entitled to the same priority as regards the proceeds as the enforcing creditor. If there were insufficient proceeds to pay equal ranking creditors then the payments to them would abate in equal proportions.

28.29 Example 2. Kelvin and Marion have equal ranking statutory pledges over a combine harvester. Kelvin's secured debt is £30,000 and Marion's is £60,000. The ratio of the debts is therefore 1:2. After expenses are deducted, there are proceeds of £48,000 from the sale of the vehicle. Kelvin will get £16,000 and Marion £32,000. In other words, both get approximately one half of what is due to them (in the ratio 1:2 because the amount owed to Marion is double that owed to Kelvin).

28.30 Next come any lower ranking creditors. They must be paid in the order of their ranking.

28.31 Example 3. A patent owned by Henry is the subject of three statutory pledges. The first ranking is held by Ophelia who is owed £3,000. The second ranking is held by Peter, who is owed £2,000. The third ranking is held by Quentin, who is also owed £2,000. Ophelia enforces her security right and after expenses the proceeds are £6,000. Ophelia recovers her £3,000, Peter his £2,000 but Quentin only obtains £1,000 and is an unsecured creditor for the £1,000 shortfall.

Distribution: (c) residue

28.32 Finally, any residue should be returned to the provider. Thus, to complete Example 1 above, the figure which Ann receives is £49,000. If, however, the provider has become insolvent it will be paid instead to the relevant insolvency official.

²³ See para 28.32 below.

28.33 We recommend:

- 143. (a) Any proceeds arising from enforcement should be applied:**
- (i) firstly, in payment of all expenses reasonably incurred by or on behalf of the secured creditor in connection with the enforcement,**
 - (ii) secondly, in payment of the amount due under any right in security over the property from which the proceeds arose, or to a creditor who has executed diligence against that property in accordance with ranking, and**
 - (iii) thirdly, in payment to the provider of any residue.**
- (b) No payment should be made to a higher ranking creditor unless it has consented to the realisation.**
- (c) Where payment is to be made to more than one person with the same ranking but the proceeds are inadequate to enable those persons to be paid in full, their payments should abate in equal proportions.**
- (d) “Expenses” should be defined to include the costs of taking possession of, immobilising and managing the property.**

(Draft Bill, s 82(1) to (5) & (10))

Consignation

28.34 Occasionally, it may be unclear to whom payment should be made or it may not be practical to make payment because a person has disappeared. In these circumstances the secured creditor should be required to pay (consign) the money into court for the person appearing to have the best right to that payment.²⁴ If another creditor with a security right over the property cannot be traced it may not be possible to ascertain what is owed to that person and therefore consignation will not be possible. Ascertainment is easier where there is a residue owed to an absent provider.²⁵ Consignation should operate as a payment of the amount due and a certificate from the court should be sufficient evidence of that payment. The court would normally be the sheriff court.²⁶

28.35 We recommend:

- 144. (a) Where a question arises as to whom a payment should be made, the secured creditor should be required to:**
- (i) consign the amount of the payment (so far as ascertainable) in court for the person appearing to have the best right to that payment, and**

²⁴ See eg Conveyancing and Feudal Reform (Scotland) Act 1970 s 27(2) & (3).

²⁵ Cf NZ PPSA 1999 s 118.

²⁶ Unless the sum is sufficiently large that it comes within the jurisdiction of the Court of Session.

(ii) lodge in court a statement of the amount consigned.

(b) Such a consignment should operate as a payment of the amount due and a certificate of the court should be sufficient evidence of that payment.

(Draft Bill, s 82(6) to (9))

Statements

28.36 After applying the proceeds the secured creditor should have to supply relevant parties who have an interest in the matter with a statement as to how this was done.²⁷ This will enable them to check that the proceeds are applied properly. The parties who we think have an interest are (a) the provider; (b) the debtor in the secured obligation if a person other than the provider; (c) other secured creditors or parties who have executed diligence against the property; and (d) any prescribed persons with statutory duties in relation to the provider's property. For the last of these categories we have in mind insolvency officials. Where the property is sold, a single statement would suffice, but if it is leased or licensed monthly statements would seem appropriate.

28.37 We recommend:

145. (a) The secured creditor should be required, as soon as reasonably practicable, to present:

- (i) the provider,**
- (ii) the debtor in the secured obligation if a person other than the provider,**
- (iii) any other creditor affected by the enforcement, and**
- (iv) any prescribed person who has statutory duties in relation to the provider's estate**

with a written statement of how the proceeds arising from the enforcement have been applied.

(b) But where the proceeds arise from the letting or licensing of the property a monthly statement should be sufficient.

(Draft Bill, s 82(11) & (12))

Appropriation

Introduction

28.38 Imagine that Jennifer owes Keith £5,000 and grants a statutory pledge over her painting in security of the debt. The painting is worth £100,000. It would be unfair for the

²⁷ Cf NZ PPSA 1999 s 116.

painting simply to be forfeited to Keith if the debt is not paid because Keith would obtain a £95,000 windfall.²⁸ Thus while forfeiture was the default remedy for pledge in earlier times, it became replaced by sale, with any proceeds in excess of the debt being returned to the provider. Post-classical Roman law then prohibited forfeiture clauses, that is to say an agreement between the provider and the secured creditor that the property is forfeited on default.²⁹ The ban on forfeiture clauses was received into modern European countries and English law has a similar rule (equity of redemption).³⁰

28.39 Modern comparator legislation, however, does allow forfeiture but in restricted circumstances. Pre-default agreements are still prohibited.³¹ But post-default a secured creditor can *appropriate* the asset in satisfaction of the secured obligation if there is no objection from the provider and other creditors.³² Sale is seen as the primary remedy because it may well fetch more money and therefore the provider and other creditors can veto appropriation. But in some circumstances, such as financial instruments, which have an objectively verifiable market price, a sale will not achieve more and all with an interest may be content for the secured creditor to appropriate at that value.

28.40 We consider therefore that, subject to restrictions, appropriation should be a remedy that is available to the secured creditor. In framing our recommendations here we have drawn on the DCFR.

General

28.41 For a secured creditor to have power to appropriate, in common with the other methods of realisation, they must have first served a Pledge Enforcement Notice. We think that appropriation should be excluded in consumer cases³³ and thus in the case of sole traders should be confined to assets used wholly or mainly for the purposes of the provider's business.

28.42 If the amount to be obtained by the appropriation is greater than the amount secured we think that it should only be possible for the appropriation to take place if the secured creditor holds the excess amount in trust to be applied as if it were proceeds.

28.43 For corporeal property or financial instruments payable to bearer it should be necessary for the secured creditor to have possession prior to appropriating as the general law requires delivery of such assets to the transferee for transfer to take place.³⁴ For intellectual property and non-bearer financial instruments further steps may be required for the secured creditor to take ownership, such as being entered in a register such as an IP register or the register of a company's shareholders. We recommend:

146. (a) The secured creditor should be entitled to appropriate any or all of the encumbered property in total or partial satisfaction of the secured obligation.

²⁸ See also paras 25.14–25.17 and 25.20–25.21 above.

²⁹ By legislation of Constantine in AD 326. See Codex 8.34.3.

³⁰ See M Bussani, *Il problema del patto commissorio: studio di diritto comparato* (2000). The classic study in English law is R W Turner, *The Equity of Redemption* (1931).

³¹ See eg DCFR IX.–5:101(2).

³² Under the NZ PPSA 1999 s 120 and the Australian PPSA 2009 s 134 this is known as “retention”.

³³ Cf DCFR Book IX.–7:105(3).

³⁴ But the Sale of Goods Act 1979 does not.

(b) But it should not be competent to appropriate:

- (i) the property of an individual unless that person is a sole trader and the appropriation is of assets used wholly or mainly for the purposes of the person's business,**
- (ii) corporeal property, or a financial instrument payable to bearer, unless it is in the possession of the secured creditor, or**
- (iii) property the value of which exceeds the amount for the time being remaining due under the secured obligation and the costs of enforcement unless the secured creditor holds the excess amount on trust to be applied as if it were proceeds.**

(Draft Bill, s 78)

28.44 The DCFR draws a distinction between cases where (i) there is an agreement as to appropriation between the provider and the secured creditor made prior to default (which is only allowed in restricted circumstances) and (ii) there is no such agreement. We begin with the latter.³⁵

Where no pre-default agreement

28.45 The secured creditor should be required to serve notice of its intention to appropriate to parties who have an interest in the matter, namely (a) the provider; (b) the debtor in the secured obligation if a person other than the provider; (c) any person with a right in security over all or part of the property; (d) any person who has executed diligence against all or part of the property; and (e) any prescribed person who has statutory duties in relation to the provider's estate (once again we have in mind here insolvency officials). As regards (c) and (d) the duty should only apply in so far as the secured creditor knows or can reasonably be expected to know of the other right in security or diligence.

28.46 First, the notice should identify the property to be appropriated. For example, a statutory pledge may have been granted over several assets and appropriation is only to take place in respect of one of them. Secondly, it should specify the sum remaining due under the secured obligation and the amount to be obtained by the appropriation.³⁶ Thirdly, it should state that the addressee has the right to object within 14 days.

28.47 There are various reasons why an addressee would object, although in common with comparator legislation they should not require to have to set out their reasons. The addressee may, for example, consider that sale would achieve a greater amount. It may be a higher ranking creditor who wishes to preserve its priority in relation to the asset. It may not be happy about the amount which the secured creditor wishing to appropriate states is to be obtained by the appropriation. In relation to the last of these, we believe following the

³⁵ DCFR IX.-7:105 and 7:216.

³⁶ See DCFR IX.-7:216(d).

DCFR³⁷ that the appropriation should not be permitted unless the amount to be obtained by it bears a reasonable relationship to the market value of the property.

28.48 Where an addressee of the appropriation notice objects then the appropriation may not proceed. We recommend:

147. (a) Before exercising any right to appropriate property, the secured creditor should require to serve a notice on:

- (i) the provider,**
- (ii) the debtor in the secured obligation if a person other than the provider,**
- (iii) any other person with a right in security over all or part of the property,**
- (iv) any person who has executed diligence against all or part of the property, and**
- (v) any person who has statutory duties in relation to the provider's estate and is prescribed under this paragraph.**

(b) But the duty in cases (iii) and (iv) is to be waived if the secured creditor does not know and cannot reasonably be expected to know of the right in security or diligence.

(c) Any notice should require to:

- (i) identify the property to be appropriated,**
- (ii) specify:**
 - (a) the amount for the time being remaining due under the secured obligation, and**
 - (b) the amount to be obtained by the appropriation,**
- (iii) state that the recipient has a right to object within 14 days of the receipt of the notice.**

(d) The appropriation may not proceed unless the amount to be obtained by it bears a reasonable relationship to the market value of the property.

³⁷ DCFR IX.-7:216(c).

(e) If within 14 days after receiving notice a recipient, by means of a written statement made to the secured creditor, objects to the appropriation, it is not to proceed.

(Draft Bill, s 79)

Where pre-default agreement

28.49 The DCFR permits the provider and the secured creditor to enter into a pre-default agreement as to appropriation in limited circumstances. These are:

“(a) if the encumbered asset is a fungible asset that is traded on a recognised market with published prices; or

(b) if the parties agree in advance on some other method which allows a ready determination of a reasonable market price.”³⁸

28.50 The policy behind these two cases is that there is less risk of the property being appropriated below value and prejudice being caused to the provider.³⁹ An example of the first case would be publicly tradeable shares on a stock exchange. An example of a second case might, in respect of motor vehicles, be prices listed in a particular used car guide. We find the policy of the DCFR here persuasive and recommend similar rules for pledge.

28.51 The provider and the secured creditor should be entitled to enter into a pre-default agreement as to appropriation, but such an agreement would require to be in writing. Such an agreement would only be permissible in respect of two types of property.

28.52 The first type would be fungible assets traded on a specified market, being a market where the prices are published and widely available (whether on payment of a fee or otherwise). The relevant markets would be specified by regulations. A “fungible asset” would be defined as an asset of a nature to be dealt in without identifying the particular asset involved. Financial instruments will often come into this category. Patents and paintings will not.

28.53 The second type would be property in relation to which the parties in their agreement have set out a method of determining a reasonable market price.

28.54 The appropriation would require to be for the published market price or the price determined by the parties, as at the date of the appropriation. If that price exceeded the amount due under the secured obligation, the residue would require to be returned to the provider.

28.55 While the provider, having entered into the agreement, would be bound by it, other parties with an interest would not. Therefore notice of the intended appropriation would require to be given to the same parties as where there is no pre-default agreement. Where, however, the debtor and the provider are not the same person we consider that the debtor is sufficiently protected by the recommendation that a pre-default agreement can only authorise appropriation at market price. Therefore we do not think that the debtor should

³⁸ DCFR IX.–7:105.

³⁹ Drobniq and Böger, *Proprietary Security in Movable Assets* 720.

have a right of objection. But the other parties could object within 14 days of receipt of the notice. Other than a higher ranking creditor which wishes to preserve its priority, we think it unlikely that there would be objection in such circumstances. We recommend:

148. (a) The provider and the secured creditor should be able, before the pledge becomes enforceable, to agree in writing that the secured creditor is entitled to appropriate the encumbered property or part of that property.

(b) Any property to be appropriated in accordance with that agreement must be:

(i) a fungible asset that is traded on a specified market, being a market the prices on which are published and widely available (whether on payment of a fee or otherwise), or

(ii) if it is not such an asset so traded, property as regards which the provider and the secured creditor have, in the agreement, set out a method of readily determining a reasonable market price,

and be appropriated only for the value of its market price as so published or as the case may be as so determined.

(c) Notice should require to be given to the same parties as mentioned in the previous recommendation of the proposed appropriation and other than the provider (or debtor where different from the provider) they should have the right to object within 14 days of receiving the notice.

(d) “Fungible asset” should be defined as an asset of a nature to be dealt in without identifying the particular asset involved, and “specified” as specified for these purposes by the Scottish Ministers by regulations. It should be possible for the regulations to specify different markets or descriptions of market in relation to different kinds of fungible asset.

(Draft Bill, s 80)

Effect of appropriation

28.56 Where the secured creditor exercises the right to appropriate encumbered property, having had no objection from the holders of any other rights in security over the property or creditors who have executed diligence against the property, the secured creditor should acquire an unencumbered title.

28.57 We recommend:

- 149. Where the secured creditor appropriates encumbered property, the property should be acquired unencumbered by any right in security or any diligence.**

(Draft Bill, s 81)

Correcting the register

28.58 Where a statutory pledge has been extinguished as a result of being enforced we consider that the secured creditor should have to apply to the Keeper as soon as reasonably practicable to correct the statutory pledges record to remove the entry.⁴⁰ Leaving it in place could prejudice the provider by giving a false impression. Similarly, if a statutory pledge is extinguished as a result of the enforcement of another right in security over the same property, or the execution of diligence against that property, there should be the same duty. For example, A Ltd grants a statutory pledge over its equipment to the Brilliant Bank. A Ltd then grants a second ranking statutory pledge over the same equipment to the Less Brilliant Bank. A Ltd defaults on its secured obligation to the Brilliant Bank and the office equipment is sold, with all the proceeds going to that bank. There is nothing left for the lower ranking Less Brilliant Bank. But, nevertheless, its statutory pledge has been extinguished and it should require to correct the RSP to remove the relevant entry. We recommend:

- 150. Where a statutory pledge is extinguished as a result of it or another right in security over the same property being enforced, or as a result of diligence being executed against that property, the secured creditor should be required, as soon as reasonably practicable, to apply to the Keeper to correct the Register of Statutory Pledges to remove the relevant entry.**

(Draft Bill, s 83)

Liability for loss suffered by virtue of enforcement

28.59 In this chapter we have set out a series of rules in relation to how a pledge may be enforced. Where these rules are transgressed, a party who suffers a loss should be entitled to compensation from the secured creditor on the basis of breach of statutory duty.⁴¹ Some examples may assist.

28.60 Example 1. John owns a house boat. He grants a first statutory pledge over it in favour of Kirk in security of a loan. One year later he grants a second statutory pledge over it in favour of Louise in security of another loan. John defaults on the loans. After obtaining a court order, since John is a private individual, Kirk enforces by selling the house boat. He fails to obtain the price that is the best reasonably obtainable resulting in no proceeds being left for Louise and John. If he had made proper efforts there would have been a surplus which could have paid Louise's debt with some money left to return to John. Both Louise and John have a compensation claim against Kirk for their financial loss.

⁴⁰ On corrections, see Chapter 33 below. Of course there would be no need for a correction where a statutory pledge has been created without registration as a financial collateral arrangement under the FCARs. See Chapter 37 below.

⁴¹ Cf DCFR IX.-7:104; City of London Law Society draft Secured Transactions Code s 50.

28.61 Example 2. Same as example 1, but there are free proceeds to pay Louise and some money to return to John. Kirk fails to pay them. They have a compensation claim against Kirk in respect of what is due to them.

28.62 Example 3. Same as example 1, but this time Kirk fails to obtain a court order and unlawfully evicts John and members of his family who are living in the house boat. They have a compensation claim in respect of the loss suffered by them, for example, the cost of finding alternative accommodation.

28.63 We think that the entitlement to compensation should be subject to the general legal doctrines that a party making a claim has a duty to mitigate loss and that claims for losses which are not reasonably foreseeable should be disallowed.⁴² For example, in relation to mitigation, if the provider is aware that the secured creditor is about to sell the property in a manner which would not achieve the price that is the best reasonably obtainable they should seek to prevent this from happening. In contrast with other liability provisions which we recommend,⁴³ we consider that claims in respect of non-patrimonial loss (*solatium*) should *not* be excluded. In Example 3 above, John and his family may have been caused stress by the unlawful eviction.

28.64 We recommend:

151. (a) A person should be entitled to be compensated by a secured creditor for loss suffered in consequence of the secured creditor's failure to comply with the statutory obligations imposed on the secured creditor in relation to enforcement.

(b) But the secured creditor should have no liability:

(i) in so far as the loss could have been avoided by the person taking certain measures which it would have been reasonable for the person to take, and

(ii) in so far as the loss is not reasonably foreseeable.

(Draft Bill, s 85)

Service of documents

28.65 As has been seen, some parts of the enforcement procedure would involve the service of documents by the secured creditor on the provider, notably the Pledge Enforcement Notice. Section 26 of the Interpretation and Legislative Reform (Scotland) Act 2010 sets out rules on service which apply to Acts of the Scottish Parliament except where contrary provision is made.⁴⁴ In essence, service can be made (a) personally; (b) by post; and (c) electronically, subject to certain conditions.⁴⁵ Section 26 also contains a definition of

⁴² We have drawn here on the Land Registration etc. (Scotland) Act 2012 ss 94 and 106.

⁴³ See paras 11.22–11.42 above and paras 35.33–35.36 below.

⁴⁴ We refer to this provision elsewhere in this Report. See paras 5.48–5.57 above.

⁴⁵ Interpretation and Legislative Reform (Scotland) Act 2010 s 26(2).

a person's "proper address", at which service is to be made.⁴⁶ For example, in the case of a body corporate it is the address of the registered or principal office of the body.

28.66 We think that the secured creditor and provider should be able to agree that enforcement documents are to be served by only one of the specified methods, for example, electronically. In addition it should be possible for them to agree an address, other than the "proper address" as defined in section 26, as the place where service is to be made. We think that such an agreement should require to be made in writing. If, however, the agreement is made and it is impossible for service to be effected in terms of it, the agreement should be disregarded and service permitted in terms of section 26. For example, if a particular postal address is provided, but the provider is found no longer to be at that address, service can be effected at that person's "proper address".

28.67 We recommend:

- 152. (a) In respect of the application of section 26 of the Interpretation and Legislative Reform (Scotland) Act 2010 in relation to the service of enforcement notices the provider and the secured creditor should be able to agree that service is to be effected either or both at a specified address and by a specified method.**
- (b) Such an agreement should require to be in writing.**
- (c) Where there is such an agreement but service cannot be effected in accordance with it the agreement is to be disregarded.**

(Draft Bill, s 86)

⁴⁶ 2010 Act s 26(4).

Chapter 29 Register of Statutory Pledges: introduction

Introduction

29.1 In this chapter we consider the setting-up, management and nature of the new Register of Statutory Pledges (RSP). We draw here on a number of our earlier recommendations in relation to the Register of Assignations (RoA).

Establishment of the RSP

29.2 In the Discussion Paper we set out our view that registration in a new register should be (i) an optional alternative to intimation as a method of transferring claims; and (ii) the method by which statutory pledges would be created.¹ Elsewhere in this Report, following support from consultees, we have now taken forward these suggestions as recommendations.²

29.3 The Discussion Paper proposed that a new public register should be established, provisionally to be called the Register of Moveable Transactions, in which (i) assignations of personal rights and (ii) securities over moveable property (corporeal and incorporeal) could be registered. This proposal was supported by consultees.

29.4 As we explained earlier,³ when we came to work on the draft legislative provisions which would establish the new register it became apparent that the assignation and statutory pledge parts would be significantly different. We reached the view that it would be preferable to have two separate registers.

29.5 We therefore recommend:

153. A new public register should be established, to be called the Register of Statutory Pledges, in which statutory pledges can be registered.

(Draft Bill, s 87(1))

Management of the RSP

29.6 There are two main possibilities for the management of the RSP. The first is Companies House. The Murray Report proposed that the new “moveable security” which it recommended should be registrable in the Companies Register.⁴ But, as we noted in the Discussion Paper,⁵ there was a certain awkwardness with this as the security right could be granted by persons other than companies. This is true also of the statutory pledge.

¹ Discussion Paper, para 20.1.

² See paras 5.1–5.22 and 23.11–23.19 above. But registration would not be required in respect of statutory pledges over financial instruments. See Chapter 37 below.

³ See paras 6.4–6.6 above.

⁴ Murray Report, para 3.11.

⁵ Discussion Paper, para 20.2.

Furthermore, unlike the Murray Report security, it would be available to consumers (subject to certain restrictions). A further issue with using Companies House is that it reports to the Department for Business, Energy and Industrial Strategy rather than the Scottish Government. In this Report our objective is to present a set of recommendations that can for the most part be implemented using devolved powers.

29.7 The second candidate is Registers of Scotland. We have already recommended that it should be responsible for the new RoA.⁶ The RSP would be its sister register. It clearly makes sense for Registers of Scotland to be responsible for this register too. Registers of Scotland agree.

29.8 We therefore recommend:

154. The register should be under the management and control of the Keeper of the Registers of Scotland.

(Draft Bill, s 87(2))

Merger with the Register of Floating Charges

29.9 In the Discussion Paper we asked whether the new register should be merged with the Register of Floating Charges provided for by Part 2 of the Bankruptcy and Diligence etc. (Scotland) Act 2007.⁷ But, as discussed above,⁸ Part 2 has never been brought into force. This question is therefore effectively superseded.

Costs

29.10 The costs implications in relation to RSP are equivalent to those for the RoA and we refer to our earlier discussion of this subject.⁹

The RoA and RSP compared

29.11 Like the RoA, the RSP would not be a title register in relation to moveable property.¹⁰ It would only be a register of statutory pledges. The fact that Yuliya has granted a statutory pledge over her motor vehicle in favour of Zara and that this grant has been registered in the RSP would not amount to confirmation that Yuliya owns the vehicle.

29.12 That said, the RSP would be markedly different from the RoA in that the RoA would be a register of assignment documents. As discussed earlier in the Report, an assignment differs materially from a statutory pledge in that the former is a transfer whereas the latter is a right.¹¹ The RSP therefore cannot be a mere register of constitutive documents of statutory pledges. It requires to take account of other juridical acts in relation to a statutory pledge, in particular amendment, assignment, restriction and discharge. Therefore in contrast to the RoA where an entry would be for the assignment document, the entry in the RSP would be for the statutory pledge and it would be possible to amend the registration in accordance

⁶ See paras 6.8–6.10 above.

⁷ Discussion Paper, para 20.3.

⁸ See paras 18.23–18.25 above.

⁹ See para 6.11 above.

¹⁰ See para 6.12 above.

¹¹ See para 1.35 above.

with the recommendations set out in Chapter 23 above¹² or correct the entry in accordance with the recommendations set out in Chapter 33 below.

What is to be registered?

Constitutive documents

29.13 Earlier in this Report in relation to assignments we discussed at length the relevant merits of (i) notice filing and (ii) transaction filing, by means of registering the assignment/security document.¹³ We concluded in favour of the latter. The arguments are little different for the constitutive document of a statutory pledge and indeed document registration is familiar for grants of existing security rights by companies under Part 25 of the Companies Act 2006.¹⁴ Document registration was overwhelmingly supported by consultees and our advisory group.

29.14 We recommend:

- 155. Where an application is made for registration of a statutory pledge it should require to be accompanied by a copy of the constitutive document.**

(Draft Bill, s 91(2)(a)(ii))

Other documents

29.15 We discussed the various juridical acts in relation to a statutory pledge in Chapter 23 above. We concluded that in the interests of commercial flexibility and reducing costs it should be possible for these generally to be carried out without the need for registration (and thus the need for registration of the relevant document). But for amendments extending the scope of the encumbered property or secured obligation we recommended registration because of the impact on third parties.

29.16 A “registration-light” approach is the broad position under UCC–9 and the PPSAs, where there is notice filing. In contrast, registration is normally required with standard securities,¹⁵ but this is in the context of an asset-based register and land transactions being more registration-based than moveable transactions. For example, the transfer of land requires registration whereas the transfer of a corporeal moveable does not. The position as regards floating charges is patchy. The instrument itself and any amendment (“instrument of alteration”) require to be registered.¹⁶ An assignment of a floating charge cannot be registered. Instruments altering ranking may be registered.¹⁷ A restriction (“release”) or discharge (“satisfaction”) may be registered. But in these cases rather than a document only a “statement” and “particulars” must be delivered to the register.¹⁸

¹² See paras 23.33–23.56 above.

¹³ See paras 6.13–6.30 above.

¹⁴ See Chapter 36 below.

¹⁵ Conveyancing and Feudal Reform (Scotland) Act 1970 ss 14–17.

¹⁶ Companies Act 2006 s 859A(3); Companies Act 1985 s 466(4B).

¹⁷ Companies Act 2006 s 859O(2)(a).

¹⁸ Companies Act 2006 s 859L.

29.17 We have considered this matter carefully. The more documents that appear on the register the more cluttered it becomes and the more difficult to search. We have concluded, however, that amendments which add further property to the encumbered property or which increase the secured obligation should require registration of the relevant document.

29.18 If there is a requirement to register the constitutive document which describes the initial encumbered property, then it would seem to follow logically that any document adding property should also be registered. Third parties consulting the register need to be able to see the amended description of the encumbered property. While this policy could be achieved by means of registering a statement, the same could be said in relation to the original description and, as we saw above, our advisory group favoured document registration. Requiring registration of the amendment document also provides a measure of debtor protection. Of course there is always the possibility of forgery, but this is likely to be rare.

29.19 Similar arguments apply to increasing the extent of the secured obligation. An amendment which changes the secured debt from say £10,000 to all sums due and to become due makes the statutory pledge more powerful and is of material interest to prospective secured creditors. In practice, security documentation often defines the secured obligation from the outset as being all sums due or to become due. Alternatively it defines it by reference to off-register documents. As discussed earlier,¹⁹ here there would seem to be no point in having to update the entry if these documents are amended because the scope of the secured obligation cannot be directly seen from the register in any event. We therefore think that registered amendments of the secured obligation would be rare.

29.20 For the juridical acts of assignation, restriction or discharge it is worth reiterating that registration would not be necessary or indeed possible. As discussed in Chapter 23 above,²⁰ these acts would take place off-register, but the relevant entry in the register could be altered or deleted to reflect the up-to-date legal position by means of an application for correction.²¹ We do not think that the correction should be required to be accompanied by a document giving effect to the juridical act. This would clutter the register.

29.21 We recommend:

156. A copy of a document amending a registered statutory pledge to add property to the encumbered property or to increase the extent of the secured obligation should require to be registered.

(Draft Bill, s 92(2)(b))

Form and protection of the RSP

29.22 As with the RoA we think that the Keeper should keep the RSP in electronic form, although the exact detail should be a matter for her.²² In the interests of flexibility, once again, we do not formally recommend that the register must be held electronically.

¹⁹ See para 23.35 above.

²⁰ See paras 23.49–23.56 above.

²¹ See Chapter 33 below.

²² See para 6.31 above.

29.23 In line with the position for the Land Register and the RoA,²³ we consider that the Keeper should be under a duty to take such steps as appear reasonable to her to protect the RSP from interference, unlawful access or damage. We recommend:

157. (a) Subject to the requirements of statute, the register should be in such form as the Keeper thinks fit.

(b) The Keeper should take such steps as appear reasonable to her for protecting the register from interference, unauthorised access, or damage.

(Draft Bill, s 87(3) & (4))

Form of registration

29.24 For the reasons discussed above in relation to the RoA we think that registration in the RSP should be online only and automated. The application would not be checked by the Keeper.²⁴

158. Registration in the RSP should be by electronic means only and should be by means of an automated system under which applications are not checked by the Keeper.

(Draft Bill, s 119)

²³ Land Registration etc. (Scotland) Act 2012 s 1(5).

²⁴ See paras 6.33–6.45 above.

Chapter 30 Register of Statutory Pledges: structure, content and applications for registration

Introduction

30.1 In this chapter we consider the structure of the RSP, the data and documents which should be registered and the application process for registration.

Structure of the RSP

30.2 The main part of the RSP would be the statutory pledges record. As for the Land Register and the RoA,¹ we consider that there should also be an archive record, in which archived material is kept by the Keeper. The archive record in the RSP would have a more significant role than its counterpart in the RoA, because it would be the home for discharged statutory pledges where the RSP is corrected to reflect the discharge. We consider archiving further later,² but for the moment we recommend:

159. The Keeper should make up and maintain, as parts of the Register of Statutory Pledges:

- (a) the statutory pledges record, and**
- (b) the archive record.**

(Draft Bill, s 88)

Information appearing in the RSP: general

30.3 As for the RoA, we think that an entry in the register should contain key data, such as the details of the provider and secured creditor, rather than merely hold the constitutive document of the statutory pledge.³ Our draft Bill makes provision for the information that is to appear in an entry. It also confers power on the Scottish Ministers to make rules (known as RSP Rules)⁴ providing for more detailed requirements.

Statutory pledges record

30.4 We think that the statutory pledges record should contain similar data to that in the assignments record in the RoA.⁵ Of course rather than the details of the assignor and assignee there would be details of the provider and the secured creditor. And rather than a copy of the assignment document there would be a copy of the constitutive document of the

¹ Land Registration etc. (Scotland) Act 2012 s 14. On the RoA see para 7.2 above.

² See paras 35.30–35.32 below.

³ See para 7.3 above.

⁴ See paras 35.37–35.38 below.

⁵ See paras 7.3–7.27 above.

statutory pledge. There would also be a copy of any amendment document adding property to the encumbered property or increasing the extent of the secured obligation.

30.5 In the Discussion Paper, we expressed the view that the secured obligation should be stated in the entry.⁶ But this is typically not a requirement under UCC–9 and the PPSAs. Nor is it a requirement under the post-1 April 2013 version of Part 25 of the Companies Act 2006.⁷ The DCFR Book IX allows for the maximum amount of the security to be registered.⁸ The UNCITRAL Model Law on Secured Transactions gives countries the option of requiring registration of a statement of the maximum amount for which the security right may be registered.⁹ In line with these comparators, we have now concluded that the secured obligation should not be required data in the entry. Our thinking is as follows. It would be possible to see the secured obligation in the constitutive document which would appear in the entry. We expect that this would often be for all sums due and to become due. It should also be possible to enquire as to the up-to-date position as regards the secured obligation by means of a request for information.¹⁰ Further, the secured obligation is not data which would be suitable as the subject of a search. Any search against “all sums due and to become due” would produce thousands of results.

30.6 The encumbered property would have to be described in the way which any rules required. Similar possibilities arise as for the description of claims described above.¹¹ As we mentioned, many of the PPSA jurisdictions have asset classes. For example, the classes in New Zealand include “goods: motor vehicles”, “goods: livestock”, “goods: crops” and “goods: other”. An advantage of this is that someone only interested in say livestock can rely on there being no perfected security interest if the livestock category has not been completed on the notice that has been registered.

30.7 Unlike claims whose assignation is registered in the RoA, some encumbered property would have a unique number which could be required to be stated in the entry. The leading example of this is the vehicle identification number (VIN) of motor vehicles. UCC–9 and the PPSAs typically allow, or in some cases require, VINs to be registered.¹² The Canadian PPSAs (other than Ontario and Yukon) also provide for the registration of the serial numbers of trailers, motor homes, aircraft,¹³ boats and outboard motors for boats.¹⁴

30.8 The advantage of using unique numbers is that they can protect remote transferees. Imagine that Jack grants a statutory pledge over his car to the Braemar Bank. He then sells it to Katherine without the permission of the bank. The car remains subject to the statutory pledge. Katherine then sells the car to Louise. But a search in the RSP against Katherine would not reveal the statutory pledge, because it has been registered against Jack and not Katherine. The RSP is primarily a person-based register. But if the VIN for the car were registered Louise would be able to find the statutory pledge by searching against that

⁶ Discussion Paper, para 20.26.

⁷ Companies Act 2006 s 859D.

⁸ DCFR Book IX.–3:307(c).

⁹ UNCITRAL Model Law on Secured Transactions art 8(e).

¹⁰ See paras 35.2–35.19 below.

¹¹ See paras 7.15–7.22 above.

¹² Under the NZ Personal Property Securities Regulations 2001 sch 1 art 9 it is necessary for the VIN to appear on the financing statement where the motor vehicle is “consumer goods” or “equipment”.

¹³ Statutory pledges may not be granted over aircraft. See para 21.12 above.

¹⁴ See Cuming, Walsh and Wood, *Personal Property Security Law* 349–351.

number and the good faith acquirer provisions which we recommend later would not be engaged, thus making the pledge more robust.¹⁵

30.9 Finally, the entry should contain any data otherwise required by legislation, for example, details of corrections.¹⁶

30.10 We recommend:

160. An entry in the statutory pledges record should comprise:

- (a) the provider's name and address,**
- (b) where the provider is an individual, the provider's date of birth,**
- (c) any number which the provider bears or other information relating to the provider which, by virtue of RSP Rules, must be included in the entry,**
- (d) the secured creditor's name and address,**
- (e) any number which the secured creditor bears or other information relating to the secured creditor which, by virtue of RSP Rules, must be included in the entry,**
- (f) where the secured creditor is not an individual, an address (which may be an email address) to which requests for information regarding the statutory pledge may be directed,**
- (g) such description of the encumbered property as may be required or permitted by RSP Rules,**
- (h) a copy of the constitutive document of the statutory pledge and any amendment document,**
- (i) the registration number allocated to the entry,**
- (j) the date and time of registration of the statutory pledge and any amendment to it, and**
- (k) such other data as may be required by legislation.**

(Draft Bill, s 89(1))

Applications for registration: general

30.11 Applications for registration would be made online. The following transactions could be registered in the RSP: (a) a statutory pledge; and (b) an amendment to a statutory pledge adding encumbered property or increasing the extent of the secured obligation. A contrast

¹⁵ For discussion of this issue further in the context of the protection of good faith purchasers, see Chapter 32 below.

¹⁶ On corrections, see Chapter 33 below.

can be noted with the RoA where only an assignation document is registrable. This underlines the previously mentioned distinction between an assignation as a transfer and a statutory pledge as a right.¹⁷

Application for registration of a statutory pledge

30.12 The applicant would be the secured creditor. But the application could be made by an agent such as a solicitor.

30.13 We think that the Keeper should have to accept the application provided that certain conditions are satisfied. First, it would have to conform to RSP Rules. The rules would set out the form of application and the data fields that would require to be completed.¹⁸ Secondly, a copy of the constitutive document would require to be submitted.¹⁹ Thirdly, the application would require to provide the Keeper with the necessary information to make up an entry for it in the RSP. Fourthly, the applicant would have to pay the relevant fee. If the requirements were not satisfied the Keeper would be bound to reject the application.

30.14 We recommend:

- 161. (a) An application for registration of a statutory pledge should be made by or on behalf of the secured creditor.**
- (b) The Keeper should be required to accept an application if:**
- (i) it conforms to RSP Rules in relation to applications,**
 - (ii) it is submitted with a copy of the constitutive document,**
 - (iii) it provides the Keeper with the necessary data to make up an entry in the RSP, and**
 - (iv) the registration fee is paid or the Keeper is satisfied that it will be.**
- (c) Where these requirements are not satisfied, the Keeper should be required to reject the application and inform the applicant accordingly.**

(Draft Bill, ss 91(1) to (3) and 118(4))

Creation of an entry in the statutory pledges record

30.15 The process for creation of an entry would be very similar to that for the RoA.²⁰ Provided that the application requirements were met, the Keeper's computer system would make up the entry and allocate a unique number to it.

¹⁷ See para 6.4 above.

¹⁸ Registration legislation in Scotland and elsewhere typically leaves the details of applications to secondary legislation in the interests of flexibility.

¹⁹ See paras 29.11–29.12 above.

²⁰ See para 7.30 above.

30.16 We recommend:

162. On accepting an application for registration, the Keeper should be required to:

- (a) make up and maintain in the statutory pledges record an entry for the statutory pledge, and**
- (b) allocate a registration number to the entry.**

(Draft Bill, s 91(4))

Applications for registration of an amendment

30.17 The process for registration applications in relation to amendments would be very similar to that for the original registration of the statutory pledge described above. While the details would be for the Keeper to specify when the register is being set up, we envisage a system used in other jurisdictions²¹ where, following the initial registration of the statutory pledge, the secured creditor is provided with a PIN number/password which can be used to make changes to the registration.²² It would be necessary of course to submit a copy of the amendment document.

30.18 We recommend:

163. (a) An application for registration of an amendment of a statutory pledge to add property to the encumbered property or to increase the extent of the secured obligation should be made by or on behalf of the secured creditor.

(b) The Keeper should be required to accept an application if:

- (i) it conforms to RSP Rules in relation to applications,**
- (ii) it is submitted with a copy of the amendment document,**
- (iii) it provides the Keeper with the necessary data to update the entry in the RSP, and**
- (iv) the registration fee is paid or the Keeper is satisfied that it will be.**

(c) Where these requirements are not satisfied, the Keeper should be required to reject the application and inform the applicant accordingly.

(Draft Bill, ss 92(1) to (3) and 118(4))

²¹ Notably New Zealand.

²² That is to say on the registration of a financing statement, the password/PIN number is issued and must be used to register a financing change statement.

Giving effect to amendment applications

30.19 Where an application for registration of an amendment is accepted, the Keeper's computer system would have to amend the entry. Thus the amendment document would be added to it.

30.20 If a system of asset classes were used, then in the case of an amendment adding a type of property in a different asset class²³ from the original encumbered property the entry would also have to be altered to state the added class.

30.21 We recommend:

164. On accepting an application for registration of an amendment the Keeper should be required to update the entry for the statutory pledge accordingly.

(Draft Bill, s 92(4))

Verification statements

30.22 As with the RoA, we think that the Keeper's computer system should send the applicant a verification statement which confirms that the application has been successful and that the statutory pledge has been registered. We mentioned earlier the PIN (personal identification number) system used in some jurisdictions which enables the secured creditor to register a financing change statement to amend the entry.²⁴ The PIN is issued with the verification statement. The RSP might operate using a similar system in relation to statutory pledges where further registrations are possible, to amend the pledge, as well as applications for correction of the entry.²⁵

30.23 For the reasons discussed earlier in relation to the RoA we do not recommend a duty on the secured creditor to send a copy of the verification statement to the provider, but we think that the provider should be entitled to request a copy, with the secured creditor having to respond within 21 days.²⁶ This would enable the provider to check that its contact details were correct so that it would be notified of any correction made by the secured creditor under the automated procedure which we recommend below.²⁷

30.24 We recommend:

165. (a) The Keeper should be required to issue a verification statement on accepting an application for registration.

(b) The statement should require to conform to RSP Rules. It should include the date and time of the registration and the unique number allocated to the entry to which the application relates.

²³ See para 30.6 above.

²⁴ See para 30.17 above. We are grateful to Sheree McDonald, Senior Solicitor in the Ministry of Economic Development in Auckland for her help here.

²⁵ On corrections, see Chapter 33 below.

²⁶ See paras 7.33–7.40 above.

²⁷ See paras 33.11–33.22 below.

(c) The provider should be entitled to request a copy of the verification statement and the secured creditor should be required to supply this within 21 days after the request is made.

(Draft Bill, s 93)

Date and time of registration

30.25 As with the RoA,²⁸ the date and time of a registration would be of high importance for priority purposes as regards statutory pledges. The Keeper's computer system would determine when the relevant entry is made up or amended. The relevant date and time would then be stated in the entry. The registration in respect of which the application reaches the Keeper first should have priority.²⁹ The computer system should be able to ascertain which application that is. We recommend:

166. (a) A registration should be taken to be made on the date and time which are entered for it in the Register of Statutory Pledges.

(b) The Keeper should be required to deal with applications for registration and allocate these registration numbers in order of receipt.

(Draft Bill, s 94)

²⁸ See paras 7.41–7.42 above.

²⁹ See LR(S)A 2012 s 39(1).

Chapter 31 Register of Statutory Pledges: effective registration

Introduction

31.1 This chapter considers effective registration in the statutory pledges record. Our thinking here is very similar to that in relation to effective registration in the assignments record, which we discussed in Chapter 8 above. Here we can therefore be briefer. The central ideas are that the entry in the register should be capable of being found and provide a copy of the constitutive document (and any amendment document) which can be inspected by the searcher.

Effective registration of statutory pledge

31.2 As for assignments, a registration would fail to be effective in the following two circumstances.

(1) *Entry does not include a copy of the constitutive document or document is invalid*

31.3 If the correct constitutive document does not appear in the relevant entry in the statutory pledges record or that document is invalid the registration should be ineffective.¹

(2) *Entry contains an inaccuracy which is seriously misleading*

31.4 If the data in the entry contains an inaccuracy which is seriously misleading at the time of the registration the registration should be ineffective. Below, we consider the “seriously misleading” test in more detail, but before that we recommend:

167. The registration of a statutory pledge should be ineffective if the entry made up for it:

- (a) does not include a copy of the constitutive document,**
- (b) that document is invalid, or**
- (c) there is an inaccuracy in relation to the data registered which, as at the time of registration, is seriously misleading.**

(Draft Bill, s 95(1))

Effective registration of amendment to statutory pledge

31.5 Similar rules would apply in relation to amendments of statutory pledges. First, a copy of the correct amendment document should require to appear in the register entry or the registration of the amendment would be ineffective. Secondly, the document should

¹ See also para 8.4 above.

require to be valid. Thirdly, the entry as amended should not contain an inaccuracy in relation to the data in it which, in consequence of the amendment, is seriously misleading. For example, Jill grants Keith an amendment document extending the statutory pledge over her vehicle to include a patent which she holds. In registering this Keith fails to comply with RSP Rules and fails to tick the box for “intellectual property” on the application. This could be subsequently put right by means of a correction.²

31.6 We recommend:

168. The registration of an amendment to a statutory pledge should be ineffective if:

- (a) the entry for the statutory pledge does not include a copy of the amendment document,**
- (b) that document is invalid, or**
- (c) there is an inaccuracy in relation to the data registered for the statutory pledge in consequence of the amendment which is seriously misleading.**

(Draft Bill, s 96(1))

Seriously misleading inaccuracies in entries in the statutory pledges record

Introduction

31.7 Similar detailed rules should apply as for the assignments record in the RoA.³ But, in contrast to the position there, where the “seriously misleading” test would only be relevant to the details at the time the assignment document was registered, in the RSP the test would also play a key role in the question of supervening inaccuracies. These are the subject matter of the next chapter.

(1) *An objective test*

31.8 The “seriously misleading” test would be an objective one.

(2) *No account should be taken of statutory pledge documents*

31.9 Determining where an inaccuracy is seriously misleading should not take any account of the constitutive document or any amendment document.

(3) *Registration ineffective in part*

31.10 Some inaccuracies would only make the registration ineffective in part. Example 1. Hannah grants a statutory pledge over her Porsche and patent to Jasmine. Jasmine registers the statutory pledge in the RSP but only ticks the box in the application form for vehicles and not the one for intellectual property. The registration should be ineffective as regards the patent. Example 2. Ben and Catherine own a car. They grant a statutory

² See Chapter 33 below.

³ See paras 8.16–8.30 above.

pledge over it to Diane. She registers the statutory pledge in the RSP, but when completing the application for registration states that Ben is the provider but fails to mention Catherine. The registration is only effective as regards Ben's share of the car. Example 3. Sally grants a statutory pledge over her patent to Tom and Una. Tom (with Una's consent) registers the statutory pledge in the RSP, but when completing the application form for registration by mistake only states that Tom is the secured creditor. The registration is only effective as regards the share of the pledge granted to Tom.

(4) *Specific cases where search does not retrieve entry*

31.11 We recommend similar rules as for assignment, but with an additional one for property with a unique number.

31.12 The first rule would apply where the provider is a person required by RSP Rules to be identified in the entry by a unique number. If a search against that number did not retrieve the entry the registration should be ineffective because of this seriously misleading inaccuracy. In contrast a wrongly-stated name for such a person would not be fatal.

31.13 The second rule would apply where the provider was not required by RSP Rules to be identified in the entry by a unique number. If a search against the provider's "proper name" did not retrieve the entry the registration should be ineffective.

31.14 The third rule would apply to providers who were individuals. If a search against the provider's "proper name" and date of birth did not retrieve the entry the registration should be ineffective.

31.15 The fourth and additional rule would relate to property with a unique number. The classic example is VINs (Vehicle Identification Numbers). In some circumstances, the PPSAs require a VIN to be registered. The advantage of this is that it is possible to search against the vehicle, no matter whose possession it is in. For example, in New Zealand where the motor vehicle in question is "consumer goods, or equipment" there are requirements to register the registration number (plate number), VIN and, if there is no VIN, but there is a chassis number, that number.⁴ A similar approach could be taken under RSP Rules. One controversial issue in some PPSA jurisdictions is whether a registration is ineffective where although the property's unique number is correctly stated there is a seriously misleading error or omission in the debtor's (provider's) details.⁵ The better view is that the registration here should be ineffective.⁶ This is the view which we take too.⁷

31.16 Once again these rules would have common features. First, the search would be for the provider's details as at the date and time the registration was made. It is at that point that the details have to be correct. In Chapter 32 we deal with the consequences of these details changing later, for example if the provider changes name. Secondly, the search would be by means of a specific type of search facility which the Keeper would provide.

⁴ NZ PPSA 1999 s 150(b) and Personal Property Securities Regulations 2001 Sch 1 art 9. See Gedye, Cuming and Wood, *Personal Property Securities in New Zealand* 474–476.

⁵ Compare *Kelln (Trustee of) v Strasbourg Credit Union Ltd* (1992) 89 DLR (4th) 427, 3 PPSAC (2d) 44 (Sask CA) and *Re Lambert* (1994) 119 DLR (4th) 93; 7 PPSAC (2d) 240 (Ont Ca).

⁶ See Gedye, Cuming and Wood, *Personal Property Securities in New Zealand* 477–478 and Cuming, Walsh and Wood, *Personal Property Security Law* 367–368.

⁷ But we recommend a different rule where the provider's name is originally registered correctly, but there is a supervening inaccuracy as to that name. See para 32.50 below.

(5) *Power to specify further instances in which an inaccuracy is seriously misleading*

31.17 As for assignments, we think that the Scottish Ministers should have a power to specify other circumstances in which an inaccuracy would be seriously misleading.

31.18 We recommend:

169. (a) An inaccuracy in an entry in the statutory pledges record may be seriously misleading irrespective of whether any person has been misled.

(b) In determining whether an inaccuracy is seriously misleading no account should be taken of any document included in the entry.

(c) An inaccuracy which is seriously misleading in respect of part of an entry should not affect the rest of the entry.

(d) Without prejudice to the generality, an inaccuracy should be seriously misleading:

(i) where the provider (or as the case may be, a co-provider) is not a person required by RSP Rules to be identified by a unique number, if a search using a designated facility provided for by the Keeper for:

(a) the provider's (or co-provider's) proper name, or

(b) the provider's (or co-provider's) proper name and the provider's (or co-provider's) date of birth

does not disclose the entry,

(ii) where the provider (or, as the case may be, co-provider) is a person required by RSP Rules to be identified by a unique number, if a search using a designated facility provided for by the Keeper for that number does not disclose the entry, including where a search using such a facility for the provider's (or co-provider's) number does disclose the entry,

(iii) in respect of so much of the encumbered property as bears a unique number which must, by virtue of RSP Rules, be included in the statutory pledges record, if a search using a designated facility provided for by the Keeper for that number does not disclose the entry.

(e) The meaning of "proper name" should be set out in RSP Rules.

(f) The Scottish Ministers should be able to specify further instances in which an inaccuracy is seriously misleading.

(Draft Bill, s 98)

Chapter 32 The Register of Statutory Pledges: supervening inaccuracies and the protection of third parties

Introduction

32.1 In the previous chapter we set out recommendations on what would be required for an effective registration in the Register of Statutory Pledges. In broad terms the secured creditor who is registering would require to ensure that the details which were entered into the application for registration and which would form the basis of the entry are correct. In particular, there would require to be no seriously misleading inaccuracies.

32.2 In contrast to an entry in the Register of Assignations which would relate to an assignment document, an entry in the RSP would relate to a right – the statutory pledge. The accuracy of that entry could be affected by subsequent events affecting that right. As a result, the entry would misstate what the position is in fact or law in relation to the statutory pledge. This inaccuracy might well be seriously misleading. In particular, there would be a risk of “false negatives” in that a search fails to disclose a subsisting statutory pledge due to the fact that the the provider’s details have changed since the original registration.

32.3 The question of supervening inaccuracies involves a classic property law dilemma: having to choose between two innocent parties. Here these are (1) the secured creditor who is unaware of the inaccuracy and (2) the third party who acquires a right in property unaware that it is encumbered by a statutory pledge. There is no objectively correct answer. Policy choices have to be made.¹

Types of supervening inaccuracy

General

32.4 The principal types of supervening inaccuracy which are of concern relate to the identity of the provider. This is because the RSP would primarily be a person-based register. Searches would therefore normally be made against the provider.

Provider changes name

32.5 An example best explains the issue. Imagine that Anna Smith grants a statutory pledge over her grand piano in favour of the Berlin Bank. The bank registers the security in the RSP. Anna subsequently marries and changes her name to Anna Taylor. She does not tell the bank. Without obtaining the bank’s permission, she sells the piano for £5,000 to

¹ The classic modern statutory example in Scotland is the Land Registration etc. (Scotland) Act 2012 s 86. For discussion in the context of the Canadian PPSAs, see Cuming, Walsh and Wood, *Personal Property Security Law* 356–359.

Colin Davies. He searches against “Anna Taylor” in the RSP and finds nothing. A variation of this example is that rather than buying the piano Colin obtains a statutory pledge over it, not knowing that there is a subsisting pledge in favour of the bank.

32.6 Both the bank and Colin are innocent. On the other hand Anna, by dealing with the piano without obtaining the bank’s consent, is blameworthy. The entry in the register is inaccurate because Anna’s name has changed. But in the absence of a special rule on supervening inaccuracies the bank’s statutory pledge would continue to encumber the property as a fixed security and real right.

Provider transfers the encumbered property

32.7 Again an example helps explains the issue. We can begin with the same facts as above. Anna grants a statutory pledge over her grand piano in favour of the bank. But this time she does not change her name. She sells the piano to Colin for £5,000 without the bank’s permission. If Colin had troubled to search the RSP he would have discovered the statutory pledge. He does not bother. He swiftly resells the piano to Denise O’Neill.² She carries out a search in the RSP against Colin and finds nothing because the statutory pledge is registered against Anna and not Colin. Once again a variation of this example is Denise obtaining her own statutory pledge over the piano rather than acquiring ownership of the instrument.

32.8 As a result of the transfer from Anna to Colin, Colin becomes the provider of the statutory pledge as successor owner of the piano.³ At the time of Denise’s acquisition the register entry is thus inaccurate. But in the absence of a special rule the bank’s statutory pledge would continue to encumber the property and Denise, despite being in good faith and having checked the RSP would suffer prejudice.

Secured creditor changes name or transfers the statutory pledge

32.9 We do not recommend a search facility directly against the secured creditor’s name.⁴ Thus the impact of the creditor changing its name or transferring the statutory pledge is less severe.

32.10 If the secured creditor does change name (say due to corporate reorganisation) the secured creditor would obviously know about this and could in principle contact the Keeper to update the entry by means of a correction.⁵ In contrast, the provider may change identity as described above without the secured creditor knowing about it. But we do not consider in any event that there should be a general rule that secured creditors are obliged to update their details. This would be costly and time consuming, and is of course not the position for

² This situation has been described as the “A-B-C-D problem”. See R C C Cumming, “Double-Debtor A-B-C-D Problems in Personal Property Security Legislation” (1992) 7 Banking & Finance Law Review 359. See also R Gengatharen, “Double-debtor problems and the PPSA priority rules” 2012 Journal of International Banking Law and Regulation 469.

³ Even although he did not provide the statutory pledge in the sense of granting it.

⁴ See para 34.3 below.

⁵ It may be possible for the Keeper to devise a system whereby all entries for a particular secured creditor can be updated at the same time.

standard securities and floating charges.⁶ Indeed earlier we recommended that a statutory pledge should be assignable without registration.⁷

32.11 The main prejudice to a third party by reason of a change of secured provider name or identity which resulted in an inaccuracy in the register would be where this prevented an information request in relation to a statutory pledge being answered. We deal with information duties of secured creditors in Chapter 35 below. As regards change of identity, where there has been an assignation the secured creditor identified in the entry would be obliged to provide the requester with the details of the assignee so there should be no prejudice there. As regards change of name, in the case of an incorporated secured creditor the registration number would not have changed nor indeed probably the address. An information request would still probably be able to reach the secured creditor. It is only in cases of non-corporate secured creditors changing name and address that there could be prejudice because of the ensuing difficulty in trying to contact the creditor. In such cases the secured creditor would be best advised to correct the entry.

Some mitigations

32.12 Before considering whether there should be special rules protecting acquirers where the RSP has a supervening inaccuracy, it must be mentioned that some of the recommendations made elsewhere in this Report would provide mitigation.

32.13 In Chapter 24 above we recommended a number of rules protecting good faith acquirers. Thus, for example, if the encumbered property is acquired in good faith from a seller in the ordinary course of a business, or has a value below a prescribed amount and is acquired in good faith wholly or mainly for personal, domestic or household purposes, the acquirer would take free of the statutory pledge.

32.14 Further, in Chapter 31 above we recommended a “seriously misleading” test in relation to effective registration. But for prescribed persons with unique numbers we were of the view that it should be a mistake in that number as stated in the entry which would jeopardise effectiveness and not an error as to name. We had in mind persons such as companies and LLPs which have registration numbers. Therefore, although the RSP would contain a supervening inaccuracy because a company’s name had changed, the relevant entry would remain discoverable by searching against the company’s number.

32.15 There are some further points on change of name. First, in the original example given above it was not Anna’s change of name in itself which was the problem. It is entirely blameless to marry. The problem was caused by her selling the piano without the bank’s consent.⁸ Supervening inaccuracies are not an issue where the provider behaves and seeks the bank’s permission to any dealing with the encumbered property. We expect that most providers would so behave. But inevitably some would not.

32.16 Secondly, the way in which a provider is to be correctly identified for the purposes of the RSP, that is to say the definition of the “proper name” of the provider, would be a matter

⁶ Admittedly, standard securities are normally found by a search against the relevant land and not against the provider.

⁷ See paras 23.41–23.48 above.

⁸ Since the statutory pledge is a fixed security and real right the effect of transfer without the creditor’s consent is that the property continues to be encumbered.

for secondary legislation following consultation. We discuss this subject above.⁹ Clearly marriage is the commonest reason for change of name and a woman conventionally takes her husband's name. If a person's name as per that person's birth certificate was chosen as the "proper name" this would remove the difficulty of such name changes. But there are counter-arguments. For example, documentation such as driving licences tends to be more readily to hand.

Four approaches

32.17 There are broadly four ways of approaching the difficulty of supervening inaccuracies in the RSP.

(1) Ignore the inaccuracy

32.18 Under this approach a statutory pledge is unaffected by the inaccuracy. In the examples above the bank would retain its priority despite its security right being undiscoverable. Broadly speaking this is the approach of UCC-9.¹⁰ It can be argued that subsequent acquirers can protect themselves by making enquiries into the history of the asset and the seller.¹¹ Colin could ask Anna if she has ever changed her name. Denise could ask Colin how long he has owned the piano and from whom he purchased it. But of course the reply may not be accurate. This approach is therefore generous to the secured creditor.

(2) Extinguish the statutory pledge when the entry becomes inaccurate

32.19 The effect of the entry becoming inaccurate is that the statutory pledge is extinguished. In its pure form this approach is patently unsupportable. There may be no subsequent acquirer of a right in the encumbered property who is prejudiced by the inaccuracy. Moreover, a windfall benefit would be conferred on the provider's unsecured creditors. Extinguishing the statutory pledge in such circumstances cannot be justified.

32.20 Many of the PPSAs, however, effectively take this approach but only in a modified way. Where the details of the provider change and the secured creditor becomes aware of this a grace period starts to run during which the register must be corrected.¹² If it is not, then on the expiry of the period the registration becomes ineffective against third parties subsequently acquiring rights in the asset. As between the secured creditor and the third party relying on the register this approach strongly favours the former because the grace period does not start to run until they have knowledge of the inaccuracy. This seems fair in the case of an authorised transfer. But where the transfer is unauthorised the secured creditor is unlikely to know about it. The Australian PPSA, in contrast, takes an approach which more favours the good faith acquirer. Where there is an unauthorised transfer the

⁹ See paras 7.5–7.6 and 30.3 above.

¹⁰ See UCC § 9–507. And see also UNCITRAL Model Law on Secured Transactions Model Registry Provisions art 26 option C.

¹¹ Compare Cuming, "Double-Debtor A-B-C-D Problems in Personal Property Security Legislation" at 375.

¹² For New Zealand see the NZ PPSA 1999 ss 87–92. For the Canadian PPSA provisions see Cuming, Walsh and Wood, *Personal Property Security Law* 356–359. Under the Ontario PPSA 1990 failure to correct during the grace period leads to the security interest being wholly unperfected, but under the other Canadian PPSAs the result is for the interest to be unperfected as regards interests acquired in the encumbered property after the commencement of the grace period. See also the UNCITRAL Model Law on Secured Transactions Model Registry Provisions arts 25 and 26.

security interest remains temporarily perfected for a grace period.¹³ But a good faith purchaser will normally take the property free of the security interest.¹⁴ In contrast where the provider changes name a good faith purchaser is not protected until the grace period expires.¹⁵

(3) Extinguish the statutory pledge when a right in the property is acquired by a good faith third party

32.21 Under this approach the statutory pledge survives a supervening inaccuracy but is extinguished when a good faith third party acquires a right in the property. Such a party is favoured over the secured creditor. The approach applies to the acquisition of any property right in the asset and thus to new security rights as well as ownership.

(4) Extinguish the statutory pledge when the property is acquired by a good faith third party but only alter its ranking against a subsequently acquired security right

32.22 This approach is similar to (3) although more subtle and thus more complex as regards subsequent security rights acquired in good faith. Acquirers of such security rights are protected as against the statutory pledge affected by the supervening inaccuracy by means of an entitlement to rank as if it did not exist. But the statutory pledge remains valid against others, in particular those who acquired rights between the creation of the statutory pledge and the entry in the register becoming inaccurate.

32.23 The difference between approaches (3) and (4) can be demonstrated by means of an example. Imagine that Alison grants a statutory pledge over her piano to Bank X which registers the pledge in the RSP. She then grants a second statutory pledge over the piano to Bank Y which registers the pledge in the RSP. Alison changes her name to Anne. She subsequently grants a third statutory pledge over the piano to Bank Z. This pledge is also registered. Bank Z is in good faith. Under approach (3) the statutory pledges of Banks X and Y are extinguished by Bank Z's good faith acquisition. Under approach (4) they are not but Bank Z obtains top ranking followed by Bank X and then Bank Y.

32.24 It would appear that this approach is close to that of the DCFR Book IX, at least in the case of an unauthorised transfer. A good faith acquirer of ownership takes free of the security right where the entry in the register is filed against a security provider different from the transferor.¹⁶ And a good faith acquirer of a security right takes free of an existing security right where that party does not know nor can reasonably be expected to know that the security provider has no right to deal with the encumbered asset free of the existing security right.¹⁷ As regards changes of names the DCFR envisages a system whereby providers will

¹³ See Australian PPSA 2009 s 34. The grace period lasts for five business days after the secured creditor acquires knowledge of the transfer. But there is a long-stop of 24 months after the transfer at which time the security becomes unperfected.

¹⁴ Australian PPSA 2009 s 52. This provision has been reviewed as to its fairness between secured creditor and purchaser, with the reviewer recommending that the Australian Government consider the matter as part of any wider review as to whether the Australian PPSA should be amended to follow the Canadian and NZ PPSAs. See Australian Statutory Review 2015 para 7.6.11.

¹⁵ Australian PPSA 2009 s 166 where the grace period again is five business days from the secured creditor acquiring knowledge of the defect with a long-stop of 60 months.

¹⁶ DCFR IX.-6:102(2)(b). And see also DCFR IX.-3:330(2) and IX.-5:303. See Drobniig and Böger, *Proprietary Security in Movable Assets* 690.

¹⁷ DCFR IX.-2:109. See Drobniig and Böger, *Proprietary Security in Movable Assets* 315.

have to accredit with the register and be given a “personal unique identification number”¹⁸ which presumably would stay constant.

A conceptual point

32.25 As discussed earlier, a fundamental aspect of the UCC–9/PPSA approach is the “attachment/perfection” distinction, which does not fit well with property law in Scotland.¹⁹ Where there are grace period provisions and the secured creditor fails to correct the entry timeously, the effect under some of the PPSAs is for the security interest to cease to be perfected.²⁰ But if the secured creditor subsequently corrects the entry the security interest becomes perfected once more. The security interest in a question with third parties is in effect switched on, switched off and then switched back on again.

32.26 Such an approach once again is a bad fit with our property law. It seems to us more attractive and consistent with principle to address the question of effective registration only at the time that registration is made, but if justified by policy reasons allow good faith acquirers to prevail over a statutory pledge where they are prejudiced by a supervening inaccuracy in the register which means that the statutory pledge cannot be discovered.

Consultation

32.27 In the Discussion Paper we said: “We . . . think that a buyer who has searched the register without discovering the security should take free of it. For example, suppose that W grants a security to X and then sells to Y who later sells to Z. If Z searches the register, the security will not be discovered, since Z will be searching against Y’s name. In that case, Z, if in good faith, should be protected.”²¹ We subsequently asked two questions.²² The first was whether consultees agreed that a good faith buyer who has used reasonable diligence in searching the register should take free from entries not thereby revealed. The second was whether such a rule should also apply to creditors taking security.

32.28 An overwhelming majority of consultees answered the first question in the affirmative. Most also agreed in relation to the second. ABFA and the WS Society, however, proposed that good faith purchasers should be protected although they have not consulted the register, but that good faith acquirers of security rights should only be protected where they have consulted the register. Dr Hamish Patrick did not favour protecting the acquirers of security rights on the basis that they carry out “other relevant due diligence”. Scott Wortley was concerned about priority circles, an issue to which we return below.

Discussion

32.29 Approach (1) favours the secured creditor at the expense of the acquirer who relies on the register. The purpose of requiring registration is publicity. It enables third parties who may be affected by a right to find out about it before transacting. Retaining complete effectiveness irrespective of inaccuracy would render the RSP unreliable for potential

¹⁸ See Hamwijk, *Publicity in Secured Transactions Law* 350–351.

¹⁹ See para 18.7 above.

²⁰ For example, the Australian PPSA 2009 s 166 and the Ontario PPSA s 48(3). But under others such as the NZ PPSA 1999 s 90 the acquirer is given priority over the security interest. This is also the approach under the UNCITRAL Model Law on Secured Transactions Model Registry Provisions arts 25 and 26.

²¹ Discussion Paper, para 16.42.

²² Discussion Paper, questions 37 and 38.

acquirers because any asset could be subject to an undiscoverable statutory pledge. We therefore discount approach (1).

32.30 As we have already concluded, approach (2) in its pure form must also be rejected. When subject to a grace period it is more palatable. But the approach taken under the PPSAs strongly favours the secured creditor because the grace period does not start to run until that party has knowledge of the inaccuracy. The acquirer remains unprotected until that point. It seems preferable to give the secured creditor less absolute protection but only to penalise that party when it is necessary in order to protect the reliability of the register. This points to approaches (3) and (4).

32.31 In relation to good faith acquirers of the property, approaches (3) and (4) are identical. The acquirer takes an unencumbered title. The difference is as regards good faith acquirers of security rights. Earlier we gave an example of how the two approaches contrasted.²³ On the basis of that example it seems that approach (4) is more attractive because approach (3) seems to be too blunt an instrument in simply extinguishing the first statutory pledge. Altering its ranking seems much fairer.

32.32 The difficulty, however, is that the example which we gave earlier was a simple one. Approach (4) can in fact lead to complex ranking questions. Take the following example, under which all the statutory pledges relate to the same piano.

32.33 Bank X has a statutory pledge, the entry for which has become inaccurate. Bank Y (who knows about Bank X's pledge) and later Bank Z (who is in good faith) also acquire statutory pledges in the piano. Bank Y, because of its knowledge, was not misled by the inaccuracy and should not therefore be protected by a rule designed to protect those relying on the register. But Bank Z should be. The ranking under approach (4) is therefore as follows. Bank Z ranks above Bank X because of the good faith protection rule. Bank X ranks above Bank Y because Bank Y is in bad faith and the ordinary ranking rule applies, that the earlier created security ranks first. But Bank Y ranks above Bank Z under that ordinary ranking rule. To put it succinctly, Bank Z ranks above Bank X which ranks above Bank Y which ranks above Bank Z. There is a priority circle, the difficulty that Scott Wortley warned against.

32.34 One solution to this is to remove the requirement to be in good faith (notwithstanding that the fairness of doing so can be questioned) and treat all parties as if they know what is discoverable from the register, no more no less. This would mean Y ranking above Z who would rank above X. But even this approach does not remove the potential for priority circles as the following example involving the same piano demonstrates.

32.35 Bank X registers a statutory pledge. The entry in the register becomes inaccurate because the provider changes its name. Bank Y registers a statutory pledge. Bank X then corrects the inaccuracy in the entry for its statutory pledge. The provider changes its name again, leading to an inaccuracy in both entries. Bank X corrects but Bank Y does not. Bank Z registers a statutory pledge. Bank Z ranks above Bank Y because of the protection rule. Bank Y ranks above Bank X once again because of the protection rule. But Bank X ranks above Bank Z because of ordinary ranking as Bank X's security was discoverable from the register when Bank Z obtained its right. Once again there is a priority circle.

²³ See para 32.23 above.

32.36 Dr John MacLeod, who has assisted us with the registration aspects of the project, has suggested that the priority circle problem under approach (4) can be solved by reference to a more complex ranking tool from the law of inhibitions: Bell's canons of ranking.²⁴ This would mean Bank X being treated equivalently to a grantee receiving a right in breach of an inhibition and a good faith acquirer as equivalent to an inhibitor. Applying this approach would mean (a) calculating what the secured creditors would obtain on an ordinary distribution (ignoring good faith protection), (b) next calculating what any party entitled to protection would obtain if the statutory pledge against which it is protected was disregarded and (c) then drawing back sums to which the holder of that statutory pledge would be otherwise entitled to make up the difference. Dr MacLeod provided us with a research paper setting out a series of examples. We take the simplest.

32.37 Imagine that the encumbered piano is worth £10,000. Bank X is owed £9,000, Bank Y £8,000 and Bank Z £9,000. They had registered their statutory pledges in that order but Bank X's entry in the register became inaccurate before the other banks registered.

32.38 The ordinary ranking is that Bank X obtains £9,000, Bank Y obtains £1,000 and Bank Z obtains nothing. If Banks Y and Z were in bad faith this ranking would stand. But let us assume that they were in good faith. Both are now entitled to rank as if Bank X's statutory pledge does not exist. This establishes the following "target" sums: Bank Y obtains £8,000 and Bank Z obtains £2,000.

32.39 The second canon of ranking requires "drawback" from the sums due to the holder of the statutory pledge with the inaccurate entry (Bank X). This is then used to top up the allocation due to the other secured creditors towards their target sum. Bank Y, who obtains £1,000 under the ordinary ranking, needs to take £7,000 from Bank X to reach £8,000. Bank Z, who obtains nothing under the ordinary ranking, needs to take £2,000.

32.40 The final ranking is therefore that Bank X obtains nothing,²⁵ Bank Y obtains £8,000²⁶ and Bank Z obtains £2,000.²⁷

32.41 Variations in timings as well as in good and bad faith on the part of various secured creditors can produce significantly more complicated examples, albeit in practice unlikely to arise. While we agree with Dr MacLeod that this approach can be used to address the difficulty of priority circles, its complexity reduces its attractiveness. In addition this Commission recommended the abolition of Bell's canons of ranking in relation to inhibition specifically because of their complexity.²⁸ That recommendation was implemented by section 154 of the Bankruptcy and Diligence etc. (Scotland) Act 2007, although as Dr MacLeod has pointed out that provision is not without difficulty.²⁹

²⁴ Bell, *Commentaries* II, 519.

²⁵ £9,000 - £7,000 (to Bank Y) - £2,000 (to Bank Z) = 0.

²⁶ £1,000 + £7,000 (from Bank X) = £8,000.

²⁷ 0 + £2,000 (from Bank X) = £2,000.

²⁸ Scottish Law Commission, Report on Diligence (Scot Law Com No 183, 2001) paras 6.39–6.47.

²⁹ J MacLeod, *Fraud and Voidable Transfer: Scots Law in European Context* (PhD Thesis, University of Edinburgh, 2013) 162–164.

Conclusion on possible approaches

Good faith acquirers of the encumbered property

32.42 We have reached the view that approach (3)³⁰ should be adopted where a third party acquires the encumbered property when the register entry for a statutory pledge has become inaccurate and has not been corrected.³¹ This approach was supported by consultees and most of our advisory group. The rule would only operate where the provider has transferred the encumbered property without the secured creditor's consent. Most providers would not so behave. Banks, however, take account of the fact that a small minority of customers will breach the terms of their security or even commit fraud.

Good faith acquirers of security rights

32.43 We have found this a more difficult matter. Approach (3) is simpler as it avoids ranking issues, in particular priority circles. Approach (4) is more just but it has the potential to be considerably more complicated. A policy choice has to be made. We have concluded in favour of approach (3) given our statutory duty to simplify the law.³² The result is that the acquisition of a subsequent security right in the encumbered property when the entry for the statutory pledge is seriously misleading would lead to the extinction of the statutory pledge.

32.44 The secured creditor in the statutory pledge would suffer from this approach in two principal situations.³³ The first would be where a subsequent security right is granted following an unauthorised transfer of the encumbered property (whether or not following the provider changing name). As we noted above in relation to good faith acquisition of the encumbered property itself, only a small minority of providers are likely to do this.

32.45 The second would be where the provider changes name and then grants another security right over the property. The change of name in itself is not blameworthy and arguably neither is the second grant of security right as such a grant would not normally prejudice the first creditor under ordinary ranking rules. There may, however, be an express term of the security agreement³⁴ forbidding subsequent grants. In the absence of that the provider cannot be said to fall into the category of a bank customer who misbehaves. Extinguishing the statutory pledge because of the good faith of the subsequent security holder is perhaps less easy to justify here.

Good faith and reasonable care

32.46 We think that a way of dealing with the issue just highlighted may be to shift the balance slightly towards the holder of the (original) statutory pledge and require the acquirer not only to be in good faith but to exercise reasonable care before it is protected. As to what is reasonable, this would depend on the circumstances. When a bank is offering a secured loan it is standard practice to carry out identity checks including enquiring about previous

³⁰ Or approach (4) as these are identical in this regard.

³¹ On corrections see the next chapter.

³² Law Commissions Act 1965 s 3(1).

³³ A further possibility is where there is a supervening inaccuracy because the Keeper's computer system fails and deletes data or the entry. But here the Keeper would require to pay compensation. See para 35.34 below.

³⁴ Generally called a "negative pledge" clause.

names. Indeed there are duties to do so under money laundering legislation.³⁵ Of course the provider may lie but in asking the question the bank would have exercised reasonable care. Actually having carried out a search in the register and not discovering anything would be further evidence of this standard. It is arguable whether a purchaser should be expected to meet exactly the same standards as a prospective secured creditor. We think that it should depend on the individual facts of the case and would ultimately have to be determined by a court.

Value

32.47 We consider that good faith acquirers should only be protected where they give value. Fairness points to favouring the secured creditor in the statutory pledge over a donee.

Liferents

32.48 Proper liferents³⁶ over moveable property are now rare, but in principle the same rules protecting subsequent acquirers of security rights in the encumbered property from supervening inaccuracies in a register entry should also apply to acquirers of liferents.

Inaccuracies affecting only part of the property acquired

32.49 Usually a supervening inaccuracy would affect all the encumbered property in which the good faith acquirer obtains a right. This would be the case for example where the provider's name changes or where that property is the subject of an authorised transfer. There might, however, be circumstances where an entry is only inaccurate as regards some of the encumbered property. Imagine that a statutory pledge is created over a vehicle and a patent. Under RSP Rules³⁷ the application for registration requires that the encumbered property is identified by reference to certain categories, including "vehicles" and "intellectual property". The encumbered property is duly identified but sometime later due to an erroneous correction by the secured creditor³⁸ or a fault in the Keeper's computer system the entry is changed so that the data field for intellectual property is deleted. A good faith acquirer of the patent should be protected but not of course an acquirer of the vehicle where the entry remains accurate.

Property with unique numbers

32.50 Some moveables, notably motor vehicles, have unique numbers and we recommend elsewhere that it should be possible in prescribed cases for these numbers to appear in a data field in the register entry which can be directly searched.³⁹ We consider that where this number does appear in the entry the rules protecting acquirers from supervening inaccuracies should not apply because this number would remain constant and the statutory pledge would remain discoverable.

32.51 We recommend:

³⁵ See the Proceeds of Crime Act 2002 and the Money Laundering, Terrorist Financing and Transfer of Funds (Information on the Payer) Regulations 2017 (SI 2007/692), especially reg 10.

³⁶ In other words a real right in property entitling the holder to use the property for life.

³⁷ See paras 35.37–35.38 below.

³⁸ On corrections see the next chapter.

³⁹ See para 34.5 below.

- 170. (a) Where:**
- (i) a statutory pledge is effectively registered over property,**
 - (ii) at some time after that registration either**
 - (a) the relevant entry in the statutory pledges record comes to contain an inaccuracy which is seriously misleading (whether or not in respect of all the encumbered property), or**
 - (b) is removed from that record, and**
 - (iii) prior to any correction being effected a person acquires, for value and in good faith while exercising reasonable care,**
 - (a) all or part of the encumbered property, or**
 - (b) a right in, or in part of, that property**

the statutory pledge should be extinguished, but in the case of an inaccuracy only as regards so much of the property acquired as is property in respect of which the inaccuracy is seriously misleading.

- (b) This rule should not apply where there is an inaccuracy in an entry but the property acquired is of a prescribed type and the unique number for the property appears in the entry.**

(Draft Bill, s 97)

Chapter 33 Register of Statutory Pledges: corrections

Introduction

33.1 The Register of Statutory Pledges, like the Register of Assignations, would inevitably contain inaccurate data or incorrect documents. A correction mechanism is therefore essential. The scheme which we recommend for the RSP has similarities to that for the RoA which we recommended in Chapter 9 above.

33.2 But, as we have mentioned elsewhere in this Report,¹ different considerations apply to assignations and statutory pledges because the former is a transfer and the latter is a right. Once a transfer has been registered it would be incoherent to be able to “cancel” it by deletion of the relevant entry. Rather, what is required is a re-transfer (retrocession). Therefore we recommended in Chapter 9 that the power to correct the assignations record should be restricted by requiring the involvement of the Keeper. Assignees should not be free to delete an entry ostensibly on the basis that they are “correcting” it.

33.3 In contrast the statutory pledge, as a right, is capable of extinction or being the subject of other juridical acts which render the register inaccurate because these take place off-register. Thus the secured creditor may have discharged the pledge by means of a written statement² or consented to the encumbered property being transferred to a third party unencumbered by the pledge.³ In such circumstances the secured creditor should be able freely to correct the record so that it reflects the true legal position and remove the entry. We recommend below also that there should be a system modelled on the “change demand” procedure in comparator legislation. This would enable another party with an interest, typically the provider, to require the secured creditor to make a correction.

Types of correction

33.4 As for the RoA, five main types of correction may be identified. First, data in an entry could be removed. For example, the entry might state that Alice and Brad are co-providers of a statutory pledge, whereas in truth Alice is the sole provider. Brad’s details could be removed by means of a correction. Secondly, an entry could be removed from the statutory pledges record to the archive record. This might happen after a statutory pledge has been set aside by the court. Thirdly, data or a copy document in an entry might be replaced. For example, an error in the Keeper’s computer system leads to Kirsten being entered as the provider in an entry whereas it should be Jane. Fourthly, data or a copy document could be restored, for example where it has been erroneously deleted by the Keeper’s computer system. Fifthly, an entry could be restored, for example, where the Keeper’s computer system has deleted it by mistake.

¹ See eg para 1.35 above.

² See paras 23.49–23.54 above.

³ See paras 20.37–20.45 above.

33.5 We recommend:

171. Except in so far as the context otherwise requires any reference to “correction” should include correction by:

- (a) the removal of data included in an entry,**
- (b) the removal of an entry from the statutory pledges record and the transfer of that entry to the archive record,**
- (c) the replacement of data, or of a copy document, included in an entry,**
- (d) the restoration of data, or of a copy document, to an entry, or**
- (e) the restoration of an entry (whether or not by removing it from the archive record and transferring it to the statutory pledges record).**

(Draft Bill, s 105(1))

Correction by Keeper

33.6 We consider that the recommendation which we made earlier⁴ enabling the Keeper to correct the assignments record where there is a manifest inaccuracy should be mirrored in relation to the statutory pledges record. This would enable the Keeper, for example, to deal with frivolous or vexatious registrations or where the record has been affected by computer malfunction. In principle, as for the assignments record, the Keeper might make a correction using this power because the secured creditor has made an application for this to be done. In practice, however, we would expect secured creditors to apply for corrections under the automated system which we recommend below.⁵

33.7 We recommend:

172. (a) Where the Keeper becomes aware of a manifest inaccuracy in an entry in the statutory pledges record the Keeper should have to correct the inaccuracy if what is needed to correct it is manifest. If what is needed to correct is not manifest the Keeper should have to note the inaccuracy on the entry.

(b) Where an inaccuracy is corrected by:

- (i) removal of the entry the Keeper should have to transfer the entry to the archive record and note on the entry the details of the correction, and its date and time,**
- (ii) removal or replacement of data included in the entry or by replacement of a copy document the Keeper should have**

⁴ See paras 9.12–9.22 above.

⁵ See paras 33.11–33.22 below.

to note on the entry the details of the correction, and its date and time,

(iii) replacement of a copy document, the Keeper should have to transfer it to the archive record.

(c) Where the Keeper effects a correction, the Keeper should have to notify each person specified for these purposes by RSP Rules and any other person whom the Keeper considers it appropriate to notify that the correction has been effected.

(Draft Bill, s 102)

Correction of the statutory pledges record by order of a court

33.8 Once again we envisage a scheme based on the provisions for the RoA which we set out above.⁶ This would apply where, for example, a statutory pledge has been reduced by a court order, for example, where there has been fraud. The court would order the Keeper to expunge it from the statutory pledges record.

33.9 We recommend:

173. (a) Where a court determines that the statutory pledges record is inaccurate it should have the power to direct the Keeper to correct it.

(b) In connection with any such correction, the court should be able to give the Keeper such further direction (if any) as it considers requisite.

(c) The Keeper should be required to note on the relevant entry that it has been corrected and the details of the correction, including the date and time. Where the correction requires the removal of the entry or of a copy document the Keeper should have to transfer it to the archive record.

(d) Where the Keeper effects a correction, the Keeper should have to notify each person specified for these purposes by RSP Rules and any other person whom the Keeper considers it appropriate to notify that the correction has been effected.

(Draft Bill, s 103)

Keeper's right to appear and be heard in proceedings in relation to inaccuracies

33.10 There should be the same rules here as for the RoA.⁷ We recommend:

⁶ See paras 9.23–9.27 above.

⁷ See paras 9.28–9.29 above.

174. The Keeper should be entitled to appear and be heard in any civil proceedings, whether before a court or tribunal, in which is put in question (either or both):

- (a) the accuracy of the statutory pledges record,**
- (b) what is needed to correct an inaccuracy in that record.**

(Draft Bill, s 104)

Correction by secured creditor

33.11 For corrections in the assignments record we recommended that involvement by the Keeper's staff should be required.⁸ Our reasoning for this was that an assignment is a transfer of property and that transfers cannot be extinguished. Once an assignment is registered it should stay on the register. But correction should be possible for errors such as uploading the wrong assignment document, or submitting wrong data to the Keeper. The Keeper would require to play an active role in considering applications for corrections.

33.12 This is markedly different from the position under UCC–9 and the PPSAs etc where the register is essentially fully automated.⁹ Secured creditors register an initial notice electronically. This is often known as a “financing statement”. Secured creditors then make any correction or register any juridical act (for example restriction to particular types of asset) in relation to a security interest to which the notice relates by means of a further notice. This is often known as a “financing change statement”.¹⁰ This approach can be seen to conflate registration of corrections and juridical acts.

33.13 In contrast our scheme deals with these separately. The registration of juridical acts is dealt with in Chapter 23 above. In contrast, the correction procedure is to be used for inaccuracies, where the register does not reflect the true position in fact or law. Examples of this would be where the data which has been registered in respect of the statutory pledge is erroneous, such as where the provider's details are wrong or where the register, in stating that a statutory pledge subsists, is wrong because the statutory pledge has been discharged off-register.

33.14 A statutory pledge, being a security right, has a finite existence. This means that there must be a way of removing it from the register. That way is correction.

33.15 An argument against allowing correction by the secured creditor by means of an automated procedure is that the register might be corrected by mistake or even deliberately when there is no inaccuracy. This is our concern in relation to assignments: the entry for an effectively registered assignment could simply be removed and the registered evidence of the transfer would be gone.¹¹ In the case of statutory pledges, however, it would be the registered evidence of the subsistence of a right in security which would no longer be there.

⁸ See Chapter 9 above.

⁹ Not quite fully. For example, removal of frivolous or vexatious registrations or dealing with administrative error, such as where the computer system fails, require human intervention.

¹⁰ See eg NZ PPSA 1999 s 135.

¹¹ Albeit it would be kept by the archive record. But that record would not be directly searchable. See para 34.2 below.

Good faith third parties would be protected by the recommendations which we recommend in Chapter 32.¹² Therefore an incorrect correction would not prejudice such parties.

33.16 We have come to the conclusion that an automated correction procedure should be possible. The advantages of this are the same as for automated registration of the statutory pledge or amendments in relation to it, as well as of assignments.¹³ We propose a similar procedure as for registration.

33.17 The application would be made by or on behalf of the secured creditor. Where the statutory pledge has been assigned the former creditor should be able to make the correction as it would be accredited by the Keeper's computer system in relation to the entry.¹⁴

33.18 The Keeper would be required to accept the application if it complied with the relevant RSP Rules and the appropriate fee were paid. The application otherwise would have to be rejected.

33.19 If the application was accepted the Keeper would have to correct the entry accordingly and issue the applicant with a written statement verifying the correction. RSP Rules would set out the form of the verification statement, which would include the date and time of the correction. Importantly, we think that the statement should also be sent by the Keeper's computer system to the provider so that it is notified that a correction has been made. Imagine, for example, that the secured creditor carelessly or maliciously uses the automated correction procedure to widen incorrectly the asset classes over which the statutory pledge has been granted.¹⁵ If the provider is notified it would be possible for a challenge to this to be made. Effective notification here to providers relies on their electronic contact details being correct. Thus earlier we recommended a right for the provider to see a copy of the verification statement in relation to the original registration of the statutory pledge so that these details can be checked.¹⁶

33.20 Where the correction sought is for removal of the entry, for example where the statutory pledge had been previously extinguished off-register, the Keeper would transfer it to the archive record and note the date and time of the removal. For other corrections, the details including the date and time would be added to the entry, which would remain in the statutory pledges record.

33.21 The automated procedure would only be available for an entry that was in the statutory pledges record. If an entry were moved to the archive record by mistake then application could in principle be made to the Keeper (or court) under the procedures described earlier,¹⁷ but it is far more likely in practice that the statutory pledge would simply be re-registered.

¹² These recommendations are not mirrored in the RoA. See para 8.14 above.

¹³ See paras 6.31–6.44 and 29.24 above.

¹⁴ See para 30.17 above.

¹⁵ This possibility could perhaps also be dealt with by RSP Rules preventing correction to increase the asset classes under the automated procedure, so that such a correction would require an application under the "manifest inaccuracy" route recommended in paras 33.6–33.7 above and thus the involvement of the Keeper's staff.

¹⁶ See para 30.23 above.

¹⁷ See paras 33.6–33.9 above.

33.22 We recommend:

175. (a) The secured creditor should be able to apply for correction of the entry for the statutory pledge in the statutory pledges record.
- (b) The Keeper should be required to accept an application if it conforms to RSP Rules in relation to applications and the prescribed fee is paid or the Keeper is satisfied that it will be.
- (c) Where these requirements are not satisfied, the Keeper should be required to reject the application and inform the applicant accordingly.
- (d) On accepting an application for correction of the statutory pledges record the Keeper should be required to correct the entry accordingly, and issue to the applicant and to the provider of the statutory pledge a written statement verifying the correction.
- (e) The verification statement should conform to such RSP Rules as may relate to the statement and include both the date and time of the correction and the registration number allocated to the entry to which the application relates.
- (f) The Keeper should be required to note on the relevant entry that it has been corrected and the details of the correction, including the date and time. Where the correction requires the removal of the entry the Keeper should have to transfer it to the archive record.

(Draft Bill, s 100)

Demands for corrections

33.23 The register could contain an inaccuracy which prejudices (a) the provider or (b) a third party. An example of (a) would be where the secured obligation has been performed¹⁸ but the statutory pledge has not been removed from the register. Another example would be where property has been released from the statutory pledge but the entry for it still refers to that property.

33.24 An example of (b) would be where a statutory pledge granted by Philip is mistakenly registered against Paul. Thus someone searching the RSP against Paul would find the entry and this could affect his ability to obtain credit.¹⁹ Another example would be where encumbered property is identified by reference to a unique number (most likely a VIN in respect of motor vehicles).²⁰ An entry which refers to the wrong number and in consequence

¹⁸ This would typically be where the secured obligation is a fixed sum which has been paid. Under the accessoriness principle the security is extinguished because it does not secure anything. In commercial practice security rights are normally granted for all sums due and to become due. Such security rights remain valid until discharged because although there may be no present indebtedness they are capable of securing a debt which may subsequently arise.

¹⁹ Even with the constitutive document granted by Philip on the register third parties would need to be persuaded that the entry is a mistake and that it is the data and not the document which is wrong.

²⁰ See para 30.7 above.

to property belonging to another person would prejudice the ability of that person to use that asset as collateral or indeed even to sell it.

33.25 There are various possible ways of dealing with this situation. First, the provider or third party could attempt to contact the secured creditor informally and ask for the correction to be made. But there might be no response. Secondly, the Keeper could be approached. In the case of manifestly inaccurate entries such as where there has been a vexatious registration the Keeper would probably make the correction.²¹ But in other cases the Keeper would be unwilling to intervene as the Keeper does not act quasi-judicially. Thus the determination of factual questions such as whether the secured obligation has been performed or whether property has been released is not for the Keeper. Thirdly, a court order could be sought requiring the Keeper to correct the register.²² But this could be an expensive option.

33.26 The way in which several of the PPSAs deal with this issue is by means of a procedure whereby a formal demand can be made to the secured creditor to register a financing change statement to correct the inaccuracy.²³ The details of the procedure vary in the different jurisdictions but essentially where such a demand is made the secured creditor is required to comply with it within a specified period and correct the registration, or justify why the registration should be maintained. In several jurisdictions notably in Canada (but not Ontario) and New Zealand the secured creditor requires to obtain a court order confirming that the registration should not be corrected. The Statutory Review of the Australian PPSA recommended that it should be amended to adopt the same approach.²⁴ At first sight this may seem onerous on the secured creditor not least because a provider might be making a demand spuriously. But we understand that the system works well in practice. Providers are highly unlikely to make a groundless demand because in doing so they would damage their relationship with their bank or other lender. Moreover, they would have to bear the bank's costs. The procedure enables a party who is prejudiced by an inaccurate registration a relatively quick and inexpensive way of having the register corrected. We consider that it would be beneficial to have an equivalent procedure in the RSP.

33.27 The procedure should be available, first, to a person incorrectly identified in an entry in the statutory pledges record as a provider or co-provider and second, to a person with a right in property which is incorrectly identified in an entry as being encumbered property. The person should be able to issue a notice to the person identified in the entry as the secured creditor. The notice would demand that the entry is corrected within a specified period of time. We think that this time should not be any less than 21 days.²⁵ The demand should be issued on a prescribed form which would have notes as to its completion.

33.28 An issue which requires consideration is that the person identified as the secured creditor may no longer be the secured creditor because the statutory pledge has been

²¹ See paras 33.6–33.7 above.

²² See paras 33.8–33.9 above.

²³ See eg NZ PPSA 1999 ss 162–169, on which see Gedye, Cuming and Wood, *Personal Property Securities in New Zealand* 507–518 and the Australian PPSA 2009 ss 177–182, on which see Allan, *The Law of Secured Credit* 494–496. For the Canadian PPSAs see Cuming, Walsh and Wood, *Personal Property Security Law* 337–340. And see also the Belgian Pledge Act of 11 July 2013 art 39 (which provides for art 33 of the new Book III title XVII of the Civil Code).

²⁴ Australian Statutory Review 2015 para 6.10.5.8.

²⁵ This is similar to the period in New Zealand, which is 15 working days. See NZ PPSA 1999 s 163. In Australia the period is only five working days. See Australian PPSA 2009 s 179(1)(b).

assigned. Earlier we recommended that an assignation could take place without registration as is the case for floating charges and for security interests under UCC–9 and the PPSAs.²⁶ We understand that in the jurisdictions which have change demand procedures an assignor secured creditor would ensure that it alerted the assignee secured creditor of the demand, because otherwise they would have a claim for loss suffered if the security interest becomes unperfected as a result of the relevant notice being removed from the register.²⁷ Further, although an assignation of a statutory pledge is not registrable it would also be possible to update the entry by means of a correction, meaning that it would be the assignee who would receive the notice.

33.29 A secured creditor should not be entitled to charge a fee for making the correction.²⁸ The person making the demand would normally be doing so because the inaccuracy in respect of which correction is sought is causing prejudice and therefore it does not seem reasonable that the cost is met by that person.

33.30 Where following the expiry of the specified period the demand has not been complied with the person making it should be entitled to apply to the Keeper for correction. The application would require to conform to RSP Rules made in respect of such applications.

33.31 On receipt of the application the Keeper should be required to do several things. First, the Keeper should have to serve a notice on the person identified in the entry as the secured creditor. This would state that the Keeper intends to correct the record on a date specified in the notice (which could not be fewer than 21 days after the date of the notice). Secondly, the Keeper should have to note the details of the application and the date on which it was received in the relevant entry. Thirdly, the Keeper should be required to issue the applicant with a verification statement confirming receipt of the application. Fourthly, the Keeper should have to notify the person identified in the entry as the provider of the receipt of the application if that person is not the applicant. This might happen where the applicant is a third party owner of property identified in the entry.

33.32 We noted earlier that under the change demand procedures in several jurisdictions the register will be corrected unless the secured creditor obtains a court order within a 21-day period requiring the registration to be maintained. We canvassed this approach with our advisory group and in our draft Bill consultation in July 2017, but it drew significant criticism for being too short a period. In response to this, we recommend now that the secured creditor should, prior to the minimum 21-day period specified in the Keeper’s notice elapsing, only be required to apply to the court to oppose the correction. If such an application is made the Keeper should have to be notified within that period and the court should not be able to consider the matter unless satisfied that the Keeper has been duly notified. Were this to be otherwise there is a risk that the Keeper would make the correction because she was unaware that an application had been made. The court would ultimately have to determine whether the record should be corrected or not.

33.33 Where the correction is to remove the entry it would have to be transferred to the archive record. In other cases where only data or a document is to be removed then the entry would remain in the statutory pledges record. The Keeper should be required to notify,

²⁶ See paras 23.41–23.48 above.

²⁷ We are grateful to Professor Catherine Walsh for her assistance.

²⁸ See the NZ PPSA 1999 s 169 (although this provision is subject to the agreement of the parties).

in so far as it is reasonable and practicable to do so, any persons specified by the RSP Rules for these purposes, that the correction has been made. The Rules would be likely to specify the person identified as the secured creditor and the applicant, and perhaps others. The Keeper should also have a discretion to notify any other person whom the Keeper considers it appropriate to notify.

33.34 We recommend:

176. (a) A person who:

- (i) is identified incorrectly as the provider, or as a co-provider, of a statutory pledge in an entry in the statutory pledges record, or**
- (ii) holds a right in property identified incorrectly as the encumbered property in an entry in the statutory pledges record**

may issue a demand in a prescribed form to the person identified in the entry as the secured creditor that the person so identified apply to the Keeper for correction of the statutory pledges record.

(b) Such a demand should require to specify a period (being not less than 21 days after it is received) within which it must be complied with.

(c) No fee may be charged by the person identified as the secured creditor for such compliance.

(d) Where the demand is not complied with the person making it should be able to apply to the Keeper for the correction.

(e) The application should require to conform to such RSP Rules as may relate to it.

(f) On receiving an application the Keeper should be required to:

- (i) serve a notice on the person identified in the entry as the secured creditor stating that the Keeper will correct the record on a date specified in the notice (being a date no fewer than 21 days after the date of the notice),**
- (ii) note on the relevant entry that an application has been received and include in that note the details of the correction sought and the date of receipt,**
- (iii) issue to the applicant a written statement verifying that the application has been received, and**
- (iv) notify the person identified in the entry as the provider (if a different person from the applicant) that the notice mentioned in (i) has been served.**

(g) The person identified as the secured creditor should have the right to apply to the court prior to the date specified in the notice to oppose the making of the correction and on making any such application should have to notify the Keeper.

(h) The court should be able to direct whether the entry should be corrected or left unchanged, but only if satisfied that the Keeper has been notified of the application to the court prior to the date specified in the notice.

(i) If the Keeper does not receive such notification prior to the date specified in the notice, the Keeper should be required to make the correction on that date.

(j) The Keeper should be required to note in the relevant entry that it has been corrected and the details of the correction, including the date and time. Where the correction requires the removal of the entry the Keeper should have to transfer it to the archive record.

(k) Where the Keeper effects a correction, the Keeper should have to notify each person specified for these purposes by RSP Rules and any other person whom the Keeper considers it appropriate to notify that the correction has been effected.

(Draft Bill, s 101)

Effect of correction

33.35 Many of the corrections mentioned above would be to remove bad data and entries. Here the correction would simply make the register reflect legal reality.

33.36 But where the original registration of a statutory pledge has been ineffective a correction by the secured creditor would put matters right and render the registration effective. For example, a wrong copy of the constitutive document could be replaced with the correct one. The result would be that the pledge would then be created at this time (other than as regards after-acquired assets or assets not yet identifiable as being encumbered property).

33.37 We recommend:

177. A registration which is ineffective should become effective if and when the entry is corrected.

(Draft Bill, ss 95(3) and 96(3))

Date and time of correction

33.38 Finally, the register should always state the date and time of correction. This is particularly important in circumstances where the correction has substantive effect, in other words makes an ineffective registration effective. We recommend:

- 178. A correction should be taken to be made on the date and at the time which are entered for it in the register.**

(Draft Bill, s 105(2))

Chapter 34 Register of Statutory Pledges: searches and extracts

Introduction

34.1 In Chapter 10 above we dealt with the issues of searches and extracts in the Register of Assignations. Almost identical considerations apply in relation to the Register of Statutory Pledges and unsurprisingly we take the same approach to these. We envisage once again that searches would be carried out electronically under an automated system and would not require the involvement of the Keeper's staff.

Searches: general

34.2 An entry in the statutory pledges record would contain (a) data; (b) the constitutive document of the statutory pledge; and (c) any amendment document that has been registered. We expect that amendment documents would be relatively unusual.¹ As with the RoA, it would be the data which would be directly searchable using the Keeper's computer system. In contrast the archive record would not be directly searchable, but it would be possible to obtain an extract of an entry in that record by means of an application to the Keeper.²

34.3 The RSP would be primarily (although, in contrast to the RoA, not exclusively) a person-based register. Searches would normally be carried out against the provider of the statutory pledge. As is the position under UCC-9 and the PPSAs we do not recommend that searching should be available against secured creditors on the basis that this would enable information on a financial institution's customers to be garnered too simply by a competitor.³

34.4 For searches against providers we recommend the same approach as for assignors in the RoA.⁴ There would be three possibilities. First, a search could be made against the provider's name. Secondly, a search could be made against the provider's name *and* date of birth. Thirdly, a search could be made by reference to the unique number of the provider where the provider is a person required by RSP Rules to be identified in the statutory pledges record by such a number. We would expect the Rules to prescribe UK companies and LLPs, but there may be further possibilities.

34.5 Sometimes encumbered property would have a unique serial number, such as a VIN in the case of motor vehicles, or a registration number in the case of a patent. RSP Rules should be able to specify relevant asset types which have such numbers. Where such specification is made the secured creditor in applying for registration can then input the

¹ Amendment documents that are registrable may either (a) increase the extent of the secured obligation; or (b) add property to the encumbered property.

² See paras 34.14–35.15 below.

³ But in the interests of flexibility the provision which we recommend below allowing the register to be searched by other factors or characteristics specified in RSP Rules could in theory be used to allow this.

⁴ See paras 10.4–10.6 above.

number in the relevant data field in the application. The advantage of doing this is that the RSP can then be directly searchable against that number and it does not matter who the current holder is. This to some extent can obviate the issue of supervening inaccuracies in the register when the provider changes name or makes an unauthorised transfer of the property to a third party.⁵

34.6 Finally, it should also be competent to search the statutory pledges record by reference to the unique number for an entry and by reference to any other factor or characteristic specified by RSP Rules.

34.7 We recommend:

179. The statutory pledges record should be searchable only:

(a) by reference to any of the following data in the entries contained in that record:

- (i) the names of providers,**
- (ii) the names and dates of birth of providers who are individuals,**
- (iii) the unique numbers of providers required by RSP Rules to be identified in the statutory pledges record by such a number,**

(b) if RSP Rules require or permit the encumbered property to be identified by a unique number by reference to that number,

(c) by reference to registration numbers allocated to entries in that record, or

(d) by reference to some other factor, or characteristic, specified for these purposes by RSP Rules.

(Draft Bill, s 106(2))

Who can search?

34.8 As for the RoA,⁶ our view is that the RSP should be searchable by anyone on complying with RSP Rules and making payment to the Keeper.

34.9 We recommend:

180. A person should be able to search the statutory pledges record if the search accords with RSP Rules and either such fee as is payable for the search is paid or the Keeper is satisfied that it will be paid.

(Draft Bill, s 106(1))

⁵ See Chapter 32 above.

⁶ See paras 10.11–10.17 above.

Search facilities

34.10 Once again we propose the same approach as for the RoA.⁷ There would require to be an “official” search facility for the purposes of the “seriously misleading” test in relation to effective registration. There should be discussion with stakeholders when the register is being set up as to whether an “exact match” or a “close match” approach is taken, and the matter dealt with in RSP Rules. It should also be possible for the Keeper to offer other forms of search.

34.11 We recommend:

181. (a) The Keeper should be required to provide a search facility in relation to which the search criteria are specified by RSP Rules, but may provide such other search facilities, with such other search criteria, as the Keeper thinks fit.

(b) “Search criteria” should be defined as the criteria in accordance with which what is searched for must match data in an entry in order to retrieve the entry.

(Draft Bill, s 107)

Printed search results

34.12 In line with the position in comparator legislation⁸ it should be possible to use a printed search result as evidence of data on the register. In the absence of challenge, this should be sufficient proof of a registration or correction.

34.13 We recommend:

182. A printed search result which purports to show an entry in the statutory pledges record:

(a) should be admissible in evidence, and

(b) in the absence of evidence to the contrary, should be sufficient proof of:

(i) the registration of the statutory pledge, or amendment to the entry in the statutory pledges record, to which the result relates,

(ii) a correction of the entry in the statutory pledges record to which the result relates, and

(iii) the date and time of such registration or correction.

(Draft Bill, s 108)

⁷ See paras 10.22–10.29 above.

⁸ See para 10.30 above.

Extracts

34.14 There should be a facility to apply to the Keeper for extracts, as with the RoA.⁹ This would include the archive record, where the entry for a statutory pledge would be transferred following a correction to take account of its discharge. The archive record would also be the destination of an entry which has been removed from the statutory pledges by means of a correction.

34.15 We recommend:

- 183. (a) Any person should be able to apply to the Keeper for an extract of an entry in the register.**
- (b) The Keeper should be required to issue the extract if such fee as is payable for issuing it is paid or arrangements satisfactory to the Keeper are made for payment of that fee.**
- (c) The Keeper should be able to validate the extract as the Keeper considers appropriate.**
- (d) The Keeper should be able to issue the extract as an electronic document if the applicant does not require that it be issued as a traditional document.**
- (e) The extract should be accepted for all purposes as sufficient evidence of the contents, as at the date on which and time at which the extract is issued (being a date and time specified in the extract).**

(Draft Bill, s 109)

⁹ See paras 10.32–10.34 above.

Chapter 35 Register of Statutory Pledges: miscellaneous

Introduction

35.1 In this chapter we consider miscellaneous matters in relation to the register, namely (1) information duties; (2) duration of registration and decluttering; (3) archiving; (4) liability of the Keeper and other parties for errors and breach of duties; and (5) RSP Rules.

Information duties

General

35.2 Similar issues arise here as for the Register of Assignations.¹ The information which appears in entries in the Register of Statutory Pledges may not be up-to-date. The secured creditor may have discharged the pledge by means of a written statement but not corrected the register.² Earlier in this Report we recommended that the assignment of a statutory pledge should not require registration to take effect.³ It should therefore be possible to seek information as to whom the statutory pledge has been assigned. As under the PPSAs and other comparator legislation we consider that there should be limited information duties to limited classes of third party.

What information?

35.3 We think that the information which may be requested should fall into three categories. The first would be whether a particular item of property is still encumbered by the statutory pledge. As with the RoA⁴ we do not think that it should be possible to “fish” for a list of all the encumbered property. The party making the request should have to specify particular property. The second would be a description of the secured obligation, as this may well not be fully apparent from the entry if it is described in the constitutive document by reference to off-register documentation.

35.4 The third would be information as to the holder of the statutory pledge. Thus where the person identified in the entry as the secured creditor receives a request as to whether certain property is encumbered and that person has assigned the statutory pledge it should be required to supply the details of the assignee and indeed, if known, any subsequent assignees.⁵

¹ See paras 11.2–11.17 above.

² See paras 23.49–23.54 above.

³ See paras 23.41–23.48 above.

⁴ See para 11.5 above.

⁵ As under DCFR IX.–3:320(3).

Who can request?

35.5 There would be a limited list of persons entitled to information and that list would be similar to the equivalent list for the RoA.⁶ It would include (a) those who have the consent of the provider, for example, a prospective secured creditor; (b) those who are entitled to execute diligence against the property, even if a charge for payment has not been executed; and (c) those who are prescribed by the Scottish Ministers, such as perhaps insolvency officials⁷ and executors.

35.6 In addition we think that any person with a right in the encumbered property should be entitled to request information, for example another secured creditor. This category is not required in the equivalent provisions for assignation because it is not possible to have a subordinate property right in an incorporeal such as a claim.⁸

How should a request be made?

35.7 The request would be made to the person identified in the entry as the secured creditor, normally we expect by electronic communication.

35.8 We recommend:

184. (a) An entitled person should be entitled to request from the person identified in an entry in the statutory pledges record as the secured creditor:

(i) if that person is the secured creditor, a written statement:

(a) as to whether or not property specified by the entitled person is, or is part of, the encumbered property; or

(b) describing the secured obligation, or

(ii) if that person has assigned the statutory pledge, the name and address of the assignee and (as the case may be and in so far as known) the names and addresses of subsequent assignees.

(b) The following should be entitled persons:

(i) a person who has a right in the property so specified,

(ii) a person who has the right to execute diligence against that property (or who is authorised by decree to execute a charge for payment and will have the right to execute

⁶ See paras 11.6–11.8 above.

⁷ Although we are aware that insolvency officials already have powers to examine the debtor and other relevant parties.

⁸ See para 17.5 above.

diligence against that property if and when the days of charge expire without payment),

- (iii) a person who is prescribed for these purposes, and**
- (iv) a person who has the consent of the person identified in the entry as the provider.**

(Draft Bill, s 110(1) to (2))

Duty to comply

35.9 The rules here would be similar to those for the RoA. The person identified in the entry as the secured creditor would have 21 days to comply. They could seek an extension to that period from the court. It would be entitled to grant the extension if it was satisfied in all the circumstances that it would be unreasonable for there to be compliance within that period. The court could also be asked to rule that the request need not be complied with, but again would have to be satisfied that in all the circumstances requiring compliance would be unreasonable. For example, while the person seeking the information is entitled to do so because they have the provider's consent they may have no objective need to have the information.

35.10 There should be no duty to comply if it is manifest from the entry that the property in question is not encumbered.⁹ For example, in an entry it is stated that the encumbered property is a yacht. It is therefore directly apparent that no car is encumbered. Similarly, if the full terms of the secured obligation can be determined from the entry the secured creditor should not have to respond to a request for a description of that obligation.

35.11 Further, there should be no duty to comply if it is manifest that the registration is ineffective. For example, if the entry states that the secured creditor (in whose favour the statutory pledge was granted and not an assignee¹⁰) is Martin but the constitutive document is granted in favour of Neil then no property is encumbered because of the seriously misleading inaccuracy.

35.12 We recommend also that if the same person has made the same request within the last three months and there has been no change, no reply should be required.¹¹

35.13 If none of the exceptions are relevant and the person identified in the entry as the secured creditor fails to supply the requested information the entitled person should be entitled to seek a court order requiring them to do so within 14 days. The court should grant the order if it is satisfied that there is no reasonable excuse for failing to supply it. The recommendations so far here mirror those which we made earlier in relation to the RoA.¹² But for the statutory pledge we considered whether the court should also have the power to penalise the non-complying party by extinguishing the statutory pledge and directing the

⁹ DCFR IX.-3:320(5)(a).

¹⁰ If the statutory pledge has been assigned and the details of the secured creditor corrected to reflect this the secured creditor named in the entry would be different from the one in the constitutive document.

¹¹ DCFR IX.-3:320(5)(a).

¹² See para 11.11 above.

Keeper to remove it from the register. The power to order deletion from the register for failure to comply is found in comparator legislation.¹³ We did not recommend it in relation to the RoA because the concept of the extinction of a transfer is incoherent. In theory the order could effect a re-transfer but this would be complicated because the claim may have been further assigned. In response to our draft Bill consultation in July 2017 R3 criticised the idea that a statutory pledge should be extinguished for failure to comply with information duties and similar views were expressed by some of our advisory group. We have therefore decided against such a power.

35.14 We recommend:

185. (a) An information request should require to be complied with within 21 days of its receipt, unless:

- (i) the court is satisfied that in all the circumstances this would be unreasonable and either extends the 21-day period or exempts the recipient from complying with the request in whole or in part,**
- (ii) it is manifest from the entry that the property specified in the notice has not been encumbered by the statutory pledge or that the registration is ineffective,**
- (iii) where a request has been made for a description of the secured obligation where it is manifest from the entry alone what the extent of that obligation is, or**
- (iv) the same request has been made by the same person within the last 3 months and the information supplied in response to the last request has not changed.**

(b) The recipient should be entitled to recover from the requester any costs reasonably incurred in complying with the request.

(c) If the court is satisfied on the application of the requester that the recipient has not complied with the duty to provide information without reasonable excuse it should by order require that the recipient complies within 14 days.

(Draft Bill, s 110(3) to (7))

¹³ See eg NZ PPSA 1999 s 182. Although the effect is less extreme because the security interest becomes unperfected rather than extinguished. But our recommended scheme does not recognise the attachment/perfection distinction as it was rejected by consultees. See para 18.45 above. An alternative approach taken by the DCFR IX.–3:323 is that if information is not provided the acquirer takes the right free of the security.

Where incorrect information is supplied

35.15 Imagine that Bank A holds a statutory pledge over the car fleet of the Rothienorman Taxi Company Ltd. Bank B is willing to lend the Company money but also wants to take security over the cars. The Company informs Bank B that Bank A has restricted the statutory pledge off-register so that it no longer encumbers any Volkswagens. This is in fact not true. But with the Company's permission Bank B makes an information request to Bank A in relation to the Volkswagens. Bank A mistakenly advises that these vehicles are no longer encumbered. Bank B promptly takes a statutory pledge over them. What should be the position?

35.16 Below we recommend that there should be statutory liability for loss caused to a party by reason of incorrect information being supplied in response to a request, which would apply where the secured creditor failed to take reasonable care.¹⁴ But to make such a claim would more than likely require court action. Drawing on the DCFR we consider that the effect of supplying incorrect information that an item of property is unencumbered when in fact it is encumbered should result in the pledge being extinguished in certain circumstances.¹⁵ These would be where the entitled person who received the wrong information went on to acquire the property or a right in it within three months of receipt of the information provided that they were in good faith. Hence if the entitled person knew by whatever means that the information was wrong it would not be protected.

35.17 In formulating this rule we have drawn on our earlier recommendations in relation to supervening inaccuracies.¹⁶ We accept, however, that policy choices here are difficult and that there are arguments that the protection should be narrower and apply only where the property is acquired rather than also where a security right is acquired in it. Similarly, in the case of the acquisition of a subsequent security it can be argued that the statutory pledge should only be ineffective as regards the creditor who was given the wrong information rather than extinguished. The broader approach, however, encourages more firmly the supply of accurate information.

35.18 We recommend:

186. Where:

- (a) an entitled person in response to an information request is incorrectly informed that the property specified in the request is unencumbered by the statutory pledge, and**
- (b) within 3 months of being so informed acquires in good faith**
 - (i) the property so specified or any part of it,**
 - (ii) a right in that property (or any part of it),**

¹⁴ See paras 35.35–35.36 below.

¹⁵ DCFR IX.–3:322(1).

¹⁶ See Chapter 32 above.

on the acquisition the statutory pledge is extinguished as regards the property or part.

(Draft Bill, s 110(8) to (9))

Where a statutory pledge has been assigned

35.19 If in response to an information request the person identified in the statutory pledges record as the secured creditor advises that the statutory pledge has been assigned and provides the details of the assignee, the information duties set out above should also apply to that person. For example, that person too should be required to advise whether particular property is encumbered. We recommend:

187. The duties to provide information should also apply to any assignee of the statutory pledge.

(Draft Bill, s 110(10))

Duration of registration and decluttering

35.20 It is generally the case in the Land Register that a standard security will be discharged when the loan is repaid, and thus be removed from the register. And purchasers of land will normally be unwilling to proceed until they (or perhaps more accurately, their solicitors) are satisfied that any standard security granted by the seller will be discharged.

35.21 The experience as regards moveable property is different, no doubt partly because there is not registration of title to moveables¹⁷ and thus no comparator to registration of title to land. For example, in England and Wales, the discharge of a bill of sale is commonly not registered.¹⁸ This leads to a cluttered register. The risk of cluttering is particularly high where a functional approach is taken to security rights, so that registration is required for any transaction functioning as a security. This is dealt with in various ways.

35.22 One is for registration to be time-limited, with the possibility of renewal. If there is no renewal the entry lapses. This is the position under, for example, UCC–9 (5 years);¹⁹ the NZ PPSA (5 years);²⁰ DCFR Book IX (5 years);²¹ and the Belgian Pledge Act (10 years).²² Another is for the registration to be for such period as is chosen by the applicant, with higher fees for longer periods. This is the position under the Australian PPSA, where registrations in respect of consumer and serial-numbered property can have a maximum duration of

¹⁷ With some minor exceptions, notably ships. See Chapter 21 above.

¹⁸ In 2007 and 2008 fewer than 20 memorandums of satisfaction were registered, despite almost 80,000 bills of sale being registered. See Department for Business, Innovation and Skills, *A Better Deal for Consumers: Consultation on proposal to ban the use of bills of sale for consumer lending* (2009) p 34 available at <https://www.gov.uk/government/consultations/consultation-on-proposal-to-ban-the-use-of-bills-of-sale-for-consumer-lending>. See also Law Com Report No 369 paras 6.70–6.86 for recommendations in relation to the proposed new goods mortgages, including a ten-year lapsing period where the encumbered property is not a vehicle.

¹⁹ UCC § 9–515.

²⁰ NZ PPSA 1999 s 153. A shorter period can be chosen.

²¹ DCFR Book IX.–3:325.

²² Belgian Pledge Act of 11 July 2013 art 33 (which provides for art 41 of the new Book III title XVII of the Civil Code).

seven years, but for other types of property there is no maximum.²³ The Canadian PPSAs generally allow applicants for registration to choose the duration, from one year to infinity.²⁴ The UNCITRAL Model Law on Secured Transactions has three possible approaches: (A) fixed period; (B) period chosen by applicant; and (C) period chosen by applicant up to a maximum.²⁵

35.23 In a non-functional system, the approach is different. Registration under Part 25 of the Companies Act 2006 is indefinite.²⁶ This is also the position under the draft Secured Transactions Code prepared by the Financial Law Committee of the City of London Law Society.²⁷ In its Report on Bills of Sale, the Law Commission for England and Wales does not recommend any fixed period of registration for the new “goods mortgage” in respect of motor vehicles. Rather, it is of the view that debtors are sufficiently protected if a creditor fails to remove the mortgage from the relevant asset finance registry by being able to complain to the Financial Conduct Authority. But it recommends a 10 year lapse period for registrations at the High Court of goods mortgages over assets other than motor vehicles.²⁸

35.24 In the Discussion Paper we said that while the issue was an open one, we inclined to the UCC–9 approach, on the basis that the inconvenience to lenders of having to renew a registration every five years is outweighed by the inconvenience of a register choked by dead entries.²⁹ We asked consultees for their views.

35.25 Most of our consultees opposed the suggestion that a registration should lapse after a certain period unless renewed. These included the Faculty of Advocates and the Law Society of Scotland. The WS Society argued that it would be “a recipe for confusion. There is no more justification for entries lapsing than for floating charges or standard securities lapsing.” There was limited support for a system under which the applicant had to specify a registration period. Most of our advisory group preferred a system under which registration entries last indefinitely. Their arguments are similar to those made during the statutory review of the Australian PPSA, where stakeholders were generally opposed to a New Zealand-style system of lapse after a certain period. As the reviewer stated: “Respondents argued that the secured parties often have long-term secured relationships with grantors, and that it would be unfair to require those secured parties to re-register part way through the term of that relationship.”³⁰

35.26 We have concluded that registration in the statutory pledges record in principle should be for an indefinite period, as is the case for standard securities and floating charges. We are in particular persuaded by the fact that the context is different from a functional system of registration, so that the number of registrations would be substantially lower. Nevertheless, we think that the legislation should be future-proofed. There may come a date

²³ Australian PPSA 2009 s 153.

²⁴ Although in Ontario for consumer goods the period is limited to five years. See Cuming, Walsh and Wood, *Personal Property Security Law* 353–354.

²⁵ UNCITRAL Model Law on Secured Transactions Model Registry Provisions art 14.

²⁶ But see Law Com Report No 296 paras 3.110–3.111.

²⁷ Although at p 93 in the commentary it is stated that consideration should be given to a mechanism by which a chargor could have a charge removed from the register following release, where the charge cannot be tracked down, perhaps by means of a court application.

²⁸ Law Com Report No 369, paras 6.70–6.86.

²⁹ Discussion Paper, para 20.52.

³⁰ Australian Statutory Review 2015 para 6.92.

many years in the future where the statutory pledges record clearly does need decluttering of “dead” entries. We therefore consider that the Scottish Ministers should have the power by regulations to set a period after which a statutory pledge would be extinguished unless the entry for it is renewed in the meantime. Clearly there should be consultation before that power is used. In particular, we think that there should require to be consultation with the Keeper.

35.27 If the Scottish Ministers did exercise the power there would need to be the ability to renew entries in advance of when the lapse would otherwise take effect. It is possible also that Ministers may wish to have different rules for (a) existing statutory pledges and (b) statutory pledges registered after the power is used. For example, if a ten-year lapse period were introduced as regards existing statutory pledges, the period could be provided to run from the commencement date of the lapse regulation and not the date on which the statutory pledge was registered. Imagine that a statutory pledge is registered in favour of the Ballater Bank on 1 April 2025. On 1 December 2050 a ten-year lapsing rule is introduced. The statutory pledge would lapse on 1 December 2060 unless renewed beforehand.

35.28 Finally, it should be stressed that whereas under the UCC–9/PPSA approach the lapsing of a registration means that the security right is no longer perfected (and in general will not have third party effect), in the RSP the statutory pledge would be entirely extinguished. This is because of the rejection of the attachment/perfection discussed above.³¹

35.29 We recommend:

- 188. (a) The Scottish Ministers should have power to make regulations specifying a period after which an entry in the statutory pledges record will lapse unless it is renewed.**
- (b) Before exercising this power, the Scottish Ministers must consult the Keeper.**

(Draft Bill, s 99)

Archiving

35.30 In the RoA the purpose of the archive record would be to store entries which have been removed from the assignments record following a correction.³² Clearly, the RSP would require an archive record to perform this function too. We expect that where a statutory pledge is discharged it should become standard practice for the secured creditor to correct the register to remove it.

35.31 There would be one further case where the archive record would be used. This would be where the Scottish Ministers made regulations for the lapsing of statutory pledges after a certain period of time.³³

³¹ See paras 18.44–18.49 above.

³² See paras 11.19–11.21 above.

³³ See paras 35.20–35.29 above.

35.32 We recommend:

189. The archive record should be the totality of all the entries transferred from the statutory pledges record following:

- (a) correction to remove an entry, and**
- (b) lapsing of a statutory pledge under regulations made by the Scottish Ministers,**

and should also contain such other information as may be specified by RSP Rules.

(Draft Bill, s 90)

Liability of Keeper and other parties

Introduction

35.33 Earlier we recommended statutory liability rules for the Keeper and other parties in relation to the RoA.³⁴ We explained that while liability questions could in principle be left to the common law, placing the matter on a statutory footing would provide more certainty. Further, in relation to the Keeper we considered that there should be strict liability.

Liability of Keeper

35.34 The RSP would be managed by the Keeper in a very similar way to the RoA and it would plainly therefore be appropriate for the same liability rules to apply.³⁵ We set out the basis for these rules above.³⁶ We recommend:

- 190. (a) A person should be entitled to be compensated by the Keeper for loss suffered in consequence of:**
- (i) an inaccuracy attributable to the Keeper in the making up, maintenance or operation of the Register of Statutory Pledges, or in an attempted correction of the register,**
 - (ii) the issue of a statement or notification which is incorrect, or**
 - (iii) the issue of an extract which is not a true extract.**
- (b) But the Keeper should have no statutory liability:**

³⁴ See paras 11.22–11.42 above.

³⁵ One difference between the RoA and the RSP is that in the former corrections would always require the intervention of the Keeper's staff. In contrast it would be possible for a secured creditor in the RSP to make a correction using the automated system. But this does not necessitate different liability provisions.

³⁶ See paras 11.24–11.34 above.

- (i) in so far as the person's loss could have been avoided had the person taken measures which it would have been reasonable for the person to take,**
- (ii) in so far as the person's loss is not reasonably foreseeable, or**
- (iii) for non-patrimonial loss.**

(Draft Bill, s 111)

Liability of certain other persons

35.35 Once again we consider that the same rules should apply as for the RoA.³⁷ There should be fault-based (rather than strict) liability in certain circumstances. The first would be where a person who has registered a statutory pledge creates an inaccurate entry which causes another person loss, such as a person being identified as a provider when that is not the case. The second would be where the secured creditor fails to respond to a request for information or supplies incorrect information in response to such a request.³⁸ There would be the same limitations on liability as for the equivalent provisions in relation to the RoA.

35.36 We recommend:

191. (a) Where a person suffers loss in consequence of:

- (i) an inaccuracy in an entry in the Register of Statutory Pledges (which is not caused by the Keeper), the person should be entitled to be compensated for that loss by the person who made the application which gave rise to that entry if, in making it, that person failed to take reasonable care, or**
- (ii) a failure to respond to a request for information under the information duty provisions, or the provision of information in which there is an inaccuracy, the person is entitled to be compensated for that loss by the person who failed to supply the information if that failure was without reasonable cause or if, in supplying it, that person failed to take reasonable care.**

(b) But there should be no liability:

- (i) in so far as the person's loss could have been avoided had the person taken measures which it would have been reasonable for the person to take,**
- (ii) in so far as the loss is not reasonably foreseeable, or**

³⁷ See paras 11.35–11.42 above.

³⁸ On duties to provide information see paras 35.2–35.19 above.

(iii) for non-patrimonial loss.

(Draft Bill, s 112)

RSP Rules

35.37 We explained earlier in relation to the RoA that it is typical in statutes on registration both in Scotland and internationally for there also to be secondary legislation in the interest of flexibility.³⁹ We therefore recommend that the Scottish Ministers should have the power to make regulations in relation to the RSP, which would be known as “RSP Rules”. The power should be a wide-ranging one and should be very similar to that for the RoA.

35.38 We recommend:

- 192. The Scottish Ministers should, following consultation with the Keeper, be able by regulations to make rules (to be known as “RSP Rules”):**
- (a) as to the making up and keeping of the register,**
 - (b) as to procedure in relation to applications:**
 - (i) for registration, or**
 - (ii) for corrections,**
 - (c) as to the identification, in any such application of any person or property, including:**
 - (i) how the proper form of a person’s name is to be determined, and**
 - (ii) where the person bears a number (whether of numerals or of letters and numerals) unique to the person, whether that number must (or may) be used in identifying the person,**
 - (d) as to the degree of precision with which time is to be recorded in the register,**
 - (e) as to the manner in which an inaccuracy in the statutory pledges record may be brought to the attention of the Keeper,**
 - (f) as to information which, though contained in a constitutive document or amendment document, need not be included in a copy of that document submitted with an application for registration,**

³⁹ See paras 11.43–11.49 above.

- (g) as to whether a signature contained in a constitutive document or amendment document need be included in a copy of that document so submitted,**
- (h) as to searches in the register,**
- (i) as to information which, though contained in the register, is not to be:**
 - (i) available to persons searching it, or**
 - (ii) included in any extract issued by the Keeper,**
- (j) prescribing the configuration, formatting and content of:**
 - (i) applications,**
 - (ii) notices,**
 - (iii) documents,**
 - (iv) data,**
 - (v) statements, and**
 - (vi) requests****to be used in relation to the register,**
- (k) as to when the register is open for:**
 - (i) registration, and**
 - (ii) searches,**
- (l) requiring there to be entered in the statutory pledges record or the archive record such data as may be specified in the rules, or**
- (m) regarding other matters in relation to registration, being matters for which the Scottish Ministers consider it necessary or expedient to give full effect to the purposes of the draft Bill.**

(Draft Bill, s 114)

Chapter 36 The company charges registration scheme

Introduction

36.1 The company charges registration scheme requires that most security rights granted by companies are registered in the Companies Register.¹ In the Discussion Paper we briefly reviewed the history of the scheme.²

36.2 “Charge” is a term in English law for a certain type of security right.³ English law traditionally did not accept the publicity principle in relation to charges and indeed more widely,⁴ but this began to change in the nineteenth century. In particular, there was increasing concern that companies could charge their assets in secret. This led to section 14 of the Companies Act 1900, the modern day successor of which is Part 25 of the Companies Act 2006.

36.3 Originally, the requirement to register company charges did not apply to Scotland. But, when the floating charge was introduced by the Companies (Floating Charges) (Scotland) Act 1961, so too was company charges registration. Thus not only does a floating charge have to be registered, so does a standard security granted by a company. This is even although the standard security requires to be registered in the Land Register. Likewise, where a patent is assigned in security the assignation has to be registered in both the Register of Patents and the Companies Register to be effective against third parties. This requirement for double registration has been trenchantly criticised,⁵ but there are many in practice who like the fact that the Companies Register amounts to a “one stop shop” for checking the security rights granted by a particular company.

36.4 In 2004 this Commission recommended that the company charges registration should be abolished and that floating charges should be registered instead in a new Register of Floating Charges. The first part of this recommendation was not accepted by the Department of Trade and Industry.⁶ The second part was accepted by the Scottish Government, leading to Part 2 of the Bankruptcy and Diligence etc. (Scotland) Act 2007. But, as we saw above, Part 2 has not been brought into force.⁷

¹ There are parallel provisions for security rights granted by LLPs and certain other entities, but in the interests of brevity we refer only to companies in the chapter.

² Discussion Paper, para 8.1.

³ See eg Beale, Bridge, Gullifer and Lomnicka, *The Law of Security and Title-Based Financing* para 1.18.

⁴ On this principle, see the Discussion Paper, Chapter 11.

⁵ See G L Gretton, “Registration of Company Charges” (2002) 6 EdinLR 146.

⁶ A predecessor of the Department for Business, Energy and Industrial Strategy.

⁷ See paras 18.23–18.25 above.

Companies Act 2006 Part 25 since 1 April 2013

36.5 As a result in part of the work of the Law Commission for England and Wales,⁸ the companies charges registration scheme was overhauled with effect from 1 April 2013.⁹ Previously there had been separate versions applying north and south of the border. Now there is a unified scheme. Formerly, the charges which required to be registered were specified. Now all charges must be registered, except where they are expressly excluded. A “charge” includes “a standard security, assignation in security, and any other right in security constituted under the law of Scotland, including any heritable security, but not including a pledge”.¹⁰

36.6 Charges must be registered in the Companies Register within 21 days of their date of creation.¹¹ That date has different definitions for different types of security right.¹² For standard securities it is 21 days after their date of registration in the Land Register. Prior to 1 April 2016 a standard security would be recorded in the Register of Sasines if the land over which it was being granted was not yet registered in the Land Register. Now only registration in the Land Register is possible, meaning that the land to be encumbered must be registered in that Register in order for the standard security to be created. The purpose of this rule is to speed up completion of the Land Register.¹³

36.7 For other security rights, the deadline is normally 21 days after their date of delivery. For example, if A Ltd grants a floating charge in favour of Bank B, the period runs from when the floating charge document signed by A Ltd is delivered to the bank. Prior to the floating charge being registered, there is thus an “invisibility period”. This is something which has been the subject of longstanding criticism.¹⁴ The Bankruptcy and Diligence etc. (Scotland) Act 2007 Part 2 reforms would have eliminated this.¹⁵

36.8 In a change to the position prior to 1 April 2013, it is necessary to register a certified copy of the charge.¹⁶ The consequences of not registering a charge within the 21-day period are very serious. The charge is void against a liquidator, administrator or a creditor of the company.¹⁷

⁸ Law Commission for England and Wales, *Company Security Interests* (Law Com No 296, 2005).

⁹ Companies Act 2006 (Amendment of Part 25) Regulations 2013 (SI 2013/600). For discussion, see K G C Reid and G L Gretton, *Conveyancing 2013* (2014) 172–178 and H Patrick, “Charges changing” 2013 JLSS Feb/20.

¹⁰ Companies Act 2006 s 859A(7)(b).

¹¹ Companies Act 2006 s 859A(4).

¹² Companies Act 2006 s 859E(1).

¹³ See Registers of Scotland (Voluntary Registration, Amendment of Fees, etc) Order 2015 (SSI 2015/265) art 3.

¹⁴ See D Bennett, “A Judicial Wet Blanket Upon the Register of Charges” 1967 SLT (News) 153; W W McBryde and D M Allan, “The Registration of Charges” 1982 SLT (News) 177 and Scottish Law Commission, *Report on Registration of Rights in Security by Companies* (Scot Law Com No 197, 2004) para 1.17.

¹⁵ But see G Yeowart “A register of floating charges over Scottish assets: a new “Slavenburg” problem?” 2012 *Journal of International Finance and Banking Law* 470 at 471: “experience indicates that the ‘invisibility period’ is not a serious practical problem . . . Both the Committee of Scottish Clearing Bankers and the British Bankers’ Association have also expressed the view that the “invisibility period” is not a significant problem in practice.” Nevertheless, the City of London Law Society’s draft Secured Transactions Code arts 8 and 32 provide for a charge to be created on registration, which would thus end the invisibility period.

¹⁶ Companies Act 2006 s 859A(3).

¹⁷ Companies Act 2006 s 859H(3).

The statutory pledge and registration in the Companies Register: general

36.9 We recommended above that the statutory pledge should normally require to be registered in the Register of Statutory Pledges.¹⁸ In view of the “included unless expressly excluded” approach of Part 25 of the Companies Act 2006 since 1 April 2013, statutory pledges granted by companies would have to be registered in the Companies Register too.¹⁹ In other words there would require to be double registration. This would also be the position for an assignment in security of a claim by a company completed by registration in the RoA.²⁰ It would require to be registered in the Companies Register, given the definition of “charge” referred to above.²¹

36.10 In the Discussion Paper we expressed the view that the new security right being proposed should not be registrable under Part 25.²² Following the 2013 reforms and also the view expressed by our advisory group in relation to the benefits of the “one stop shop” of the Companies Register, we no longer hold to that position.

36.11 We argued, alternatively, in the Discussion Paper that, if the new security right were to be registrable under the company charges registration scheme, the need for double registration should be removed by an order being made by the Secretary of State for Business, Energy and Industrial Strategy under section 893 of the Companies Act 2006. Under the company charges registration scheme there often has to be double registration, for example, for standard securities.²³ Section 893 allows the Secretary of State to make an order whereby registration in the Companies Register will no longer be necessary provided that a system is in place for the transmission from the “special register” (for example, the Land Register) to the Companies Register of the registered information. The effect of such an order would be that those searching the Companies Register would still be able to obtain the same information as at present.

36.12 In 2010 the Department for Business, Innovation and Skills (DBIS), the predecessor of the Department for Business, Energy and Industrial Strategy (DBEIS) set out the criteria which must be satisfied before a section 893 order can be made:

“There are several aspects to appropriate information-sharing arrangements. First, Companies House and the specialist registry must share information so that any filing that would have been rejected by Companies House (for example, because it does not include the correct name and number for the company creating the charge or any other required information is missing) is not treated as if registered at Companies House whether or not the specialist registry accepts the registration under its own procedures.

Second, anyone inspecting a particular company’s record at Companies House would have to be able to see sufficient information for any charge that has been registered at the specialist register to ensure that third parties are not disadvantaged

¹⁸ See Chapter 23 above. There would be an exception for financial collateral arrangements. See Chapter 37 below.

¹⁹ While the Companies Act 2006 s 859A(7)(b) provides that the registration requirement does not apply to “a pledge” this refers to pledge under the current law ie a possessory pledge.

²⁰ See Chapter 5 above.

²¹ See para 36.5 above.

²² Discussion Paper, para 20.47.

²³ See para 36.3 above.

by the charge not having been registered at Companies House. This information must be available to all inspecting the company's record, whether online, by bulk download, or by personal enquiry at a Companies House enquiry point; the online record would have to have a link to the relevant entry in the specialist register (see paragraphs 89-93).

Third, the specialist registry must also accept filing of a memorandum of satisfaction (in whole or in part) for any charge registered with it - and this information must be similarly shared with Companies House.

Fourth, these arrangements must not increase costs either for those who register charges or for those who use the information at Companies House to assess the financial status of companies. However the specialist registry's prices would apply to any further inspection of a charge registered with it."²⁴

No section 893 order has been made as regards any register. Nevertheless, we took the view in the Discussion Paper that such an order would be desirable.²⁵

Consultee responses

36.13 We asked consultees whether they agreed that if a new moveable security is introduced, which is created by registration, a section 893 order should be made so as to avoid a double registration requirement. Almost all consultees agreed. The response of the Law Society of Scotland, which was echoed by Brodies, was representative: "[We are] in favour of avoiding having to register the same security in two separate registers. [We do], however, see the benefit in such security appearing in both registers. A collaborative approach between the various registers would presumably assist here." The WS Society said: "We are not convinced it is anything other than a backward step to require in future a search in multiple registers instead of a single register where one is dealing with a company or LLP."

36.14 If a section 893 order were made registration would be in the specialist register (for present purposes the RSP) and the information would then be transmitted to the Companies Register. Dr Hamish Patrick, however, argued for the reverse, whereby a statutory pledge granted by a company would be registered in the Companies Register and the information would then be relayed to the RSP.

The way forward

36.15 After considering the responses of consultees we reflected on the way forward, particularly in the light of the absence of any section 893 orders to date. We engaged in discussions with Companies House, DBIS (as it was then called) and Registers of Scotland. In this regard we considered a number of different options. Our starting point was a policy that statutory pledges granted by any type of person would be registrable in the RSP. In the case of companies we then needed to take account of the company charges registration scheme. We identified three options in relation to which DBIS, on behalf of Companies House, and Registers of Scotland gave us their views.

²⁴ Department for Business, Innovation and Skills Consultation Paper, *Registration of charges created by companies and limited liability partnerships* (2010) 46.

²⁵ Discussion Paper, para 20.47.

Double registration

36.16 The first option was double registration. This is unattractive because it is cumbersome. It also involves the payment of two registration fees. But the latter is probably not a particularly strong argument, because the cost of information-sharing arrangements would inevitably lead to a higher fee for the one registration in the RSP.

36.17 As Part 25 of the Companies Act 2006 currently stands there is also an issue in that the usual rule for the 21-day period is that it runs from the day of delivery of the security document to the creditor. This leads to the possibility of a creditor complying with this timescale but then forgetting to register in the RSP. The Companies Register would then be unreliable. In contrast, the rule for standard securities is that the 21 days run from the day of registration in the Land Register. UK subordinate legislation would be needed to address this. There would also be benefit in such legislation making it clear that the current exclusion of the requirement to register a “pledge”²⁶ does not include the new statutory pledge. These issues aside, the first option could proceed without any UK legislation. It also had the support of DBIS in correspondence with us.

Section 893 order

36.18 The second option was an order under section 893 of the 2006 Act. As we have seen, it had the support of most of our consultees. It would avoid the need for double registration. In discussions with us, it also remained “on balance” the preferred option of Registers of Scotland. In contrast, in relation to the first option, Registers of Scotland said that “double registration risks becoming bureaucratic and cumbersome”. An order under section 893 would require DBIS support and it had to be satisfied that its four criteria set out above²⁷ had been met.²⁸ DBIS also advised us that no money was available from Companies House to meet the costs of establishing the new information-sharing arrangements.

36.19 A further issue with a section 893 order relates to how registration in the RSP would normally work. In the preceding chapters we recommended a registration scheme similar to that in UCC–9/PPSA jurisdictions, namely one of electronic filing with no checks being made by the Keeper. This allows also for quick and inexpensive registration. In contrast, when a charge is registered in the Companies Register, it is checked by Companies House staff²⁹ before it is entered on the register. A section 893 order would require this approach to be taken at the RSP where the provider of a statutory pledge is a company. Such an approach would be possible, although it would conceivably require legislative amendment to our

²⁶ Companies Act 2006 s 859(7)(b).

²⁷ See para 36.12 above.

²⁸ We note that in the different context of DBEIS, *A Register of Beneficial Owners of Overseas Companies and other Legal Entities: Call for evidence on a register showing who owns and controls overseas legal entities that own UK property or participate in UK government procurement* (2017) para 17 it is stated: “It is important to both the UK and Scottish Governments that no companies will be required to report their information twice under the linked proposals [in relation to ownership and control of property].”

²⁹ Note L Gullifer and M Raczynska, “The English Law of Personal Property Security: Under-reformed?” in Gullifer and Akseli (eds), *Secured Transactions Law Reform* 271 at 282.

recommended scheme in relation to companies by the UK Parliament, given that the law of business associations is currently reserved.³⁰

Joint filing service

36.20 The third option arose out of discussions with Companies House. It alerted us to the joint electronic filing service for company accounts whereby information filed once is transmitted to both Companies House and HMRC.³¹ We considered whether there would be benefit in recommending a joint electronic filing service for statutory pledges granted by companies whereby there was a single portal managed by Companies House and Registers of Scotland. The advantages of this would be one filing only and Companies House would be able to check security documents under its usual procedures, rather than rely on Registers of Scotland doing this, which is what would require to happen for a section 893 order to be made. Clearly, however, there would be set-up and running costs in relation to such a system and DBIS advised us that there would be no funding available from Companies House. Registers of Scotland were of the view that a joint filing system would be costlier than the second option of a section 893 order.

36.21 There would be other challenges with this option. It would not be possible always to use the company charges registration form (currently form MR01) as it does not have a box for unique identification numbers, such as vehicle identification numbers (VINs). We recommend elsewhere that the RSP should be searchable by reference to such numbers.³² Implementation of the joint filing scheme would require legislation, in contrast to the second option where section 893 is already on the statute book. We are of the view that the Registrar of Companies already has the power to allow statutory pledges to be registered by means of a new electronic registration system.³³ But we think that further UK legislation would be required. Under this option, there would require to be legislative provisions which would apply specifically to companies. For example, it would have to be provided that it would be possible to register statutory pledges granted by companies in the RSP by using the new joint online filing service. As discussed elsewhere,³⁴ company law is in general a reserved matter and so any legislation would need to be enacted by the UK Parliament.

36.22 Given the lack of support from two key stakeholders – DBIS/Companies House and Registers of Scotland – we do not consider the joint filing scheme option as viable. This leaves the double registration and section 893 order options. Before reaching a conclusion in relation to these, we considered other options. Two of these merit discussion here.

Reverse section 893 order

36.23 The first of these is that championed by Dr Patrick in his consultation response. It can be termed in shorthand a “reverse section 893 order”. Under this option creditors would be able to give effect to statutory pledges granted by *companies* by registering at a single registration point: the Companies Register. This would involve setting up information-sharing arrangements between Companies House and Registers of Scotland. When a

³⁰ See para 1.43 above.

³¹ Her Majesty's Revenue and Customs.

³² See para 34.5 above.

³³ Companies Act 2006 s 1068. See also the rule making power under s 1117 of the same Act.

³⁴ See paras 1.43 above.

statutory pledge was registered in the Companies Register, information about the security right would then be transmitted electronically to the RSP. As a result of these information-sharing arrangements, the RSP would contain every statutory pledge (apart from those over financial instruments perfected by possession or control).³⁵ In addition, the implementation of the information-sharing arrangements would allow statutory pledges to be treated as if registered in the RSP on the date of registration in the Companies Register. This would mean that a statutory pledge granted by a company over current and identifiable assets would be created as a real right on the date of registration in the Companies Register.

36.24 In our view, the Secretary of State would not be able to implement this option by making a section 893 order. New amending UK legislation would be required, given that company law is reserved.³⁶ We note also that the Register of Floating Charges Technical Working Group, which was set up by the Scottish Government to consider implementation of Part 2 of the Bankruptcy and Diligence etc. (Scotland) Act 2007,³⁷ looked at a similar option and rejected it for various reasons, including concerns about issues of liability and powers of the two registration agencies in relation to the creation of the security being dependent on transmission of information from Companies House to Registers of Scotland.³⁸ There would also be similar costs concerns as with the section 893 order and joint filing service options. We therefore do not recommend this option.

Registration only in the Companies Register

36.25 The remaining option does not involve information sharing and its associated costs, and for these reasons is initially very attractive.³⁹ Where a company granted a statutory pledge it would be registered in the Companies Register alone and therefore only one registration fee would have to be paid. Where a non-company, such as a sole trader or partnership, granted a statutory pledge it would be registered in the RSP. This would depart from the original proposed scheme that the RSP would contain all statutory pledges. Under this option statutory pledges would be fragmented across the Companies Register and the RSP. The RSP would therefore be incomplete.⁴⁰ It would also be somewhat anomalous to have the same type of security right created in different ways by different types of debtor.

36.26 There is another difficulty. The Companies Register can be searched by company but not by assets. As we noted above,⁴¹ we recommend elsewhere that the RSP should be searchable by reference to unique identification numbers. Thus creditors wishing to take statutory pledges from companies, for example, over motor vehicles and have the VIN(s) registered would have a problem. This could be fixed by permitting the registration of such statutory pledges in the RSP, even although granted by companies. But the result would be (i) statutory pledges granted by non-companies; and (ii) statutory pledges granted by companies over property with unique identification numbers.

³⁵ See Chapter 37 below.

³⁶ This might be only subordinate legislation made under the Companies Act 2006 s 894.

³⁷ See para 18.25 above.

³⁸ See Register of Floating Charges Technical Working Group: Report to Scottish Government (2011) para 5.1.4, available at <http://www.scotland.gov.uk/resource/doc/254430/0121799.pdf>.

³⁹ See eg J Hardman, "Some Legal Determinants of External Finance in Scotland: A Response to Lord Hodge" (2017) 21 EdinLR 30 at 47–48.

⁴⁰ Although given the Financial Collateral Arrangements (No. 2) Regulations 2003 it cannot be complete. See Chapter 37 below.

⁴¹ See para 36.21 above.

36.27 The implementation of this option would require company-specific rules. The legislation would have to provide that statutory pledges granted by companies over assets (other than prescribed assets with unique identification numbers) would only require registration in the Companies Register. It would be registration in that register which would be constitutive of the statutory pledge. For existing security rights granted by companies, registration in the Companies Register is not constitutive; it is necessary only for effectiveness in insolvency and against other creditors.⁴² As these legislative provisions would deal specifically with statutory pledges granted by companies and provide a new function for registration in the Companies Register we take the view that UK legislation would be required to implement this option. This would also mean the new law being in two different places, namely in an Act of the Scottish Parliament and in UK legislation,⁴³ which would not be user-friendly. It would also be more difficult to secure resources at DBEIS and legislative time at Westminster to effect this, given the other priorities which exist at UK level not least the withdrawal from the European Union. While therefore the option of registration in the Companies Register only is attractive at first sight, on closer examination it has significant difficulties and therefore we do not recommend it.

Conclusion

36.28 Having reviewed the various options and discussed them at length with our advisory group, we have concluded that double registration offers the most pragmatic solution as it does not require the funding that would be necessary to set up information-sharing arrangements. Further, it does not require legislation at UK level. Creditors are experienced at registering twice, because they need to do so for other securities, such as standard securities. Nevertheless, we consider that the possibility of a section 893 order should be kept under review as in the longer term it remains desirable to require only a single filing. We recommend that:

- 193. A statutory pledge granted by a company should be registered in both the Register of Statutory Pledges and the Companies Register, but the possibility of an order being made under the Companies Act 2006 section 893 should be kept under review.**

⁴² See para 36.8 above. Of course an alternative would be to put the statutory pledge on the same footing as a floating charge and not make registration constitutive so that there is an “invisibility period”. We are unwilling to so recommend. See para 36.7 above.

⁴³ Perhaps an Act of the Scottish Parliament plus an order under section 104 of the Scotland Act 1998.

Chapter 37 Financial collateral

Introduction

37.1 In Chapter 14 above we set out the special rules in relation to financial collateral. These originate from the Financial Collateral Directive of 2002 (as amended),¹ which was implemented in the UK by the Financial Collateral Arrangements (No. 2) Regulations 2003 (“FCARs”).²

37.2 Given our earlier recommendation on limiting the scope of the statutory pledge to financial instruments, it is in relation to that type of property that we now need to consider the extent to which any variations to our general scheme are required to comply with the special rules on financial collateral.

Pledge of financial instruments

Creation of statutory pledge

37.3 We recommended earlier that registration should be a requirement for the creation of a statutory pledge.³ We recommended also as regards incorporeal moveable property that the statutory pledge should be restricted to financial instruments and intellectual property. Clearly, only the former come within the scope of the Directive. Where a statutory pledge is granted in respect of a financial instrument and the requisite possession or control is achieved we consider now that the statutory pledge could qualify as a security financial collateral arrangement (SFCA).⁴ In such circumstances, given the terms of the Directive, we do not think that registration in the RSP can be insisted upon. Given, however, the opaque terms of the Directive, in particular as regards possession or control, we consider that parties would wish to retain the option of registration in the RSP as this would give them certainty as to creation. If the SFCA route, as opposed to the registration route, were chosen it would still nevertheless be necessary for the financial instrument to be the property of the provider and to be identifiable as property to which the constitutive document relates.

37.4 Where a statutory pledge is created as an SFCA it is also necessary for the usual requirement for its constitutive document to be executed or signed electronically to be disapplied. The statutory pledge need only be evidenced in writing transcribed by electronic or other means in a durable medium, or as sounds recorded in such a medium.

37.5 We therefore recommend:

¹ Directive 2002/47/EC.

² Financial Collateral Arrangements (No. 2) Regulations 2003 (SI 2003/3226) as amended by the Financial Markets and Insolvency (Settlement Finality and Financial Collateral Arrangements) (Amendment) Regulations 2010 (SI 2010/2993).

³ See para 23.19 above.

⁴ This departs from the view that we took in the Discussion Paper, para 2.25, which was that without registration the collateral provider would not have “control”. It is impossible to be certain, however, but we have now, following advice from our advisory group, decided to take a cautious approach and assume that the Directive would apply.

194. The creation of a statutory pledge over a financial instrument should require either:

(a) registration in the Register of Statutory Pledges and compliance with the ordinary rules for creation of statutory pledges, or

(b) in a case where a constitutive document or amendment document evidences a security financial collateral arrangement in respect of the instrument, the satisfaction of the following criteria:

- (i) the financial instrument to be the property of the provider,**
- (ii) the financial instrument to have come into the possession of, or under the control of, the collateral-taker or a person acting on the collateral-taker's behalf, and**
- (iii) identification of the financial instrument as one to which the constitutive document or amendment document relates.**

(Draft Bill, s 50(1)–(3) & (6))

195. Where a statutory pledge over a financial instrument is created without registration:

(a) there should be no requirement for it to be executed or signed electronically, and

(b) the constitutive document and any amendment document may be evidenced by writing transcribed by electronic or other means in a durable medium, or as sounds recorded in such a medium.

(Draft Bill, s 50(4) to (6))

Assignment of statutory pledge

37.6 We recommended earlier that the assignment of a statutory pledge should require an assignment document executed or authenticated by the secured creditor.⁵ Where a statutory pledge is an SFCA we consider that the policy aim of the Directive to reduce formalities should be implemented by removing the need for execution or authentication. Instead an evidenced agreement between the collateral-taker (secured creditor) and the assignee should suffice. In line with the position for creation of a statutory pledge, as an SFCA the agreement could be evidenced in writing transcribed by electronic or other means in a durable medium, or in sounds recorded in such a medium. We recommend:

196. Where a statutory pledge over a financial instrument is created without registration:

⁵ See para 23.42 above.

- (a) it may be assigned by an evidenced agreement between the collateral-taker and the assignee, and**
- (b) that agreement may be evidenced in writing transcribed by electronic or other means in a durable medium, or in sounds recorded in such a medium.**

(Draft Bill, ss 59(3) and 63)

Amendment of statutory pledge

37.7 We also recommended earlier that the amendment of a statutory pledge should normally require a document executed or authenticated by the provider and secured creditor.⁶ Where a statutory pledge is an SFCA, as for assignation we consider that the policy aim of the Directive to reduce formalities should be implemented by removing the requirement for execution or authentication. An evidenced agreement between the collateral-taker (secured creditor) and the collateral-provider (provider) should be competent. Once again this could be evidenced in writing transcribed by electronic or other means in a durable medium, or in sounds recorded in such a medium. We recommend:

197. Where a statutory pledge over a financial instrument is created without registration:

- (a) it may be amended by an evidenced agreement between the collateral-taker and the provider, and**
- (b) that agreement may be evidenced in writing transcribed by electronic or other means in a durable medium, or in sounds recorded in such a medium.**

(Draft Bill, ss 60(8) and 63)

Extinction of statutory pledge

37.8 Under our recommendation above, a statutory pledge which qualifies as an SFCA can be created if (a) the SFCA requirements are satisfied; or (b) if there is registration in the RSP. For (a) to be satisfied the secured creditor (collateral-taker) would require to have possession or control of the financial instrument.

37.9 Where a statutory pledge has been created as an SFCA without registration clearly it does not make sense for any action to be taken in the RSP. Instead either the statutory pledge could be extinguished by the collateral-taker relinquishing possession or control. Alternatively, we consider that it should be possible to restrict or discharge the security by an evidenced statement of the collateral-taker. In line with the provisions on creation of an SFCA, the statement could be evidenced by writing transcribed by electronic or other means in a durable medium or sounds recorded in such a medium.

37.10 We therefore recommend:

⁶ See paras 23.33–23.40 above. But an amendment adding property should only need execution or authentication by the provider.

198. (a) A statutory pledge created as a security financial collateral arrangement without registration in the Register of Statutory Pledges should be:

- (i) extinguished in relation to the financial instrument over which the pledge is created on the financial instrument ceasing to be in the possession, or under the control, of the collateral-taker or of a person acting on behalf of the collateral-taker, or**
- (ii) restricted to only part of the encumbered property by means of an evidenced statement of the collateral-taker.**

(b) Such a statement may be evidenced in writing transcribed by electronic or other means in a durable medium, or sounds recorded in such a medium.

(Draft Bill, ss 62 and 63)

Rights of substitution and withdrawal

37.11 The definition of an SFCA in the FCARs enables the parties to agree that the collateral-provider can substitute financial collateral of the same or greater value or withdraw excess financial collateral without losing possession or control of the collateral.⁷ Under English law it is very likely that such an agreement would make the SFCA a floating charge.⁸ Given that a statutory pledge is a fixed security we consider therefore that special rules in relation to substitution and withdrawal are not relevant. As we have noted elsewhere, the fixed/floating distinction is a matter of corporate insolvency law where the relevant legislation is the Insolvency Act 1986.⁹ It is possible that future developments, for example in English case law or in UK legislation, may make it clear that rights of substitution or withdrawal do not prevent an SFCA being a fixed security. If that happens then the statutory pledges legislation could be amended.

Ranking

37.12 The ranking of a statutory pledge over a financial instrument created as an SFCA would be subject to the same general ranking rule which we recommend above.¹⁰ Thus the priority point would be creation. It would seem unlikely that there could be two pledges created as SFCAs over the same instrument because of the need for possession or control. Thus if Bank A has possession or control this would preclude Bank B having possession or control. On the other hand it is possible to envisage Bank A having a statutory pledge by possession or control and Bank B having a statutory pledge by registration.

⁷ FCARs reg 3(1).

⁸ See Beale, Bridge, Gullifer and Lomnicka, *The Law of Security and Title-Based Financing* para 3.39 and Yeowart and Parsons, *The Law of Financial Collateral* paras 8.13 and 8.82–8.99.

⁹ See para 20.1 above.

¹⁰ See paras 26.1–26.10 above.

Enforcement

37.13 Elsewhere we make recommendations on enforcement of pledges.¹¹ But the Directive and FCARs make special provision for rights exercisable by the collateral-taker in the case of an SFCA, namely rights of use and appropriation.¹² Thus an SFCA may allow the collateral-taker to use and dispose of the collateral provided that it is replaced with equivalent collateral on or before the due date for the performance of the relevant financial obligations which are covered by the SFCA.¹³ Alternatively, if the SFCA permits this, the used or appropriated collateral can be set off against or applied in the discharge of the relevant financial obligations.¹⁴ Where the SFCA permits appropriation no foreclosure order is required from a court.¹⁵ But the collateral must be valued in accordance with the terms of the SFCA and in a commercially reasonable manner.¹⁶ If the value exceeds the amount of the relevant financial obligations under the SFCA then the collateral-taker must account to the collateral provider for the difference. If the value is less than these obligations then the collateral provider remains liable to the collateral-taker for the shortfall.¹⁷

37.14 Where a statutory pledge falls within the definition of an SFCA the special rights of use and appropriation require to be available. We recommend:

- 199. Nothing in the enforcement rules for pledge should be taken to derogate from such rights as a secured creditor may have by virtue of Part 4 of the Financial Collateral Arrangements (No. 2) Regulations 2003 (right of use and appropriation).**

(Draft Bill, s 84)

¹¹ See Chapters 27 and 28 above.

¹² Directive, Arts 4 and 5; FCARs Part 4. See Beale, Bridge, Gullifer and Lomnicka, *The Law of Security and Title-Based Financing* paras 3.09–3.10. In Scotland a right of use is also conferred in TTFCAAs.

¹³ Directive, Art 5(1) and (2); FCARs reg 16(1) and (2).

¹⁴ Directive, Art 5(2); FCARs reg 16(2).

¹⁵ FCARs reg 17(1).

¹⁶ Directive, Art 4(2); FCARs reg 18(1).

¹⁷ Directive, Art 4(1); FCARs reg 18(2).

Chapter 38 Floating charges and agricultural charges

Introduction

38.1 This chapter addresses reform in relation to floating charges and agricultural charges. We have a limited amount to say about floating charges. Earlier in this Report we considered Part 2 of the Bankruptcy and Diligence etc. (Scotland) Act 2007, which makes provision for substantial reform of the law of floating charges in Scotland, but has not been brought into force.¹ We also discussed the floating charge in Chapter 20 where we set out our recommendation to depart from an aspect of the scheme proposed in the Discussion Paper and not to take forward the idea of a “floating lien”. We note there the support from a significant number of our consultees for retention of the floating charge. Here we consider the reform questions raised in the Discussion Paper in relation to this type of security right.

Floating charges, sole traders and companies

38.2 The reforms proposed by the Murray Report² included a recommendation that sole traders and ordinary partnerships should be able to grant floating charges, but only over their moveable assets. The aim was to make the law on rights in security less restrictive for these forms of trading entities. In the Discussion Paper and now here we have taken a different approach, namely the introduction of the statutory pledge. We therefore asked consultees whether they agreed that the recommendation of the Murray Report that sole traders and ordinary partnerships should be able to grant floating charges, should not now be taken forward.

38.3 There was a division of opinion among consultees. Around half of those who responded to this question agreed. Brodies stated: “Subject to an adequate form of fixed security over moveable property being available to sole traders and ordinary partnerships we do not see a need for the extension of floating charges to these groups.” Of those who did not say that they agreed, the strength of feeling varied. Dr Hamish Patrick supported the introduction of floating charges for partnerships, but “probably” not for sole traders. The Judges of the Court of Session said; “Whatever the defects of the floating charge, it might be worth giving greater consideration to the Murray Report proposal as an alternative to the creation of a wholly new security over moveable property.” The Law Society of Scotland and some law firm consultees supported the Murray Report recommendation.

38.4 We consider that one of the lessons of Part 2 of the 2007 Act is that any significant reform of floating charges on a Scotland-only basis is likely to encounter opposition. We are also very much aware that the law of business associations is reserved to the UK Parliament,³ albeit floating charges law is devolved.⁴ Moreover, support for reform from our

¹ See paras 18.23–18.25 and 18.41–18.43 above.

² See paras 18.18–18.22 and 18.38–18.40 above.

³ Scotland Act 1998 Sch 5 Part II Head C1. See also Law Commission and Scottish Law Commission, Partnership Law (Law Com No 283, Scot Law Com No 192, 2003).

⁴ Scotland Act 1998 Sch 5 Part II Head C2.

consultees was limited and we do not think that the modification of our scheme to abandon the floating lien justifies the further rolling-out of the floating charge.⁵ Finally, any legislation permitting sole traders and partnerships to grant floating charges could be complex in relation to covering the possibility of business continuity when, for example, a sole trader formed a partnership. We conclude that:

200. The recommendation of the Murray Report that sole traders and ordinary partnerships should be able to grant floating charges should not now be taken forward.

Floating charges: the land issue

38.5 In the Discussion Paper we noted that there is a case for providing that floating charges granted in future should not cover immoveable/heritable property.⁶ The equivalent security rights under UCC–9 and the PPSAs, as well as German law,⁷ cover moveables only. In Scotland, the floating charge has been particularly controversial in relation to land.⁸ The Murray Report asked consultees whether they thought that in future floating charges should not be capable of covering land. In the Discussion Paper we did the same.

38.6 A clear majority of consultees including Chris Dun, the Faculty of Advocates, Dr Hamish Patrick, the Law Society of Scotland and several law firms opposed the suggestion that floating charges should be restricted to moveable property. Once again there is clearly a background here of a desire for floating charges in Scotland to have the same scope as those in England. We therefore recommend that:

201. Floating charges should continue to be capable of encumbering immoveable/heritable property.

The ranking of floating charges

38.7 It is common in floating charges to have a “negative pledge” clause, forbidding the creation of subsequent fixed securities. By statute in Scotland a registered floating charge with such a clause will rank above any such subsequent fixed security.⁹ In England the position at the time that the Discussion Paper was published was that negative pledge clauses would only affect subsequent secured creditors if they were actually aware of them. Such clauses did not appear on the Companies Register. The Discussion Paper noted proposals to alter English law so that registration would be possible and thus subsequent chargees could be regarded as having constructive notice of the negative pledge clause. This would mean that they would rank after the floating charge.¹⁰ But at that time, such a reform was by no means certain. Given the proposal that the new security could apply to after-acquired assets and some ranking problems affecting floating charges, we asked consultees whether the Scottish ranking rules should be reformed to bring them into line with those in England and Wales.

⁵ See Chapter 20 above.

⁶ Discussion Paper, para 9.17.

⁷ The *Sicherungsübereignung* and the *Sicherungsabtretung*.

⁸ In particular in *Sharp v Thomson* 1997 SC (HL) 66, on which see Scottish Law Commission, Report on *Sharp v Thomson* (Scot Law Com No 208, 2007).

⁹ Companies Act 1985 s 464(1A). See *AIB Finance plc v Bank of Scotland* 1993 SC 588.

¹⁰ Discussion Paper, para 22.32.

38.8 There was a mixed response from consultees. Several, including Dr Ross Anderson, David Cabrelli, Chris Dun and Jim McLean favoured such a change. Others, including Dr Hamish Patrick, the Law Society of Scotland and several law firms, did not.

38.9 In the meantime there has been reform in England and since 1 April 2013 it has been possible to register negative pledge clauses in the Companies Register.¹¹ The effect of this is said to be that subsequent chargees will have constructive notice and therefore rank after the floating charge.¹² We therefore do not consider that it makes sense for the Scottish rules to be brought into step with the former English rules. We recommend that:

202. The ranking rules of Scottish floating charges in relation to negative pledge clauses should not be reformed.

Floating charges and “effectually executed diligence”

38.10 A floating charge is subject to “effectually executed diligence”.¹³ In *Lord Advocate v Royal Bank of Scotland*¹⁴ it was held that where (i) a floating charge was constituted; (ii) another creditor arrested; and (iii) the charge crystallised without an action of furthcoming having been raised, the arrestment was not “effectually executed”. This decision has been widely criticised.¹⁵ Subsequent research using Hansard has also revealed that the intention of Parliament had been that in such a case the arrestment was to prevail.¹⁶ In the Discussion Paper, we proposed that the relevant statutory provisions should be amended so as to ensure that the original intention of the legislation is given effect to. Most consultees who responded to the question agreed.

38.11 There has since been a major development. In 2017 a five-judge bench of the Inner House in *MacMillan v T Leith Developments Ltd (in receivership and liquidation)*¹⁷ overruled *Lord Advocate v Royal Bank of Scotland* on the basis that the court in the earlier case had misinterpreted the relevant statutory provision. In the words of Lord President Carloway:

“The problem with the reasoning of the majority and the Lord Ordinary in *Lord Advocate v Royal Bank of Scotland* is that it effectively drives a coach-and-four through the common law of diligence in circumstances in which the statutory wording was, as Lord Johnston described it, intended to be a saving provision designed to achieve the opposite effect . . . The whole purpose of [the relevant provisions] was to preserve the rights of diligence holders notwithstanding the effect of the charge’s crystallisation.”¹⁸

¹¹ Companies Act 2006 s 859D(2)(c).

¹² See Calnan, *Taking Security* para 7.299. At para 7.300 he writes: “This is a desirable result. There is much to be said for the view that all charges – whether fixed or floating – should rank in order of creation unless the parties otherwise agree.” This in fact is what the Bankruptcy and Diligence etc. (Scotland) Act 2007 Part 2 provides, although as mentioned above the relevant provisions have not been commenced.

¹³ Companies Act 1985 s 463; Insolvency Act 1986 ss 55 and 60; Bankruptcy and Diligence etc. (Scotland) Act 2007 s 45.

¹⁴ 1977 SC 155, interpreting the pre-1985 Act legislation, the Companies (Floating Charges and Receivers) (Scotland) Act 1972, which was in similar terms.

¹⁵ See eg W A Wilson, “Effectually executed diligence” 1978 *Juridical Review* 253; A J Sim, “The receiver and effectually executed diligence” 1984 *SLT (News)* 25 and G L Gretton, “Receivers and arresters” 1984 *SLT (News)* 177.

¹⁶ See generally S Wortley, “Squaring the Circle: Revisiting the Receiver and ‘Effectually Executed Diligence’” 2000 *Juridical Review* 325.

¹⁷ [2017] CSIH 23.

¹⁸ [2017] CSIH 23 at para 57.

38.12 The decision was not appealed to the Supreme Court. We note the risk mentioned by Scott Wortley in his article on this issue that the approach now taken by the Inner House in *MacMillan* could lead to floating charge holders putting companies into liquidation so that the 60 day equalisation of diligence rule will negate the preference achieved by the creditor who has carried out diligence.¹⁹ We note also that Part 2 of the Bankruptcy and Diligence etc. (Scotland) Act 2007 did not address the issue, which suggests again that it is a difficult one. While we make no formal recommendation here, we think that the matter may benefit from review as and when future reform of corporate insolvency law is considered.

Agricultural charges

38.13 The agricultural charge is a security which was introduced by the Agricultural Credits (Scotland) Act 1929. This followed similar legislation in England and Wales, the Agricultural Credits Act 1928. It can only be granted by agricultural co-operatives in favour of banks.²⁰ The effect is similar to a floating charge, though one important difference is that whereas a floating charge can cover property of every type, the agricultural charge is limited to “stocks of merchandise”.²¹ Under the legislation as passed, agricultural charges had to be registered in a register maintained by the Assistant Registrar of Friendly Societies for Scotland.²² This requirement was repealed by the Financial Services and Markets Act 2000 (Consequential Amendments and Repeals) Order 2001.²³ Registration is still required for agricultural charges in England and Wales under the 1928 Act.²⁴ Agricultural charges appear no longer to be enforceable outside insolvency since the 1929 Act provides only for enforcement by sequestration for rent,²⁵ a process that no longer exists.²⁶ Placing the debtor into insolvency seems a disproportionate means of enforcement.

38.14 In the Discussion Paper we stated our impression that agricultural charges are rarely used in practice.²⁷ We have since had that confirmed by the Scottish Agricultural Organisation Society Ltd,²⁸ as well as by the Law Society of Scotland in its response to our draft Bill consultation of July 2017. In practice co-operatives grant floating charges rather than agricultural charges. They have power to do this, formerly as industrial and provident societies, and now as registered societies under the Co-operative and Community Benefit Societies Act 2014.²⁹

38.15 As a result of our scheme to introduce a new security over moveable property, we proposed in the Discussion Paper that the 1929 Act should be repealed. All our consultees who responded to this proposal agreed. While we now recommend that the statutory pledge

¹⁹ Wortley, “Squaring the Circle” at 341 ff.

²⁰ 1929 Act s 5. For the definition of “bank” for this purpose, see the Financial Services and Markets Act 2000 (Consequential Amendments and Repeals) Order 2001 (SI 2001/3649) art 217.

²¹ 1929 Act s 5.

²² 1929 Act s 8.

²³ SI 2001/3649 art 216. The 2000 Act s 335 enabled the functions of the Registry of Friendly Societies to be transferred to the Financial Services Authority and for the former to be closed. This happened on 1 December 2001 by virtue of the Financial Services and Markets Act 2000 (Mutual Societies) Order 2001 (SI 2001/2617). Agricultural co-operatives are now regulated by the Financial Conduct Authority in terms of the Co-operative and Community Benefit Societies Act 2014.

²⁴ See Law Com Report No 369 para 4.36. The register is based in Plymouth and maintained by the Land Registry.

²⁵ 1929 Act s 6(1).

²⁶ Bankruptcy and Diligence etc. (Scotland) Act 2007 s 208.

²⁷ Discussion Paper, para 16.80.

²⁸ See <http://www.saos.coop/>.

²⁹ See the Co-operative and Community Benefit Societies Act 2014 ss 62–64.

should be fixed only and not floating, we do not consider that this makes a difference. The information which we now have is that the agricultural charge is redundant in practice in Scotland because of the floating charge. We therefore consider that the future grant of agricultural charges should not be possible.³⁰ Although, agricultural co-operatives are business associations and certain aspects of that area of law are reserved to the UK Parliament,³¹ rights in security are not and are therefore in our view within devolved legislative competence. We recommend:

203. It should no longer be competent for agricultural charges to be created.

(Draft Bill, s 115)

³⁰ Rather than to repeal the Act, given that some agricultural charges could be extant.

³¹ See para 1.43 above.

Chapter 39 International private law

Introduction

39.1 In Chapter 15 above we noted that some consultees questioned the approach taken in the Discussion Paper that international private law was outwith our scope. We sought to consider the subject in relation to assignation. We attempt here to outline the various international private law issues which arise from the two security strands of the project: (i) security over incorporeal moveable property; and (ii) security over corporeal moveable property. We consider also jurisdiction.

Applicable law: security over incorporeal moveable property

39.2 Article 14(3) of the Rome I Regulation specifically states that transfers of claims by way of security are included within its scope.¹ The discussion in Chapter 15 above therefore applies to assignations in security just as much as to outright transfers.

39.3 Our recommendations would enable a true security right to be granted over two types of incorporeal moveable property, namely financial instruments and intellectual property, by means of the statutory pledge, as opposed to the conventional route of assignation with a personal obligation to re-transfer the property on repayment of the debt due. Article 14 of the Rome I Regulation clearly does not apply to intellectual property. It is also unlikely that it applies to shares, but the position as regards other financial instruments is unclear.²

39.4 In relation to intellectual property there are particular issues. Such rights apply the *lex situs* conflict of laws rule. But the current UK intellectual property legislation does not attribute intellectual property to a particular legal system. Moreover, for registered rights there is only a single UK-wide register. The conflict of laws rule is therefore ineffective as it results in pointing simultaneously to both English and Scots law. As was noted in the Discussion Paper, there is no clear answer on how to fix this issue although the predominant view seems to be that the *lex situs* of intellectual property, for the purposes of security rights granted over them, is determined by the domicile of the holder of the intellectual property.³ Further, the law on intellectual property is generally reserved to the UK Parliament and therefore it would not be competent for our draft Bill to make provision on this.⁴

¹ For background see M McParland, *The Rome I Regulation on the Law Applicable to Contractual Obligations* paras 18.14–18.21.

² See McParland, *The Rome I Regulation on the Law Applicable to Contractual Obligations* paras 18.13 and 18.20. See also the special rules for book entries security collateral under reg 19 of the Financial Collateral Arrangements (No. 2) Regulations 2003 (SI 2003/3226).

³ See Discussion Paper, para 7.20 and fn 14 referring to Lord Evershed's statement that "[a]n English patent is a species of English property of the nature of a chose in action and peculiar in character" in *British Nylon Spinners Ltd v Imperial Chemical Industries Ltd* [1953] Ch 19 at 26.

⁴ See para 1.47 above.

Applicable law: security over corporeal moveable property

39.5 Transactions involving corporeal moveable property present fewer issues than with incorporeals, mainly due to the fact that their physical form makes application of the *lex situs* rule much easier. The precise rule for transactions involving corporeal moveable property is that the law applicable is that of the location of the property at the time of the relevant dealing.⁵

39.6 Once a security right has been created over corporeal moveable property and the property has been removed to a foreign jurisdiction, the recognition of that security right is a matter for the law of that foreign jurisdiction. Professor Carruthers explains:

“As a general rule, removal of an object across state borders should not undermine, per se, pre-existing, or vested, rights in the object, but this rule pertains only so long as there are no further dealings with the object in the new *situs*. Following removal of the object to a new *situs*, the law of the new *situs* will determine the existence and priority of interests in the object. Though rare, it is possible that, indirectly, mere removal of an object to a new *situs* may adversely affect ‘vested’ rights insofar as there exist difficulties of transposition of legal right or entitlement.”⁶

39.7 Thus, where a statutory pledge is granted over a car in Scotland and the car is driven to France, the security would remain valid as far as Scots law is concerned, but it would then be a matter for the French courts to decide whether or not to recognise the foreign security. This would include determining whether a subsequent purchaser or acquirer of a security right over the property would take subject to the Scottish security right. If the car was subsequently driven back to Scotland without any further transaction, there would be no effect on the security right.

39.8 This principle applies equally in Scotland where the recognition of foreign security rights is a matter for the Scottish courts. There is little authority in this area, but the case of *Hammer and Sohne v HWT Realisations Ltd*⁷ provides some guidance. It involved a foreign retention of title clause in a contract for jewellery received by a Glasgow-based company. Sheriff Jardine held that the issue of whether such a clause (and security rights in general) should be treated as a true security right was a matter for the new *lex situs* to determine. He concluded that since the contract was essentially one for the creation of a security right without possession, it was ineffective to retain the seller’s ownership of the goods.

39.9 Peculiarly, this meant characterising the issue as one pertaining to security rights, only to hold that no recognised security right existed.⁸ Sheriff Jardine’s judgment signifies that the Scottish courts will not recognise a foreign right in security which was valid under the *lex situs* when created, if no comparable security right exists under Scots law. This is particularly problematic since most other jurisdictions recognise some form of non-possessory security over corporeal moveable property. There are therefore economic implications for foreign companies considering doing business in Scotland.

⁵ *Inglis v Robertson & Baxter* (1898) 25 R (HL) 70 per Lord Watson at 73; *Armour v Thyssen Edelstahlwerke AG* 1986 SLT 452 per Lord Mayfield at 455.

⁶ J M Carruthers, *The Transfer of Property in the Conflict of Laws* (2005) para 3.45.

⁷ 1985 SLT (Sh Ct) 21.

⁸ For criticism of the case, see D Gordon, “Scotland: Romalpa clauses: some reservations on choice of law” (1986) 7 Comp Law 125 at 126; H Patrick, “Romalpa: the international dimension” 1986 SLT (News) 265 at 270.

39.10 Under our recommendations, however, a foreign form of registered non-possessory security right would be recognisable under Scots law as comparable to the new statutory pledge. There is therefore a strong economic argument for introducing the statutory pledge in order to remove any barriers to cross-border transactions involving foreign companies transacting in Scotland.

39.11 The *lex situs* rule for issues pertaining to security interests creates some concerns in relation to highly mobile corporeal moveable property, particularly with aircraft which may not have a real connection with any location since they are almost constantly moving. However, as we have seen, aircraft have their own specialised security regime under the Mortgaging of Aircraft Order 1972 and the Cape Town Convention, and are effectively excluded from being the subject of a statutory pledge.⁹

39.12 At a more general level, we think that it would be undesirable to depart from the *lex situs* rule for security rights involving corporeal moveable property without a review of the rule in the wider context of property law. We are also conscious that the *lex situs* remains the generally accepted rule internationally and therefore that reform at an international level is more appropriate. We have therefore concluded that we should not review the rule as part of this project.

Jurisdiction

39.13 We refer to our discussion of this subject in relation to assignation,¹⁰ where we concluded that the matter should be left to the existing rules. We note, however, that jurisdiction was considered in clause 30 of the draft Bill attached to the Murray Report,¹¹ which defined “court” for its purposes as:

“(a) where the granter of a floating charge or, as the case may be, moveable security is domiciled in Scotland, the Court of Session or the sheriff within whose sheriffdom the granter is domiciled; or

(b) where such granter is not so domiciled but the property which is subject to the charge or security is situated in Scotland, the Court of Session or sheriff within whose sheriffdom such property is situated;

(c) where such granter is not so domiciled but the incorporeal moveable property which is subject to the charge or security is governed by the law of Scotland, the Court of Session”.

39.14 It is unclear why such a clause was included. The Report itself is silent on the issue of jurisdiction and accordingly there is no discussion of the existing rules of jurisdiction nor are any reasons provided on why those rules are inadequate or unsatisfactory.

Conclusion

39.15 We consider that reform of the *lex situs* rule for security over moveable property is best considered at an international level in order to promote certainty for parties who

⁹ See Chapter 21 above.

¹⁰ See paras 15.33–15.38 above.

¹¹ See paras 18.18–18.22 above.

commonly deal in different jurisdictions. Moreover, the rule would most appropriately be reviewed within its broader property law application.

39.16 At a UK level, we would welcome any steps to produce a workable rule on how to identify intellectual property as either Scottish or English for the purposes of moveable transactions law and more generally, but this is beyond the scope of this Report.

39.17 Lastly, as in relation to assignation, the general rules on jurisdiction are applicable and we do not recommend reform for cases involving security rights.

Chapter 40 List of recommendations

1. There should be legislative reform of the law of assignation of incorporeal moveable property consisting of the right by a person against another person to the performance of an obligation.

(Paragraph 4.5)

2. The party granting an assignation should be referred to as the “assignor” and the grantee should be referred to as the “assignee”.

(Paragraph 4.7; Draft Bill, s 1(2)(a) & (b))

3. The subject matter of the assignation should be referred to as a “claim”.

(Paragraph 4.11; Draft Bill, s 1(1))

4. “Claim” should be defined as:

- (a) a right to the performance of an obligation; but
- (b) excluding a non-monetary right relating to land or a negotiable instrument.

(Paragraph 4.16; Draft Bill, s 42(2))

5. The party against whom the claim is enforceable should be referred to as the “debtor”.

(Paragraph 4.18; Draft Bill, s 1(2)(c))

6. (a) Agreements to assign claims should not be subject to any requirement of form.

- (b) Assignations of claims should require to be in writing signed by the assignor only. Writing and signature may be electronic as well as paper-and-ink under the rules in the Requirements of Writing (Scotland) Act 1995. The Scottish Ministers should have power to modify the rules as regards execution and authentication in relation to assignations.

(Paragraph 4.24; Draft Bill, ss 1(1), 118(1) & (5))

7. (a) The assignation document should require to identify the claim.

- (b) Where an assignation document assigns multiple claims these should not require to be individually identified provided that they are identified as a class.

(c) For a claim to be transferred it should require to be identifiable as a claim to which the assignment document relates.

(Paragraph 4.30; Draft Bill, ss 1(3) & (4) and 3(1) & (2)(c))

8. (a) It should be competent to assign a claim in whole or in part.
- (b) But if the claim is not a monetary claim, the claim should only be assignable in part where either:
- (i) the debtor consents, or
 - (ii) the claim –
 - (a) is divisible, and
 - (b) assigning it in part does not result in its becoming significantly more burdensome for the debtor.
- (c) But these rules should be subject to
- (i) any agreement of the parties to the claim or,
 - (ii) where the claim arises from a unilateral undertaking, any statement by the person giving the undertaking,
- in relation to the extent to which the claim is assignable.
- (d) Except in so far as the debtor and the assignor otherwise agree, the assignor should be liable to the debtor for any expense incurred by the debtor because the claim was assigned in part rather than in whole.

(Paragraph 4.34; Draft Bill, s 6)

9. A claim should be transferred on:
- (a) the assignment being intimated to the debtor, or
 - (b) the assignment being registered in the Register of Assignations,
- but the Scottish Ministers should have the power to specify categories of claim where registration is required for transfer.

(Paragraph 5.22; Draft Bill, s 3(1), (2)(b) & (6))

10. “Intimate/intimation” should not be replaced by “notify/notification”.

(Paragraph 5.24)

11. Intimation of the assignation of a claim should be effected and only effected:
- (a) by there being served on the debtor written notice of the assignation,
 - (b) by the debtor acknowledging to the assignee that a claim is assigned, or
 - (c) by it being intimated to the debtor, in judicial proceedings to which the debtor is a party, that the assignation is founded on in the proceedings.
12. The Transmission of Moveable Property (Scotland) Act 1862 should be repealed.
- (Paragraph 5.37; Draft Bill, ss 9(1) and 41)
13. Where intimation is by means of written notice to the debtor, it should be possible for the notice to be served by or on behalf of either the assignor or assignee.
- (Paragraph 5.40; Draft Bill, ss 9(1)(a) and 118(4))
14. A notice of an assignation:
- (a) should
 - (i) set out the name and address both of the assignor and assignee, and
 - (ii) provide details of the claim assigned (or, in the case of a claim assigned in part, both of the claim and of the part assigned),but where the notice is transmitted electronically it can provide an electronic link to a website or portal containing this information.
 - (b) should not require to be executed or authenticated,
 - (c) if the claim is a monetary claim, may but need not be in a form prescribed by the Scottish Ministers, and
 - (d) may consist of, or be contained within:
 - (i) a single document, or
 - (ii) more than one document,and “document” should be defined to include an e-mail or an attachment to an e-mail.
- (Paragraph 5.47; Draft Bill, s 9(3) & (5))
15. (a) A notice of an assignation should require to be served:
- (i) by being delivered personally to the debtor,

- (ii) by being sent by post or by courier either to the proper address of the debtor or to an address for postal communication provided to the assignor by the debtor,
 - (iii) by being transmitted to an electronic address provided to the assignor by the debtor.
- (b) The proper address of the debtor should be:
- (i) in the case of a body corporate, the address of the registered or principal office of the body,
 - (ii) in the case of a partnership, the address of the principal office of the partnership, and
 - (iii) in any other case, the last known address of the debtor.
- (c) Where a notice is posted to an address in the United Kingdom, it should be taken to have been received 48 hours after it is sent unless it is shown to have been received earlier.
- (d) Where a notice is sent electronically, it should be taken to have been received 24 hours after it is sent unless it is shown to have been received earlier.
- (e) The debtor and the holder of the claim (or the person whose unilateral undertaking gives rise to the claim) should be able in writing to determine that:
- (i) only certain of the above methods of service are to apply as respects the claim, or
 - (ii) postal service is to be to a specified address of the debtor.
- (f) It should be competent for intimation to be made or received by authorised representatives of the parties.

(Paragraph 5.57; Draft Bill, ss 9(4) & (6) to (13) and 118(4))

16. Any rule of law whereby an assignation is rendered ineffective by an instruction by the assignee to the debtor to perform to the assignor should be abolished.

(Paragraph 5.61; Draft Bill, s 17(1)(b))

17. Where there are co-debtors, intimation to any one or more of them should be treated as intimation to all of them.

(Paragraph 5.66; Draft Bill, s 9(2))

18. Priority of assignations should continue to be determined by time of completion of title.

(Paragraph 5.72)

19. (a) It should be competent to make the assignation of a claim subject to a condition which must be satisfied before the claim is transferred. Such a condition could depend on something happening or not happening (whether or not it is certain that that thing will or will not happen) or on a period of time elapsing during which something must not happen (whether it is certain or not that the thing will happen at some time.)
- (b) Any such condition should require to be specified in the assignation document.
- (c) It should be permissible for the specification to include reference to another document the terms of which are not reproduced in the assignation document.
- (d) The claim should not transfer until the condition is satisfied.

(Paragraph 5.80; Draft Bill, ss 2 and 3(1) & (2)(d))

20. It should be competent to assign a claim which does not exist at the time that the assignation document is granted, but for the claim to be transferred it should require to have come into being and be held by the assignor.

(Paragraph 5.97; Draft Bill, ss 1(5) and 3(2)(a))

21. In relation to the transfer of claims which arise after the assignation document is granted, any rule of law as to accretion should be disregarded.

(Paragraph 5.100; Draft Bill, s 3(3))

22. (a) Individuals should be prohibited from assigning a claim in respect of wages or salary, including any fee, bonus, commission, holiday pay or other emolument referable to their employment, or to expenses or a redundancy payment.
- (b) This rule should be without prejudice to any other enactment.

(Paragraph 5.103; Draft Bill, s 8)

23. (a) An assignation granted before the assignor becomes insolvent should be ineffective as regards a claim if the assignor is insolvent at the time of becoming the holder of the claim.

(b) An assignor who is an individual, or the estate of which may be sequestrated, becomes insolvent when:

- (i) the assignor's estate is sequestrated,
- (ii) the assignor grants a trust deed for creditors or makes a composition or arrangement with creditors,
- (iii) a voluntary arrangement proposed by the assignor is approved, or

- (iv) the assignor's application for a debt payment programme is approved under section 2 of the Debt Arrangement and Attachment (Scotland) Act 2002.
- (c) An assignor which is not an individual becomes insolvent when:
 - (i) a decision approving a voluntary arrangement entered into by the assignor has effect under section 4A of the Insolvency Act 1986,
 - (ii) the assignor is wound up under Part 4 or 5 of the 1986 Act or under section 367 of the Financial Services and Markets Act 2000,
 - (iii) an administrative receiver, as defined in section 251 of the 1986 Act, is appointed over all or part (being a part which includes the claim) of the property of the assignor, or
 - (iv) the assignor enters administration, ("enters administration" being construed in accordance with paragraph 1(1) and (2) of schedule B1 of the 1986 Act).
- (d) The above rule should not apply as regards a claim in respect of income from property but only in so far as the claim:
 - (i) is not attributable to anything agreed to by, or done by, the assignor after the assignor becomes insolvent, and
 - (ii) relates to the use of property in existence at the time the assignor became insolvent.
- (e) The Scottish Ministers should have power to amend the definition of "insolvent".

(Paragraph 5.109; Draft Bill, s 5(1) to (4), (7)(a) & (8))

24. (a) Where a person who has assigned a claim in whole or in part is discharged following either sequestration or the granting of a protected trust deed the assignation should be ineffective as regards the claim (or part) to which it relates if, as at the time of discharge, the claim has not come into being.
- (b) The Scottish Ministers should have the power to amend the above rule to apply it to other insolvency processes.

(Paragraph 5.112; Draft Bill, s 5(5), (6) & (7)(b))

25. A new public register should be established, to be called the Register of Assignations, in which assignations of claims can be registered.

(Paragraph 6.7; Draft Bill, s 19(1))

26. The register should be under the management and control of the Keeper of the Registers of Scotland.

(Paragraph 6.10; Draft Bill, s 19(2))

27. The assignment document should be registered.

(Paragraph 6.30; Draft Bill, s 21(1)(h))

28. (a) Subject to the requirements of statute, the register should be in such form as the Keeper thinks fit.

(b) The Keeper should take such steps as appear reasonable to her for protecting the register from interference, unauthorised access, or damage.

(Paragraph 6.32; Draft Bill, s 19(3) & (4))

29. Registration should be by electronic means only.

(Paragraph 6.39)

30. Registration should be by means of an automated system under which applications are not checked by the Keeper.

(Paragraph 6.45; Draft Bill, s 119)

31. The Keeper should make up and maintain, as parts of the Register of Assignations:

(a) the assignments record and

(b) the archive record.

(Paragraph 7.2; Draft Bill, s 20)

32. An entry in the assignments record should include:

(a) the assignor's name and address,

(b) where the assignor is an individual, the assignor's date of birth,

(c) any number which the assignor bears or other information relating to the assignor which, by virtue of RoA Rules, must be included in the entry,

(d) the assignee's name and address,

(e) any number which the assignee bears or other information relating to the assignee which, by virtue of RoA Rules, must be included in the entry,

(f) where the assignee is not an individual, an address (which may be an e-mail address) to which requests for information regarding the assignment may be directed,

- (g) such description of the claim as may be required or permitted by RoA Rules,
- (h) a copy of the assignment document,
- (i) the registration number allocated to the entry,
- (j) the date and time of registration of the assignment document, and
- (k) such other data as may be required by legislation.

(Paragraph 7.27; Draft Bill, s 21(1))

33. (a) An application for registration of an assignment document should be made by or on behalf of the assignee.
- (b) The Keeper should be required to accept an application if:
- (i) it conforms to RoA Rules in relation to applications,
 - (ii) it is submitted with a copy of the assignment document,
 - (iii) it provides the Keeper with the necessary data to make up an entry for the assignment in the RoA, and
 - (iv) the registration fee is paid or the Keeper is satisfied that it will be.
- (c) Where these requirements are not satisfied, the Keeper should be required to reject the application and inform the applicant accordingly.

(Paragraph 7.30; Draft Bill, s 23(1) to (3) and 118(4))

34. On accepting an application for registration, the Keeper should be required to:
- (a) make up and maintain in the assignments record an entry for the assignment document, and
 - (b) allocate a registration number to the entry.

(Paragraph 7.32; Draft Bill, s 23(4))

35. (a) The Keeper should be required to issue a verification statement on accepting an application for registration.
- (b) The statement should require to conform to RoA Rules. It should include the date and time of the registration and the registration number allocated to the entry to which the application relates.

(c) The assignor should be entitled to obtain a copy of the verification statement from the assignee and the assignee should be required to supply the copy within 21 days after the request is made.

(Paragraph 7.40; Draft Bill, s 24)

36. (a) A registration should be taken to be made on the date and at the time which are entered for it in the Register of Assignations.

(b) The Keeper should be required to deal with applications for registration and allocate these registration numbers in order of receipt.

(Paragraph 7.42; Draft Bill, s 25)

37. The registration of an assignation document should be ineffective if:

(a) the entry made up for it does not include a copy of the assignation document,

(b) that document is invalid, or

(c) there is an inaccuracy in relation to the data registered, which as at the time of registration, is seriously misleading.

(Paragraph 8.15; Draft Bill, s 26(1))

38. (a) An inaccuracy in an entry in the assignations record may be seriously misleading irrespective of whether any person has been misled.

(b) In determining whether an inaccuracy is seriously misleading no account should be taken of the assignation document included in the entry.

(c) An inaccuracy which is seriously misleading in respect of part of an entry, as regards the details of the claim, assignor or assignee, should not affect the rest of the entry.

(d) Without prejudice to the generality, an inaccuracy should be seriously misleading:

(i) where the assignor (or, as the case may be, a co-assignor) is not a person required by RoA Rules to be identified by a unique number, if a search using a designated facility provided by the Keeper for

(a) the assignor's (or co-assignor's) proper name as at the date and time the entry was created, or for

(b) the assignor's (or co-assignor's) proper name as at that date and time and the assignor's (or co-assignor's) date of birth

does not disclose the entry;

- (ii) where the assignor (or, as the case may be, a co-assignor) is a person required by RoA Rules to be identified by a unique number, if a search using a designated facility provided by the Keeper for that number as at the date and time the entry was created does not disclose the entry, including where a search using such a facility for the assignor's (or co-assignor's) number does disclose the entry.
- (e) The meaning of "proper name" should be set out in RoA Rules.
- (f) The Scottish Ministers should have the power to specify further instances in which an inaccuracy is seriously misleading.

(Paragraph 8.30; Draft Bill, s 27)

39. Except in so far as the context otherwise requires, any reference to "correction" should include correction by:

- (a) the removal of data included in an entry,
- (b) the removal of an entry from the assignments record and the transfer of that entry to the archive record,
- (c) the replacement of data, or of a copy document, included in an entry,
- (d) the restoration of data, or of a copy document, to an entry,
- (e) the restoration of an entry (whether or not by removing it from the archive record and transferring it to the assignments record).

(Paragraph 9.9; Draft Bill, s 31(1))

40. (a) Where the Keeper becomes aware of a manifest inaccuracy in an entry in the assignments record the Keeper should have to correct the inaccuracy if what is needed to correct it is manifest. If what is needed to correct is not manifest the Keeper should have to note the inaccuracy on the entry.

- (b) Where an inaccuracy is corrected by:
 - (i) removal of the entry the Keeper should have to transfer the entry to the archive record and note on the entry the details of the correction, and its date and time,
 - (ii) removal or replacement of data included in the entry or by replacement of a copy document the Keeper should have to note on the entry the details of the correction, and its date and time,
 - (iii) replacement of a copy document, the Keeper should have to transfer it to the archive record.

(c) Where the Keeper effects a correction, the Keeper should have to notify each person specified for these purposes by RoA Rules and any other person whom the Keeper considers it appropriate to notify that the correction has been effected.

(Paragraph 9.22; Draft Bill, s 28)

41. (a) Where a court determines that the assignments record is inaccurate it should have the power to direct the Keeper to correct it.

(b) In connection with any such correction, the court should be able to give the Keeper such further direction (if any) as it considers requisite.

(c) The Keeper should be required to note on the relevant entry that it has been corrected and the details of the correction, including the date and time. Where the correction requires the removal of the entry or of a copy document the Keeper should have to transfer it to the archive record.

(d) Where the Keeper effects a correction, the Keeper should have to notify each person specified for these purposes by RoA Rules and any other person whom the Keeper considers it appropriate to notify that the correction has been effected.

(Paragraph 9.27; Draft Bill, s 29)

42. The Keeper should be entitled to appear and be heard in any civil proceedings, whether before a court or tribunal, in which is put in question (either or both):

(a) the accuracy of the assignments record,

(b) what is needed to correct an inaccuracy in that record.

(Paragraph 9.29; Draft Bill, s 30)

43. A registration which is ineffective should become effective if and when the entry is corrected.

(Paragraph 9.32; Draft Bill, s 26(3))

44. A correction should be taken to be made on the date and at the time which are entered for it in the register.

(Paragraph 9.34; Draft Bill, s 31(2))

45. The assignments record should be searchable only:

(a) by reference to any of the following data in the entries contained in that record:

(i) the names of assignors,

(ii) the names and dates of birth of assignors who are individuals,

- (iii) the unique numbers of assignors required by RoA Rules to be identified in the assignments record by such a number,
- (b) by reference to registration numbers allocated to entries in that record, or
- (c) by reference to some other factor, or characteristic, specified for these purposes by RoA Rules.

(Paragraph 10.10; Draft Bill, s 32(2))

46. A person should be able to search the assignments record if the search accords with RoA Rules and either the appropriate fee is paid or the Keeper is satisfied that it will be paid.

(Paragraph 10.17; Draft Bill, s 32(1))

47. (a) The Keeper should be required to provide a search facility in relation to which the search criteria are specified by RoA Rules, but may provide such other search facilities, with such other search criteria, as the Keeper thinks fit.
- (b) "Search criteria" should be defined as the criteria in accordance with which what is searched for must match data in an entry in order to retrieve the entry.

(Paragraph 10.29; Draft Bill, s 33)

48. A printed search result which purports to show an entry in the assignments record should be admissible in evidence, and in the absence of evidence to the contrary, should be sufficient proof of:

- (i) the registration of the assignment document to which the result relates,
- (ii) a correction of the entry in the assignments record to which the result relates, and
- (iii) the date and time of such registration or correction.

(Paragraph 10.31; Draft Bill, s 34)

49. (a) Any person should be able to apply to the Keeper for an extract of an entry in the register.
- (b) The Keeper should be required to issue the extract if the appropriate fee is paid or the Keeper is satisfied that it will be paid.
- (c) The Keeper should be able to validate the extract as the Keeper considers appropriate.
- (d) The Keeper should be able to issue the extract as an electronic document if the applicant does not require that it be issued as a traditional document.

(e) The extract should be accepted for all purposes as sufficient evidence of the contents, as at the date on which and the time at which the extract is issued (being a date and time specified in the extract), of the entry.

(Paragraph 10.34; Draft Bill, s 35)

50. (a) An entitled person should be entitled to request from the person identified in an entry in the assignments record as the assignee a written statement as to:

- (i) whether or not a claim specified in the notice is assigned; or
- (ii) whether a condition to which the assignment is subject has been satisfied.

(b) The following should be entitled persons:

- (i) a person who has the right to execute diligence against a claim specified in the notice (or who is authorised by decree to execute a charge for payment and will have the right to execute diligence against that claim if and when the days of charge expire without payment) depending on whether the claim has been assigned by the assignment,
- (ii) a person who is prescribed for these purposes, and
- (iii) a person who has the consent of the person identified in the entry as the assignor.

(Paragraph 11.10; Draft Bill, s 36(1) to (3))

51. (a) An information request should require to be complied with within 21 days of its receipt, unless:

- (i) a court is satisfied that in all the circumstances this would be unreasonable and either extends the 21-day period or exempts the recipient from complying with the request in whole or in part,
- (ii) it is manifest from the entry that the claim specified in the notice has not been assigned by the assignment document or that the registration is ineffective, or
- (iii) the same request has been made by the same person within the last 3 months and the information supplied in response to the last request has not changed.

(b) The recipient should be entitled to recover from the requester any costs reasonably incurred in complying with the request.

(c) If a court is satisfied on the application of the requester that the recipient has not complied with the duty to provide information without reasonable excuse it should by order require that the recipient complies within 14 days.

(Paragraph 11.17; Draft Bill, s 36(4) to (8))

52. The archive record should be the totality of all the entries transferred from the assignments record following a correction and include other data specified by RoA Rules.

(Paragraph 11.21; Draft Bill, s 22)

53. (a) A person should be entitled to be compensated by the Keeper for loss suffered in consequence of:

- (i) an inaccuracy attributable to the Keeper in the making up, maintenance or operation of the Register of Assignations, or in an attempted correction of the register,
- (ii) the issue of a statement or notification which is incorrect, or
- (iii) the issue of an extract which is not a true extract.

(b) But the Keeper should have no statutory liability:

- (i) in so far as the person's loss could have been avoided had the person taken measures which it would have been reasonable for the person to take,
- (ii) in so far as the person's loss is not reasonably foreseeable, or
- (iii) for non-patrimonial loss.

(Paragraph 11.34; Draft Bill, s 37)

54. (a) Where a person suffers loss in consequence of:

- (i) an inaccuracy in an entry in the Register of Assignations (which is not caused by the Keeper), the person should be entitled to be compensated for that loss by the person who made the application which gave rise to that entry if, in making it, that person failed to take reasonable care, or
- (ii) a failure to respond to a request for information under the information duty provisions, or the provision of information in which there is an inaccuracy, the person is entitled to be compensated for that loss by the person who failed to supply the information if that failure was without reasonable cause or if, in supplying it, that person failed to take reasonable care.

- (b) But there should be no liability:
 - (i) in so far as the person's loss could have been avoided had the person taken measures which it would have been reasonable for the person to take,
 - (ii) in so far as the loss is not reasonably foreseeable, or
 - (iii) for non-patrimonial loss.

(Paragraph 11.42; Draft Bill, s 38)

55. The Scottish Ministers should, following consultation with the Keeper, have the power to make rules (to be known as "RoA Rules"):

- (a) as to the making up and keeping of the register,
- (b) as to procedure in relation to applications:
 - (i) for registration, or
 - (ii) for corrections,
- (c) as to the identification, in any such application of any person or claim, including:
 - (i) how the proper form of a person's name is to be determined, and
 - (ii) where the person bears a number (whether of numerals or of letters and numerals) unique to the person, whether that number must (or may) be used in identifying the person,
- (d) as to the degree of precision with which time is to be recorded in the register,
- (e) as to the manner in which an inaccuracy in the assignments record may be brought to the attention of the Keeper,
- (f) as to information which, though contained in an assignment document, need not be included in a copy of that document submitted with an application for registration,
- (g) as to whether a signature contained in an assignment document need be included in a copy of that document so submitted,
- (h) as to searches in the register,
- (i) as to information which, though contained in the register, is not to be:
 - (i) available to persons searching it, or
 - (ii) included in any extract issued by the Keeper,

- (j) prescribing the configuration, formatting and content of:
 - (i) applications,
 - (ii) notices,
 - (iii) documents,
 - (iv) data,
 - (v) statements, and
 - (vi) requests,to be used in relation to the register,
- (k) as to when the register is open for:
 - (i) registration, and
 - (ii) searches,
- (l) requiring there to be entered in the assignments record or the archive record such information as may be specified in the rules, or
- (m) regarding other matters in relation to registration, being matters for which the Scottish Ministers consider it necessary or expedient to give full effect to the purposes of the draft Bill.

(Paragraph 11.49; Draft Bill, s 40)

56. (a) Where after a claim has been transferred by assignation there is performance by the debtor or any co-debtor to the assignor and that performance is in good faith, the debtor should be discharged to the extent of the performance.
- (b) The fact only that an assignation document has been registered or that a notice of an assignation has been deemed to have been received, should not of itself mean that a debtor, or any co-debtor, is to be regarded as having performed other than in good faith.
- (c) In any dispute as to whether performance was in good faith the burden of proof should lie on the party asserting that performance was other than in good faith.

(Paragraph 12.9; Draft Bill, ss 11 and 120)

57. (a) Where a claim (or one and the same part of a claim) has been assigned successively, the debtor should be discharged to the extent that the debtor (or any co-debtor) performs in good faith to the first assignee from whom intimation is received.

(b) The fact only that an assignation document has been registered or that a notice of an assignation has been deemed to have been received, should not of itself mean that a debtor, or any co-debtor, is to be regarded as having performed other than in good faith.

(c) In any dispute as to whether performance was in good faith the burden of proof should lie on the party asserting that performance was other than in good faith.

(Paragraph 12.12; Draft Bill, ss 12 and 120)

58. (a) Where a claim is of a type that has been prescribed as transferable only by registration and an assignation of that claim is not registered, but intimation of it is made to the debtor or a co-debtor, the debtor should be discharged to the extent that performance is made in good faith to the assignee.

(b) A debtor or co-debtor who knows that the assignation has not been registered and that transfer of the claim requires such registration should not be taken to perform in good faith.

(Paragraph 12.15; Draft Bill, s 13)

59. (a) A debtor to whom intimation of an assignation has been made by an assignee should be entitled to request from the assignee sufficient evidence of the assignation.

(b) "Sufficient evidence" should include the written confirmation of an assignor that an assignation to which that assignor is party has taken place.

(c) A debtor who has reasonable grounds to believe that a claim has been assigned should be entitled to ask the supposed assignor whether there has been an assignation.

(d) The supposed assignor should have to confirm in writing whether the claim has been assigned.

(e) Until the debtor receives the evidence or confirmation, the debtor should be entitled to withhold performance.

(Paragraph 12.26; Draft Bill, s 15)

60. (a) The *assignatus utitur jure auctoris* rule should be put into statutory form, that is to say the debtor (or any co-debtor) should be able to assert against the assignee all defences that the debtor could assert against the assignor.

(b) The debtor (or any co-debtor) should be able to assert against the assignee any right of compensation (including a right of contractual set-off where the basis of that right is the contract which gave rise to the claim) available to the debtor against the assignor up to the time when the debtor would no longer have been in good faith had the debtor performed to the assignor.

(c) The fact only that an assignation document has been registered or that a notice of an assignation has been deemed to have been received, should not of itself mean that a debtor, or any co-debtor, is to be regarded as having performed other than in good faith.

(Paragraph 12.34; Draft Bill, s 14(1) to (3) & (5))

61. (a) The debtor and the assignor should be able to agree that any defences which the debtor may assert against the assignor may not be asserted against an assignee.

(b) This should be without prejudice to any other enactment.

(Paragraph 12.38; Draft Bill, s 14(1) & (4))

62. (a) The ability of the holder of a claim to assign should be subject to any enactment, or any rule of law, by virtue of which a claim is not assignable.

(b) Subject to any other enactment, an assignation of a claim should be ineffective in so far as the debtor and the holder of the claim agree, or the person whose unilateral undertaking gives rise to the claim states, that the claim is not to be assigned.

(Paragraph 13.11; Draft Bill, s 7)

63. (a) The following rules of law should no longer have effect:

(i) any rule whereby a mandate may operate as an assignation of a claim;

(ii) any rule whereby an assignee of a claim may sue in the name of an assignor.

(b) But this should be without prejudice to the application of any enactment or rule of law as respects subrogation.

(Paragraph 13.20; Draft Bill, s 17(1)(a) & (c), and (2))

64. The Policies of Assurance Act 1867 should be amended to confirm that it does not apply in Scotland.

(Paragraph 13.23)

65. There should be no statutory provision made in relation to the transfer of entire contracts.

(Paragraph 13.25)

66. (a) Unless the assignor and assignee provide otherwise in the assignation document, where a claim is assigned in whole, the assignee should acquire, by virtue of the assignation, any security which relates to the claim assigned and is restricted to that claim.

(b) The assignee should be required to perform any act requisite for the transfer of the security to the assignee as soon as reasonably practicable.

(Paragraph 13.33; Draft Bill, s 16)

67. (a) In assigning a claim for value the assignor should be taken to warrant to the assignee that:

- (i) the assignor is entitled to, or (in the case of a future claim) will be entitled to, transfer the claim to the assignee,
- (ii) the debtor is obliged to perform in full to the assignor, and
- (iii) the assignor has done nothing and will do nothing to prejudice the assignation.

(b) In assigning a claim other than for value the assignor should be taken to warrant to the assignee that the assignor will do nothing to prejudice the assignation.

(c) In assigning a claim, whether for value or other than for value, the assignor should not be taken to warrant to the assignee that the debtor will perform to the assignee.

(d) These rules should also apply to any contract or unilateral undertaking which the assignation implements.

(e) These rules should be subject to contrary agreement by the parties.

(f) The common law rules on warrandice in relation to the assignation of claims should be abolished.

(Paragraph 13.43; Draft Bill, ss 10 and 17(1)(d))

68. The general provisions on assignation of claims should be without prejudice to the application, as respects the assignment and acquisition of associated rights, of the International Interests in Aircraft Equipment (Cape Town Convention) Regulations 2015.

(Paragraph 13.46; Draft Bill, s 18)

69. At the present time the law of assignation of claims should not be codified.

(Paragraph 13.49)

70. (a) If an assignation document evidences a security financial collateral arrangement or a title transfer financial collateral arrangement (as defined in regulation 3 of the Financial Collateral Arrangements (No. 2) Regulations 2003) in respect of a claim, then the transfer of that claim should require either (i) intimation to the debtor or registration in the Register of Assignations, or (ii) the financial collateral

in question to come into the possession of, or under the control of, the collateral-taker or a person authorised to act on the collateral-taker's behalf.

(b) In case (ii) the assignment document need not be executed or signed electronically and may be created as writing transcribed by electronic or other means in a durable medium, or as sounds recorded in such a medium.

(Paragraph 14.43; Draft Bill, s 4)

71. The law on security over moveable property should be reformed on the lines set out in Chapter 16.

(Paragraph 18.74)

72. (a) There should be a new right in security over moveable property.

(b) It should be a new type of pledge called a "statutory pledge".

(Paragraph 19.8; Draft Bill, s 43(1), (2)(b) & (4))

73. (a) The person to whom a pledge is granted should be referred to as the "secured creditor".

(b) The person who grants the pledge should be referred to as the "provider".

(Paragraph 19.12; Draft Bill, s 43(5))

74. (a) The term "provider" should include any successor in title or representative of a provider (unless the successor or representative is a person who acquired the encumbered property unencumbered by the statutory pledge in question).

(b) The term "secured creditor" should include any successor in title or representative of a secured creditor.

(Paragraph 19.15; Draft Bill, s 116(1))

75. The secured obligation:

(a) may be any obligation owed, or which will or may become owed, to the secured creditor,

(b) should not require to be an obligation owed

(i) by the provider, or

(ii) to the secured creditor, and

(c) should include ancillary obligations owed to the secured creditor (as for example to pay interest, damages or the reasonable expenses of extra-judicial recovery of interest or damages).

(Paragraph 19.26; Draft Bill, s 44(2))

76. There should not be a non-accessory form of pledge.

(Paragraph 19.30)

77. Any person, juristic or natural, should be able to grant a pledge.

(Paragraph 19.35)

78. (a) Where the provider of a statutory pledge is an individual the encumbered property should require to consist only of assets separately identified in the constitutive document (or in any amendment document) and which are either:

- (i) the provider's property at the time that document is granted, or
- (ii) acquired by the provider after that time if the acquisition is financed by credit and an obligation to repay that credit is the secured obligation.

(b) A corporeal asset so identified should require, immediately before that document is granted, to have a monetary value exceeding £1,000 or such other prescribed amount.

(Paragraph 19.51; Draft Bill, s 52(1) to (3))

79. The restrictions on the grant of a statutory pledge in relation to individuals should not apply to sole traders as respects any assets used, or to be used, wholly or mainly for the purposes of that sole trader's business.

(Paragraph 19.55; Draft Bill, s 52(4))

80. It should be competent to grant a statutory pledge over moveable property but not over property that has acceded to immoveable (heritable) property.

(Paragraph 19.60; Draft Bill, s 43(1))

81. The encumbered property should require to be transferable (whether or not its transferability is restricted in some way).

(Paragraph 19.64; Draft Bill, s 44(4))

82. The encumbered property should (except in so far as the provider and the secured creditor agree otherwise) include the natural fruits, but not the incorporeal fruits, of the property.

(Paragraph 19.71; Draft Bill, s 44(3)(b))

83. There should not be a special regime for construction contracts.
(Paragraph 19.72)
84. (a) The statutory pledge should be a fixed security only.
(b) The definitions of “fixed security” in the Companies Act 1985 and the Insolvency Act 1986 should be amended to include reference to the statutory pledge.
(Paragraph 20.26; Draft Bill, s 65)
85. The secured creditor should not be able to give the provider a general mandate to deal with the encumbered property free of the statutory pledge.
(Paragraph 20.36)
86. (a) If the provider of a statutory pledge transfers encumbered property to a third party other than with the consent mentioned below, the property should remain subject to the pledge.
(b) That consent should be the written consent of the secured creditor to the particular transfer and to the property in question being transferred unencumbered by the pledge, but should not include consent granted more than 14 days before the particular transfer.
(c) The granting or withholding of consent should require to be at the discretion of the secured creditor.
(d) The Scottish Ministers should have the power to make regulations amending the rules relating to consent.
(e) The foregoing recommendations should be subject to the recommendations made elsewhere as regards good faith acquirers.
(Paragraph 20.45; Draft Bill, s 53(1) to (3), (5) & (6))
87. A statutory pledge should be extinguished if the secured creditor acquiesces, expressly or impliedly, in the provider’s transfer of the encumbered property or any part of it to a third party other than with the consent required by the legislation.
(Paragraph 20.53; Draft Bill, s 53(4))
88. It should be competent to create a statutory pledge over corporeal moveable property.
(Paragraph 21.3; Draft Bill, s 43(1), (2)(b) and (4))
89. For the purposes of the new legislative scheme in relation to pledge, the definition of “corporeal moveable property” should not include money.
(Paragraph 21.6; Draft Bill, s 116(1))

90. It should not be competent to create a statutory pledge over a ship (or a share of a ship) in respect of which it is competent to register a mortgage in the UK Ship Register.

(Paragraph 21.10; Draft Bill, s 47(1)(c))

91. It should not be competent to create a statutory pledge over an aircraft in respect of which an aircraft mortgage can be created.

(Paragraph 21.12; Draft Bill, s 47(1)(a))

92. The prescribed style for Scottish aircraft mortgages should be deleted from the Mortgaging of Aircraft Order 1972.

(Paragraph 21.14)

93. The Mortgaging of Aircraft Order 1972 should be the subject of a UK-wide review.

(Paragraph 21.15)

94. It should not be competent to create a statutory pledge over an aircraft object in respect of which an international security interest can be created under the International Interests in Aircraft Equipment (Cape Town Convention) Regulations 2015.

(Paragraph 21.20; Draft Bill, s 47(1)(b))

95. It should be possible to create a statutory pledge over financial instruments within the meaning of regulation 3(1) of the Financial Collateral Arrangements (No. 2) Regulations 2003.

(Paragraph 22.34; Draft Bill, ss 47(2)(c) and 116(1))

96. It should be possible to create a statutory pledge over:

- (a) intellectual property, and
- (b) applications for, or licences over, intellectual property.

(Paragraph 22.43; Draft Bill, s 47(2)(a) and (b))

97. In the case of registered intellectual property, registration of the statutory pledge in the relevant intellectual property register should not displace the requirement for registration in the Register of Statutory Pledges, but consideration should be given to establishing information-sharing arrangements between the registers.

(Paragraph 22.54)

98. Any rule of law in relation to a pledge over a negotiable instrument should be unaffected by the reforms recommended in this Report.

(Paragraph 22.60; Draft Bill, s 43(6))

99. The Scottish Ministers should have the power to prescribe other kinds of incorporeal moveable property over which a statutory pledge may be created.

(Paragraph 22.62; Draft Bill s 47(2)(d))

100. (a) A statutory pledge should require a constitutive document.

(b) The constitutive document should require to:

(i) be executed or authenticated by the provider,

(ii) identify the property which is to be encumbered property (which may be either property of, or property to be acquired by, the provider), and

(iii) identify the secured obligation.

(c) If the encumbered property is to consist of more than one item the constitutive document should not have to identify each item separately provided that the document identifies the items in terms of their constituting an identifiable class.

(Paragraph 23.10; Draft Bill, s 46)

101. Registration in the Register of Statutory Pledges should be a pre-requisite for the creation of a statutory pledge.

(Paragraph 23.19; Draft Bill, ss 48 to 49)

102. (a) A statutory pledge over property which, at the time the statutory pledge is registered, is the provider's and is identifiable as property to which the constitutive document relates, is created over that property on registration.

(b) If the property is not yet so identifiable, the statutory pledge is created over that property on it becoming so identifiable.

(Paragraph 23.21; Draft Bill, s 48(1) & (2))

103. A statutory pledge should be created over after-acquired property when the property becomes the provider's property, provided that the property is identifiable at that time as property which is to be encumbered property. If it is not so identifiable at that time then the pledge should not be created until such time as it does become so identifiable.

(Paragraph 23.27; Draft Bill, s 51)

104. (a) A statutory pledge granted prior to the provider becoming insolvent should not be able to encumber property acquired after that time.

- (b) A provider who is an individual, or the estate of which may be sequestrated, becomes insolvent when:
- (i) the provider's estate is sequestrated,
 - (ii) the provider grants a trust deed for creditors or makes a composition or arrangement with creditors,
 - (iii) a voluntary arrangement proposed by the provider is approved, or
 - (iv) the provider's application for a debt payment programme is approved under section 2 of the Debt Arrangement and Attachment (Scotland) Act 2002.
- (c) A provider which is not an individual becomes insolvent when:
- (i) a decision approving a voluntary arrangement entered into by the provider has effect under section 4A of the Insolvency Act 1986,
 - (ii) the provider is wound up under Part 4 or 5 of the 1986 Act or under section 367 of the Financial Services and Markets Act 2000,
 - (iii) an administrative receiver is appointed over all or part of the property of the provider including the encumbered property, or
 - (iv) the assignor enters administration, ("enters administration" being construed in accordance with paragraph 1(1) and (2) of schedule B1 of the 1986 Act).
- (d) The Scottish Ministers should have power to amend the definition of "insolvent".

(Paragraph 23.32; Draft Bill, s 51)

105. (a) The secured creditor and the provider should be entitled to amend a statutory pledge by means of an executed or authenticated amendment document.
- (b) An amendment document which relates to the addition of property to the encumbered property must identify the property to be added. That property may either be property of, or property to be acquired by the provider.
- (c) An amendment document by virtue of which only an amendment adding property to the encumbered property is made need not be executed or authenticated by the secured creditor.
- (d) Where an amendment document relates to (either or both):
- (i) the addition of property to the encumbered property,

- (ii) variation of the secured obligation, where the extent of that obligation is to be increased and its current extent is determinable from the entry alone,

the statutory pledge should be amended only on registration of that document.

(e) On the amendment being registered in respect of additional property, the statutory pledge is created over that property provided that it:

- (i) is identifiable as property which is to be encumbered property, and
- (ii) is the property of the provider.

(Paragraph 23.40; Draft Bill, ss 49 and 60)

106. (a) Except in so far as the provider and the secured creditor otherwise agree, a statutory pledge should be transferable by means of an assignment document executed or authenticated by the secured creditor.

(b) Subject to the provisions of the assignment document, the assignment should convey to the assignee entitlement to the benefit of any noticed served, or enforcement procedure commenced, by the assignor in respect of the statutory pledge before assignment.

(Paragraph 23.48; Draft Bill, s 59(1) to (2))

107. It should be possible to restrict a statutory pledge to part of the encumbered property or to discharge it by means of a written statement made by the secured creditor.

(Paragraph 23.54; Draft Bill, s 61(1))

108. (a) A person who purchases corporeal property which is encumbered property and which is, or has been transferred without the required consent of the secured creditor, should acquire it unencumbered by the statutory pledge if:

- (i) the person from whom the property is acquired is acting in the ordinary course of that person's business, and
- (ii) at the time of acquisition, the person is in good faith.

(b) A person should not be taken to be other than in good faith by reason only of the pledge having been registered.

(Paragraph 24.24; Draft Bill, s 54)

109. (a) An individual who acquires corporeal property which is encumbered property and which is, or has been, transferred without the required consent of the secured creditor, should acquire it unencumbered by the statutory pledge if:

- (i) the value of all that is acquired does not, at the time of acquisition, exceed such amount (if any) as the Scottish Ministers may by regulations specify,
- (ii) at the time of acquisition, the acquirer is in good faith,
- (iii) the acquirer gives value for the property acquired, and
- (iv) the property is wholly or mainly acquired for personal, domestic or household purposes.

(b) This rule should not apply in respect of the acquisition of encumbered property (or any part of that property) which consists of a motor vehicle.

(c) A person should not be taken to be other than in good faith by reason only of the pledge having been registered.

(Paragraph 24.30; Draft Bill, s 55)

110. (a) The following rule should apply where:

- (i) there is a sale agreement (or conditional sale agreement) or a hire-purchase agreement in respect of a motor vehicle,
- (ii) the motor vehicle is encumbered property,
- (iii) the purchaser or hirer is, at the time of entering into the agreement, in good faith, and
- (iv) at that time the purchaser or hirer is not a person carrying on a business described in section 29(2) of the Hire-Purchase Act 1964.

(b) On the motor vehicle being transferred to the purchaser or hirer in accordance with the agreement, that person should acquire it unencumbered by the statutory pledge.

(c) And the statutory pledge should not be able to be enforced against the motor vehicle while the agreement is extant, and before the vehicle is transferred to the purchaser or hirer.

(d) But if the transferor is, at the time the agreement is entered into, a person carrying on a business described in section 29(2) of the Hire-Purchase Act 1964, the secured creditor should be entitled to receive from the transferor the lesser of:

- (i) the amount outstanding in respect of the secured obligation, and
- (ii) the amount received, or to be received, by the transferor in respect of the acquisition.

(e) A purchaser should not be taken to be other than in good faith by reason only of the statutory pledge having been registered.

(f) “Conditional sale agreement”, “hire-purchase agreement” and “motor vehicle” should have the meanings given to those expressions by section 29(1) of the Hire-Purchase Act 1964.

(g) The Scottish Ministers should have the power to make regulations specifying the motor vehicles, or classes of motor vehicle, to which these rules are not to apply.

(Paragraph 24.43; Draft Bill, s 56)

111. (a) The following rule should apply where:

- (i) a person, in the ordinary course of trading on a specified financial market, acquires a financial instrument of a specified kind, and
- (ii) that financial instrument is encumbered property.

(b) The person should acquire the instrument unencumbered by the statutory pledge provided that:

- (i) at the time of acquisition the person does not know of the statutory pledge, and
- (ii) the acquisition takes place in accordance with the rules of the specified financial market.

(c) “Specified” should mean specified, for these purposes, by the Scottish Ministers by regulations.

(d) The regulations should be able to specify different markets or descriptions of market in relation to different kinds of financial instrument.

(Paragraph 24.48; Draft Bill, s 57)

112. (a) For a possessory pledge to be created the property delivered must be or become the property of the provider.

(b) The rule in *Hamilton v Western Bank*, that pledge is restricted to actual delivery of the property which is to be encumbered, should no longer have effect.

(c) Delivery of corporeal moveable property in order to pledge it should be effected by:

- (i) physically handing over or giving control of the property to the secured creditor or to a person authorised to accept delivery on behalf of the secured creditor,
- (ii) giving control of the premises in which the property is located to the secured creditor or to a person so authorised,

(iii) instructing an independent third party who has direct possession or custody of the property to hold the property on behalf of the secured creditor or of a person so authorised, or

(iv) delivering a bill of lading to the secured creditor or to a person so authorised (and where that bill is to the order of a particular person, by effecting the endorsement of the bill in favour of the secured creditor).

(d) Property already in the direct possession or custody of the secured creditor or of a person authorised to hold the property on behalf of the secured creditor when agreement on the creation of the pledge is reached between the provider and the secured creditor is deemed to have been delivered to the secured creditor for the purpose of creating a pledge.

(e) These rules should be without prejudice to section 2 of the Factors Act 1889 (powers of mercantile agent with respect to disposition of goods).

(Paragraph 25.10; Draft Bill, ss 45 and 118(4))

113. The rule in *North-Western Bank Limited v Poynter, Son & Macdonalds*, that pledged property can be redelivered to the provider on the basis of a trust receipt without extinguishing the pledge, should not at the present time be abolished.

(Paragraph 25.13)

114. (a) Where, under the pawnbroking provisions of the Consumer Credit Act 1974, ownership of the pledged item is lost because the loan is below the prescribed figure (currently £75), the debt (if more than the value of the item) should be reduced by the value of the item.

(b) Where, under the pawnbroking provisions of the Consumer Credit Act 1974, ownership of the pledged item is lost because the loan is below the prescribed figure (currently £75), but the value of the item exceeds the loan, the loan should be discharged, and the pawnbroker should be obliged to pay the customer the surplus value (subject always to deduction of administrative expenses etc).

(Paragraph 25.17)

115. Possessory pledge should have the same remedies as statutory pledge in non-Consumer Credit Act 1974 cases.

(Paragraph 25.22; Draft Bill, ss 67 to 84)

116. The law of possessory pledge should not be codified at the present time.

(Paragraph 25.24)

117. In general, the priority in ranking of any two pledges, or a pledge and a right in security other than a pledge, should be determined according to their creation, the earlier created having priority over the later.

(Paragraph 26.9; Draft Bill, s 64(1))

118. The priority in ranking of a pledge should be the same irrespective of whether the secured obligation is an obligation owed or is an obligation which will or may become owed.

(Paragraph 26.13; Draft Bill, s 64(5))

119. Where a provider grants two or more statutory pledges over property which, as at the time the pledges are granted, is not the provider's, the priority in ranking of any two of the pledges should be determined according to the dates on which they are registered, the earlier having priority over the later.

(Paragraph 26.19; Draft Bill, s 64(2) & (3))

120. The definitions of "fixed security" in section 486(1) of the Companies Act 1985 and section 70(1) of the Insolvency Act 1986 should be amended to include a statutory pledge.

(Paragraph 26.22; Draft Bill, s 65)

121. Where property is subject both to a pledge and to a security arising by operation of law, the security arising by operation of law should have priority over the pledge.

(Paragraph 26.29; Draft Bill, s 64(4))

122. (a) Where diligence is executed in respect of property all or any part of which is encumbered by a pledge, the pledge has priority of ranking over the diligence, except as regards further advances made after the execution of the diligence which are not required to be made by a contractual agreement entered into or undertaking given before such execution.

(b) Where a pledge is created over property in respect of all or any part of which diligence has been executed, the diligence has priority in ranking over the pledge.

(Paragraph 26.33; Draft Bill, s 66)

123. (a) The secured creditor and the holder of another pledge or other right in security should be able to set out in writing an agreement as to ranking.

(b) Such an agreement should have effect only as between the parties to the agreement and their successors and should not be registrable.

(Paragraph 26.38; Draft Bill, s 64(6) & (7))

124. The statutory pledge should not be enforceable by receivership.
(Paragraph 27.12)
125. In the scheme for the enforcement of pledges, the expression “pledge” should not include a pledge as defined in section 189(1) of the Consumer Credit Act 1974.
(Paragraph 27.17; Draft Bill, s 67)
126. A pledge should be enforceable in no other way than in accordance with the remedies set out in statute.
(Paragraph 27.27; Draft Bill, s 68(1))
127. (a) A statutory pledge should be enforceable:
- (i) where there is failure to perform the secured obligation, or
 - (ii) in such other circumstances, if any, as are agreed between the provider and the secured creditor.
- (b) Any such agreement should require to be set out in writing.
(Paragraph 27.28; Draft Bill, s 68(2) & (3))
128. A statutory pledge should be enforceable by or on behalf of the secured creditor.
(Paragraph 27.31; Draft Bill, ss 68 and 118(4))
129. In enforcing a pledge a secured creditor should have a duty to conform with reasonable standards of commercial practice. This duty should be to the provider and third parties with an interest in how the pledge is enforced.
(Paragraph 27.36; Draft Bill, s 68(4))
130. (a) Before taking any steps to enforce a pledge the secured creditor should require to serve a notice on:
- (i) the provider,
 - (ii) the holder of any right in security over all or part of the encumbered property,
 - (iii) any creditor who has executed diligence against all or part of the encumbered property, and
 - (iv) any prescribed person who has statutory duties in relation to the provider’s estate.

(b) But the duty in cases (ii) and (iii) is to be waived if the secured creditor does not know and cannot reasonably be expected to know of the right in security or diligence.

(c) Such a notice is to be known as a “Pledge Enforcement Notice” in, or as nearly as may be in, such form as may be prescribed.

(d) The Scottish Ministers should have the power to prescribe different forms for different categories of provider.

(e) If by virtue of the Consumer Credit Act 1974, a default notice must be served on the provider, the requirements of that Act in relation to such a notice should require to be satisfied before a Pledge Enforcement Notice can be served.

(Paragraph 27.45; Draft Bill, s 69)

131. (a) A court order should not generally be required to enforce a pledge.

(b) Such an order should be required where the provider of a pledge is an individual unless:

(i) after the pledge becomes enforceable, the provider and the secured creditor agree in writing that it may be enforced without such an order, or

(ii) the provider being a sole trader, enforcement is against property used wholly or mainly for the purposes of the provider’s business.

(Paragraph 27.54; Draft Bill, s 70(1))

132. (a) The definitions of “dealing” in the Matrimonial Homes (Family Protection) (Scotland) Act 1981 and the Civil Partnership Act 2004 should be amended so as to include the grant of a statutory pledge.

(b) The protections conferred by the Matrimonial Homes (Family Protection) (Scotland) Act 1981 and the Civil Partnership Act 2004 on heritable creditors who have acted in good faith should be amended so as to apply to secured creditors of statutory pledges.

(Paragraph 27.58; Draft Bill, s 58(1) and (7) to (12))

133. (a) Before taking any steps to enforce a statutory pledge the secured creditor should be required to serve a special form of Pledge Enforcement Notice on any occupier of the encumbered property or part of it.

(b) A court order should be required for enforcing a statutory pledge as regards encumbered property which is the sole or main residence of an individual (whether or not the individual is the provider of the security) unless:

- (i) after the statutory pledge becomes enforceable the secured creditor, the provider and (if the individual is not the provider) the individual agree otherwise, and
 - (ii) the agreement is a written agreement.
- (c) The court should not grant an order unless satisfied that enforcement is reasonable in all the circumstances of the case.
- (d) Those circumstances should include:
- (i) the nature of, and reason for, the default by virtue of which authority to enforce is sought,
 - (ii) whether the person in default has the ability to remedy the default within a reasonable time,
 - (iii) whether the secured creditor has done anything to remedy the default,
 - (iv) whether it is, or was, appropriate for the person in default to take part in a debt payment programme approved under Part 1 of the Debt Arrangement and Attachment (Scotland) Act 2002, whether the person in default is taking part, or has taken part, in such a programme, and
 - (v) whether reasonable alternative accommodation is available for (or can be expected to be available for) the individual whose sole or main residence is the property.

(Paragraph 27.63; Draft Bill, ss 69(1)(e) and 70(2), (4) and (5))

134. The protections conferred by the Matrimonial Homes (Family Protection) (Scotland) Act 1981 and the Civil Partnership Act 2004 in relation to creditors under hire-purchase and conditional sale agreements in relation to furniture and plenishings should be extended to include secured creditors of statutory pledges.

(Paragraph 27.67; Draft Bill, s 58(1) to (6))

135. (a) The following rules should apply in relation to corporeal property in respect of which a secured creditor in a statutory pledge has served a Pledge Enforcement Notice.
- (b) The secured creditor should be entitled:
- (i) to take possession of the property, or
 - (ii) to take any reasonable steps necessary to ensure, whether or not by immobilising the property, that it is not disposed of or used in an unauthorised way.

- (c) The secured creditor should be able to take such possession, or such steps,
 - (i) personally if authorised to do so by the court but otherwise only with the consent of the provider given after default, and of any third party who is in direct possession of, or has custody of, the property, or
 - (ii) through the agency of an authorised person.
- (d) The secured creditor should be entitled, in taking possession of the encumbered property to remove any individual from it, but only through the agency of an authorised person.
- (e) An “authorised person” should mean:
 - (i) a messenger-at-arms or sheriff officer,
 - (ii) a person qualified to act as an insolvency practitioner, or
 - (iii) such other person as the Scottish Ministers may by regulations specify.

(Paragraph 27.76; Draft Bill, s 71(1) to (4) and (8) to (9))

136. (a) The secured creditor should not have an entitlement to take possession of the encumbered property or to take the steps set out in the previous recommendation if the property is in the possession of a person:
- (i) who has a right in security over the property, or over any part of the property, being a right in security which has priority over, or ranks equally with, the pledge to which the Pledge Enforcement Notice relates, or
 - (ii) who has executed diligence against the property, or against any part of the property, and by virtue of that diligence has priority in ranking over, or ranks equally with, that pledge.
- (b) But in these circumstances the secured creditor may take possession or take these steps:
- (i) with the consent of the person who has the right in security over the property, or has executed diligence against it,
 - (ii) if authorised by the court, through the agency of an authorised person, or
 - (iii) personally, if authorised to do so by the court.

(Paragraph 27.79; Draft Bill, s 71(6) & (7))

137. The taking of possession of financial instrument certificates by the secured creditor should be subject to similar rules as the taking of possession of corporeal property.

(Paragraph 27.81; Draft Bill, s 72)

138. (a) Where a pledge is being enforced, the secured creditor should be entitled to sell all or any of the encumbered property.

(b) The secured creditor, in selling the property, should require to take all reasonable steps to ensure that the price obtained is the best reasonably obtainable.

(c) The secured creditor should be entitled to purchase all or any of the property only if the sale is by public auction and if the price bears a reasonable relationship to market value.

(d) If the property is tradeable in a public market in which the current market value is verifiable the secured creditor should be entitled to purchase all or any of the property only in that market and for market value.

(e) Any proceeds derived from the sale should require to be held in trust until applied by the secured creditor.

(Paragraph 28.8; Draft Bill, s 73)

139. Where the secured creditor sells encumbered property on enforcement the purchaser should acquire the property unencumbered by:

(a) the pledge,

(b) any right in security or any diligence ranking equally with, or postponed to, the pledge, and

(c) any right in security or any diligence which has priority in ranking over the pledge, but only if the holder of that right in security, or as the case may be the creditor who executed that diligence, consented to the sale.

(Paragraph 28.13; Draft Bill, s 74)

140. (a) Where a pledge is being enforced it should be competent for the secured creditor to let all or any of the encumbered property.

(b) The secured creditor in letting the property should require to take all reasonable steps to ensure that the rental income obtained is the best reasonably obtainable.

(c) The rental income obtained should be held in trust by the secured creditor until applied towards the satisfaction of the secured obligation.

(d) The provider and the secured creditor should be able to agree that the right to let is excluded in respect of all or any of the encumbered property. Such an agreement should require to be set out in writing.

(Paragraph 28.15; Draft Bill, s 75)

141. (a) Where a statutory pledge over intellectual property is being enforced it should be competent for the secured creditor to grant a licence over all or any of that property (but only if and to the extent that the provider is entitled to grant such a licence).

(b) The secured creditor in granting a licence should require to take all reasonable steps to ensure that the rental income obtained is the best reasonably obtainable.

(c) The income obtained should be held in trust by the secured creditor until applied towards the satisfaction of the secured obligation.

(d) The provider and the secured creditor should be able to agree that the right to grant a licence is excluded in respect of all or any of the intellectual property encumbered by the statutory pledge. Such an agreement should require to be set out in writing.

(Paragraph 28.18; Draft Bill, s 76)

142. (a) A secured creditor who is enforcing a pledge should be entitled to take reasonable steps to protect, maintain and manage the encumbered property and to preserve its value.

(b) Such steps could include:

(i) exercising any voting rights in relation to a financial instrument which is encumbered property,

(ii) effecting or maintaining an insurance policy in relation to the encumbered property,

(iii) settling any liability in relation to that property,

(iv) bringing, defending or continuing legal proceedings in relation to that property, and

(v) taking such other steps as the provider, whether before or after the pledge has become enforceable, has agreed may be taken by the secured creditor.

(Paragraph 28.20; Draft Bill, s 77)

143. (a) Any proceeds arising from enforcement should be applied:
- (i) firstly, in payment of all expenses reasonably incurred by or on behalf of the secured creditor in connection with the enforcement,
 - (ii) secondly, in payment of the amount due under any right in security over the property from which the proceeds arose, or to a creditor who has executed diligence against that property in accordance with ranking, and
 - (iii) thirdly, in payment to the provider of any residue.
- (b) No payment should be made to a higher ranking creditor unless it has consented to the realisation.
- (c) Where payment is to be made to more than one person with the same ranking but the proceeds are inadequate to enable those persons to be paid in full, their payments should abate in equal proportions.
- (d) "Expenses" should be defined to include the costs of taking possession of, immobilising and managing the property.

(Paragraph 28.33; Draft Bill, s 82(1) to (5) & (10))

144. (a) Where a question arises as to whom a payment should be made, the secured creditor should be required to:
- (i) consign the amount of the payment (so far as ascertainable) in court for the person appearing to have the best right to that payment, and
 - (ii) lodge in court a statement of the amount consigned.
- (b) Such a consignment should operate as a payment of the amount due and a certificate of the court should be sufficient evidence of that payment.

(Paragraph 28.35; Draft Bill, s 82(6) to (9))

145. (a) The secured creditor should be required, as soon as reasonably practicable, to present:
- (i) the provider,
 - (ii) the debtor in the secured obligation if a person other than the provider,
 - (iii) any other creditor affected by the enforcement, and
 - (iv) any prescribed person who has statutory duties in relation to the provider's estate

with a written statement of how the proceeds arising from the enforcement have been applied.

(b) But where the proceeds arise from the letting or licensing of the property a monthly statement should be sufficient.

(Paragraph 28.37; Draft Bill, s 82(11) & (12))

146. (a) The secured creditor should be entitled to appropriate any or all of the encumbered property in total or partial satisfaction of the secured obligation.

(b) But it should not be competent to appropriate:

- (i) the property of an individual unless that person is a sole trader and the appropriation is of assets used wholly or mainly for the purposes of the person's business,
- (ii) corporeal property, or a financial instrument payable to bearer, unless it is in the possession of the secured creditor, or
- (iii) property the value of which exceeds the amount for the time being remaining due under the secured obligation and the costs of enforcement unless the secured creditor holds the excess amount on trust to be applied as if it were proceeds.

(Paragraph 28.43; Draft Bill, s 78)

147. (a) Before exercising any right to appropriate property, the secured creditor should require to serve a notice on:

- (i) the provider,
- (ii) the debtor in the secured obligation if a person other than the provider,
- (iii) any other person with a right in security over all or part of the property,
- (iv) any person who has executed diligence against all or part of the property, and
- (v) any person who has statutory duties in relation to the provider's estate and is prescribed under this paragraph.

(b) But the duty in cases (iii) and (iv) is to be waived if the secured creditor does not know and cannot reasonably be expected to know of the right in security or diligence.

(c) Any notice should require to:

- (i) identify the property to be appropriated,
- (ii) specify
 - (a) the amount for the time being remaining due under the secured obligation, and

- (b) the amount to be obtained by the appropriation
- (iii) state that the recipient has a right to object within 14 days of the receipt of the notice.
- (d) The appropriation may not proceed unless the amount to be obtained by it bears a reasonable relationship to the market value of the property.
- (e) If within 14 days after receiving notice a recipient, by means of a written statement made to the secured creditor, objects to the appropriation, it is not to proceed.

(Paragraph 28.48; Draft Bill, s 79)

148. (a) The provider and the secured creditor should be able, before the pledge becomes enforceable, to agree in writing that the secured creditor is entitled to appropriate the encumbered property or part of that property.
- (b) Any property to be appropriated in accordance with that agreement must be:
- (i) a fungible asset that is traded on a specified market, being a market the prices on which are published and widely available (whether on payment of a fee or otherwise) or
 - (ii) if it is not such an asset so traded, property as regards which the provider and the secured creditor have, in the agreement, set out a method of readily determining a reasonable market price,

and be appropriated only for the value of its market price as so published or as the case may be as so determined.

(c) Notice should require to be given to the same parties as mentioned in the previous recommendation of the proposed appropriation and other than the provider (or debtor where different from the provider) they should have the right to object within 14 days of receiving the notice.

(d) “Fungible asset” should be defined as an asset of a nature to be dealt in without identifying the particular asset involved, and “specified” as specified for these purposes by the Scottish Ministers by regulations. It should be possible for the regulations to specify different markets or descriptions of market in relation to different kinds of fungible asset.

(Paragraph 28.55; Draft Bill, s 80)

149. Where the secured creditor appropriates encumbered property, the property should be acquired unencumbered by any right in security or any diligence.

(Paragraph 28.57; Draft Bill, s 81)

150. Where a statutory pledge is extinguished as a result of it or another right in security over the same property being enforced, or as a result of diligence being executed against that property, the secured creditor should be required, as soon as reasonably practicable, to apply to the Keeper to correct the Register of Statutory Pledges to remove the relevant entry.

(Paragraph 28.58; Draft Bill, s 83)

151. (a) A person should be entitled to be compensated by a secured creditor for loss suffered in consequence of the secured creditor's failure to comply with the statutory obligations imposed on the secured creditor in relation to enforcement.

(b) But the secured creditor should have no liability:

(i) in so far as the loss could have been avoided by the person taking certain measures which it would have been reasonable for the person to take, and

(ii) in so far as the loss is not reasonably foreseeable.

(Paragraph 28.64; Draft Bill, s 85)

152. (a) In respect of the application of section 26 of the Interpretation and Legislative Reform (Scotland) Act 2010 in relation to the service of enforcement notices the provider and the secured creditor should be able to agree that service is to be effected either or both at a specified address and by a specified method.

(b) Such an agreement should require to be in writing.

(c) Where there is such an agreement but service cannot be effected in accordance with it the agreement is to be disregarded.

(Paragraph 28.67; Draft Bill, s 86)

153. A new public register should be established, to be called the Register of Statutory Pledges, in which statutory pledges can be registered.

(Paragraph 29.5; Draft Bill, s 87(1))

154. The register should be under the management and control of the Keeper of the Registers of Scotland.

(Paragraph 29.8; Draft Bill, s 87(2))

155. Where an application is made for registration of a statutory pledge it should require to be accompanied by a copy of the constitutive document.

(Paragraph 29.14; Draft Bill, s 91(2)(a)(ii))

156. A copy of a document amending a registered statutory pledge to add property to the encumbered property or to increase the extent of the secured obligation should require to be registered.

(Paragraph 29.21; Draft Bill, s 92(2)(b))

157. (a) Subject to the requirements of statute, the register should be in such form as the Keeper thinks fit.

(b) The Keeper should take such steps as appear reasonable to her for protecting the register from interference, unauthorised access, or damage.

(Paragraph 29.23; Draft Bill, s 87(3) and (4))

158. Registration in the RSP should be by electronic means only and should be by means of an automated system under which applications are not checked by the Keeper.

(Paragraph 29.24; Draft Bill, s 119)

159. The Keeper should make up and maintain, as parts of the Register of Statutory Pledges:

(a) the statutory pledges record, and

(b) the archive record.

(Paragraph 30.2; Draft Bill, s 88)

160. An entry in the statutory pledges record should comprise:

(a) the provider's name and address,

(b) where the provider is an individual, the provider's date of birth,

(c) any number which the provider bears or other information relating to the provider which, by virtue of RSP Rules, must be included in the entry,

(d) the secured creditor's name and address,

(e) any number which the secured creditor bears or other information relating to the secured creditor which, by virtue of RSP Rules, must be included in the entry,

(f) where the secured creditor is not an individual, an address (which may be an email address) to which requests for information regarding the statutory pledge may be directed,

(g) such description of the encumbered property as may be required or permitted by RSP Rules,

(h) a copy of the constitutive document of the statutory pledge and any amendment document,

- (i) the registration number allocated to the entry,
- (j) the date and time of registration of the statutory pledge and any amendment to it, and
- (k) such other data as may be required by legislation.

(Paragraph 30.10; Draft Bill, s 89(1))

161. (a) An application for registration of a statutory pledge should be made by or on behalf of the secured creditor.
- (b) The Keeper should be required to accept an application if:
- (i) it conforms to RSP Rules in relation to applications,
 - (ii) it is submitted with a copy of the constitutive document,
 - (iii) it provides the Keeper with the necessary data to make up an entry in the RSP, and
 - (iv) the registration fee is paid or the Keeper is satisfied that it will be.
- (c) Where these requirements are not satisfied, the Keeper should be required to reject the application and inform the applicant accordingly.

(Paragraph 30.14; Draft Bill, ss 91(1) to (3) and 118(4))

162. On accepting an application for registration, the Keeper should be required to:
- (a) make up and maintain in the statutory pledges record an entry for the statutory pledge, and
 - (b) allocate a registration number to the entry.

(Paragraph 30.16; Draft Bill, s 91(4))

163. (a) An application for registration of an amendment of a statutory pledge to add property to the encumbered property or to increase the extent of the secured obligation should be made by or on behalf of the secured creditor.
- (b) The Keeper should be required to accept an application if:
- (i) it conforms to RSP Rules in relation to applications,
 - (ii) it is submitted with a copy of the amendment document,
 - (iii) it provides the Keeper with the necessary data to update the entry in the RSP, and
 - (iv) the registration fee is paid or the Keeper is satisfied that it will be.

(c) Where these requirements are not satisfied, the Keeper should be required to reject the application and inform the applicant accordingly.

(Paragraph 30.18; Draft Bill, ss 92(1) to (3) and 118(4))

164. On accepting an application for registration of an amendment the Keeper should be required to update the entry for the statutory pledge accordingly.

(Paragraph 30.21; Draft Bill, s 92(4))

165. (a) The Keeper should be required to issue a verification statement on accepting an application for registration.

(b) The statement should require to conform to RSP Rules. It should include the date and time of the registration and the unique number allocated to the entry to which the application relates.

(c) The provider should be entitled to request a copy of the verification statement and the secured creditor should be required to supply this within 21 days after the request is made.

(Paragraph 30.24; Draft Bill, s 93)

166. (a) A registration should be taken to be made on the date and time which are entered for it in the Register of Statutory Pledges.

(b) The Keeper should be required to deal with applications for registration and allocate these registration numbers in order of receipt.

(Paragraph 30.25; Draft Bill, s 94)

167. The registration of a statutory pledge should be ineffective if the entry made up for it:

(a) does not include a copy of the constitutive document,

(b) that document is invalid, or

(c) there is an inaccuracy in relation to the data registered which, as at the time of registration, is seriously misleading.

(Paragraph 31.4; Draft Bill, s 95(1))

168. The registration of an amendment to a statutory pledge should be ineffective if:

(a) the entry for the statutory pledge does not include a copy of the amendment document,

(b) that document is invalid, or

(c) there is an inaccuracy in relation to the data registered for the statutory pledge in consequence of the amendment which is seriously misleading.

(Paragraph 31.6; Draft Bill, s 96(1))

169. (a) An inaccuracy in an entry in the statutory pledges record may be seriously misleading irrespective of whether any person has been misled.

(b) In determining whether an inaccuracy is seriously misleading no account should be taken of any document included in the entry.

(c) An inaccuracy which is seriously misleading in respect of part of an entry should not affect the rest of the entry.

(d) Without prejudice to the generality, an inaccuracy should be seriously misleading:

(i) where the provider (or as the case may be, a co-provider) is not a person required by RSP Rules to be identified by a unique number, if a search using a designated facility provided for by the Keeper for:

(a) the provider's (or co-provider's) proper name, or

(b) the provider's (or co-provider's) proper name and the provider's (or co-provider's) date of birth

does not disclose the entry,

(ii) where the provider (or, as the case may be, co-provider) is a person required by RSP Rules to be identified by a unique number, if a search using a designated facility provided for by the Keeper for that number does not disclose the entry, including where a search using such a facility for the provider's (or co-provider's) number does disclose the entry,

(iii) in respect of so much of the encumbered property as bears a unique number which must, by virtue of RSP Rules, be included in the statutory pledges record, if a search using a designated facility provided for by the Keeper for that number does not disclose the entry.

(e) The meaning of "proper name" should be set out in RSP Rules.

(f) The Scottish Ministers should be able to specify further instances in which an inaccuracy is seriously misleading.

(Paragraph 31.18; Draft Bill, s 98)

170. (a) Where:
- (i) a statutory pledge is effectively registered over property,
 - (ii) at some time after that registration either
 - (a) the relevant entry in the statutory pledges record comes to contain an inaccuracy which is seriously misleading (whether or not in respect of all the encumbered property), or
 - (b) is removed from that record, and
 - (iii) prior to any correction being effected a person acquires, for value and in good faith while exercising reasonable care,
 - (a) all or part of the encumbered property, or
 - (b) a right in, or in part of, that property

the statutory pledge should be extinguished, but in the case of an inaccuracy only as regards so much of the property acquired as is property in respect of which the inaccuracy is seriously misleading.

- (b) This rule should not apply where there is an inaccuracy in an entry but the property acquired is of a prescribed type and the unique number for the property appears in the entry.

(Paragraph 32.51; Draft Bill, s 97)

171. Except in so far as the context otherwise requires any reference to “correction” should include correction by:
- (a) the removal of data included in an entry,
 - (b) the removal of an entry from the statutory pledges record and the transfer of that entry to the archive record,
 - (c) the replacement of data, or of a copy document, included in an entry,
 - (d) the restoration of data, or of a copy document, to an entry, or
 - (e) the restoration of an entry (whether or not by removing it from the archive record and transferring it to the statutory pledges record).

(Paragraph 33.5; Draft Bill, s 105(1))

172. (a) Where the Keeper becomes aware of a manifest inaccuracy in an entry in the statutory pledges record the Keeper should have to correct the inaccuracy if what is needed to correct it is manifest. If what is needed to correct is not manifest the Keeper should have to note the inaccuracy on the entry.

- (b) Where an inaccuracy is corrected by:
- (i) removal of the entry the Keeper should have to transfer the entry to the archive record and note on the entry the details of the correction, and its date and time,
 - (ii) removal or replacement of data included in the entry or by replacement of a copy document the Keeper should have to note on the entry the details of the correction, and its date and time,
 - (iii) replacement of a copy document, the Keeper should have to transfer it to the archive record.
- (c) Where the Keeper effects a correction, the Keeper should have to notify each person specified for these purposes by RSP Rules and any other person whom the Keeper considers it appropriate to notify that the correction has been effected.

(Paragraph 33.7; Draft Bill, s 102)

173. (a) Where a court determines that the statutory pledges record is inaccurate it should have the power to direct the Keeper to correct it.
- (b) In connection with any such correction, the court should be able to give the Keeper such further direction (if any) as it considers requisite.
- (c) The Keeper should be required to note in the relevant entry that it has been corrected and the details of the correction, including the date and time. Where the correction requires the removal of the entry or of a copy document the Keeper should have to transfer it to the archive record.
- (d) Where the Keeper effects a correction, the Keeper should have to notify each person specified for these purposes by RSP Rules and any other person whom the Keeper considers it appropriate to notify that the correction has been effected.

(Paragraph 33.9; Draft Bill, s 103)

174. The Keeper should be entitled to appear and be heard in any civil proceedings, whether before a court or tribunal, in which is put in question (either or both):
- (a) the accuracy of the statutory pledges record,
 - (b) what is needed to correct an inaccuracy in that record.

(Paragraph 33.10; Draft Bill, s 104)

175. (a) The secured creditor should be able to apply for correction of the entry for the statutory pledge in the statutory pledges record.

(b) The Keeper should be required to accept an application if it conforms to RSP Rules in relation to applications and the prescribed fee is paid or the Keeper is satisfied that it will be.

(c) Where these requirements are not satisfied, the Keeper should be required to reject the application and inform the applicant accordingly.

(d) On accepting an application for correction of the statutory pledges record the Keeper should be required to correct the entry accordingly, and issue to the applicant and to the provider of the statutory pledge a written statement verifying the correction.

(e) The verification statement should conform to such RSP Rules as may relate to the statement and include both the date and time of the correction and the registration number allocated to the entry to which the application relates.

(f) The Keeper should be required to note on the relevant entry that it has been corrected and the details of the correction, including the date and time. Where the correction requires the removal of the entry the Keeper should have to transfer it to the archive record.

(Paragraph 33.22; Draft Bill, s 100)

176. (a) A person who:

- (i) is identified incorrectly as the provider, or as a co-provider, of a statutory pledge in an entry in the statutory pledges record, or
- (ii) holds a right in property identified incorrectly as the encumbered property in an entry in the statutory pledges record

may issue a demand in a prescribed form to the person identified in the entry as the secured creditor that the person so identified apply to the Keeper for correction of the statutory pledges record.

(b) Such a demand should require to specify a period (being not less than 21 days after it is received) within which it must be complied with.

(c) No fee may be charged by the person identified as the secured creditor for such compliance.

(d) Where the demand is not complied with the person making it should be able to apply to the Keeper for the correction.

(e) The application should require to conform to such RSP Rules as may relate to it.

(f) On receiving an application the Keeper should be required to:

- (i) serve a notice on the person identified in the entry as the secured creditor stating that the Keeper will correct the record on a date specified in the notice (being a date no fewer than 21 days after the date of the notice),
- (ii) note on the relevant entry that an application has been received and include in that note the details of the correction sought and the date of receipt,
- (iii) issue to the applicant a written statement verifying that the application has been received, and
- (iv) notify the person identified in the entry as the provider (if a different person from the applicant) that the notice mentioned in (i) has been served.

(g) The person identified as the secured creditor should have the right to apply to the court prior to the date specified in the notice to oppose the making of the correction and on making any such application should have to notify the Keeper.

(h) The court should be able to direct whether the entry should be corrected or left unchanged, but only if satisfied that the Keeper has been notified of the application to the court prior to the date specified in the notice.

(i) If the Keeper does not receive such notification prior to the date specified in the notice, the Keeper should be required to make the correction on that date.

(j) The Keeper should be required to note in the relevant entry that it has been corrected and the details of the correction, including the date and time. Where the correction requires the removal of the entry the Keeper should have to transfer it to the archive record.

(k) Where the Keeper effects a correction, the Keeper should have to notify each person specified for these purposes by RSP Rules and any other person whom the Keeper considers it appropriate to notify that the correction has been effected.

(Paragraph 33.34; Draft Bill, s 101)

177. A registration which is ineffective should become effective if and when the entry is corrected.

(Paragraph 33.37; Draft Bill, ss 95(3) and 96(3))

178. A correction should be taken to be made on the date and at the time which are entered for it in the register.

(Paragraph 33.38; Draft Bill, s 105(2))

179. The statutory pledges record should be searchable only:
- (a) by reference to any of the following data in the entries contained in that record:
 - (i) the names of providers,
 - (ii) the names and dates of birth of providers who are individuals,
 - (iii) the unique numbers of providers required by RSP Rules to be identified in the statutory pledges record by such a number,
 - (b) if RSP Rules require or permit the encumbered property to be identified by a unique number by reference to that number,
 - (c) by reference to registration numbers allocated to entries in that record, or
 - (d) by reference to some other factor, or characteristic, specified for these purposes by RSP Rules.

(Paragraph 34.7; Draft Bill, s 106(2))

180. A person should be able to search the statutory pledges record if the search accords with RSP Rules and either such fee as is payable for the search is paid or the Keeper is satisfied that it will be paid.

(Paragraph 34.9; Draft Bill, s 106(1))

181. (a) The Keeper should be required to provide a search facility in relation to which the search criteria are specified by RSP Rules, but may provide such other search facilities, with such other search criteria, as the Keeper thinks fit.
- (b) "Search criteria" should be defined as the criteria in accordance with which what is searched for must match data in an entry in order to retrieve the entry.

(Paragraph 34.11; Draft Bill, s 107)

182. A printed search result which purports to show an entry in the statutory pledges record:
- (a) should be admissible in evidence, and
 - (b) in the absence of evidence to the contrary, should be sufficient proof of:
 - (i) the registration of the statutory pledge, or amendment to the entry in the statutory pledges record, to which the result relates,
 - (ii) a correction of the entry in the statutory pledges record to which the result relates, and
 - (iii) the date and time of such registration or correction.

(Paragraph 34.13; Draft Bill, s 108)

183. (a) Any person should be able to apply to the Keeper for an extract of an entry in the register.
- (b) The Keeper should be required to issue the extract if such fee as is payable for issuing it is paid or arrangements satisfactory to the Keeper are made for payment of that fee.
- (c) The Keeper should be able to validate the extract as the Keeper considers appropriate.
- (d) The Keeper should be able to issue the extract as an electronic document if the applicant does not require that it be issued as a traditional document.
- (e) The extract should be accepted for all purposes as sufficient evidence of the contents, as at the date on which and time at which the extract is issued (being a date and time specified in the extract).

(Paragraph 34.15; Draft Bill, s 109)

184. (a) An entitled person should be entitled to request from the person identified in an entry in the statutory pledges record as the secured creditor:
- (i) if that person is the secured creditor, a written statement:
- (a) as to whether or not property specified by the entitled person is, or is part of, the encumbered property; or
- (b) describing the secured obligation, or
- (ii) if that person has assigned the statutory pledge, the name and address of the assignee and (as the case may be and in so far as known) the names and addresses of subsequent assignees.
- (b) The following should be entitled persons:
- (i) a person who has a right in the property so specified,
- (ii) a person who has the right to execute diligence against that property (or who is authorised by decree to execute a charge for payment and will have the right to execute diligence against that property if and when the days of charge expire without payment),
- (iii) a person who is prescribed for these purposes, and
- (iv) a person who has the consent of the person identified in the entry as the provider.

(Paragraph 35.8; Draft Bill, s 110(1) to (2))

185. (a) An information request should require to be complied with within 21 days of its receipt, unless:
- (i) the court is satisfied that in all the circumstances this would be unreasonable and either extends the 21-day period or exempts the recipient from complying with the request in whole or in part,
 - (ii) it is manifest from the entry that the property specified in the notice has not been encumbered by the statutory pledge or that the registration is ineffective,
 - (iii) where a request has been made for a description of the secured obligation where it is manifest from the entry alone what the extent of that obligation is, or
 - (iv) the same request has been made by the same person within the last 3 months and the information supplied in response to the last request has not changed.
- (b) The recipient should be entitled to recover from the requester any costs reasonably incurred in complying with the request.
- (c) If the court is satisfied on the application of the requester that the recipient has not complied with the duty to provide information without reasonable excuse it should by order require that the recipient complies within 14 days.

(Paragraph 35.14; Draft Bill, s 110(3) to (7))

186. Where:

- (a) an entitled person in response to an information request is incorrectly informed that the property specified in the request is unencumbered by the statutory pledge, and
- (b) within 3 months of being so informed acquires in good faith
 - (i) the property so specified or any part of it,
 - (ii) a right in that property (or any part of it),

on the acquisition the statutory pledge is extinguished as regards the property or part.

(Paragraph 35.18; Draft Bill, s 110(8) to (9))

187. The duties to provide information should also apply to any assignee of the statutory pledge.

(Paragraph 35.19; Draft Bill, s 110(10))

188. (a) The Scottish Ministers should have power to make regulations specifying a period after which an entry in the statutory pledges record will lapse unless it is renewed.

(b) Before exercising this power, the Scottish Ministers must consult the Keeper.

(Paragraph 35.29; Draft Bill, s 99)

189. The archive record should be the totality of all the entries transferred from the statutory pledges record following:

(a) correction to remove an entry, and

(b) lapsing of a statutory pledge under regulations made by the Scottish Ministers,

and should also contain such other information as may be specified by RSP Rules.

(Paragraph 35.32; Draft Bill, s 90)

190. (a) A person should be entitled to be compensated by the Keeper for loss suffered in consequence of:

(i) an inaccuracy attributable to the Keeper in the making up, maintenance or operation of the Register of Statutory Pledges, or in an attempted correction of the register,

(ii) the issue of a statement or notification which is incorrect, or

(iii) the issue of an extract which is not a true extract.

(b) But the Keeper should have no statutory liability:

(i) in so far as the person's loss could have been avoided had the person taken measures which it would have been reasonable for the person to take,

(ii) in so far as the person's loss is not reasonably foreseeable, or

(iii) for non-patrimonial loss.

(Paragraph 35.34; Draft Bill, s 111)

191. (a) Where a person suffers loss in consequence of:

(i) an inaccuracy in an entry in the Register of Statutory Pledges (which is not caused by the Keeper), the person should be entitled to be compensated for that loss by the person who made the application which gave rise to that entry if, in making it, that person failed to take reasonable care, or

- (ii) a failure to respond to a request for information under the information duty provisions, or the provision of information in which there is an inaccuracy, the person is entitled to be compensated for that loss by the person who failed to supply the information if that failure was without reasonable cause or if, in supplying it, that person failed to take reasonable care.
- (b) But there should be no liability:
- (i) in so far as the person's loss could have been avoided had the person taken measures which it would have been reasonable for the person to take,
 - (ii) in so far as the loss is not reasonably foreseeable, or
 - (iii) for non-patrimonial loss.

(Paragraph 35.36; Draft Bill, s 112)

192. The Scottish Ministers should, following consultation with the Keeper, be able by regulations to make rules (to be known as "RSP Rules"):

- (a) as to the making up and keeping of the register,
- (b) as to procedure in relation to applications:
 - (i) for registration, or
 - (ii) for corrections,
- (c) as to the identification, in any such application of any person or property, including:
 - (i) how the proper form of a person's name is to be determined, and
 - (ii) where the person bears a number (whether of numerals or of letters and numerals) unique to the person, whether that number must (or may) be used in identifying the person,
- (d) as to the degree of precision with which time is to be recorded in the register,
- (e) as to the manner in which an inaccuracy in the statutory pledges record may be brought to the attention of the Keeper,
- (f) as to information which, though contained in a constitutive document or amendment document, need not be included in a copy of that document submitted with an application for registration,
- (g) as to whether a signature contained in a constitutive document or amendment document need be included in a copy of that document so submitted,

- (h) as to searches in the register,
- (i) as to information which, though contained in the register, is not to be –
 - (i) available to persons searching it, or
 - (ii) included in any extract issued by the Keeper,
- (j) prescribing the configuration, formatting and content of:
 - (i) applications,
 - (ii) notices,
 - (iii) documents,
 - (iv) data,
 - (v) statements, and
 - (vi) requests

to be used in relation to the register,
- (k) as to when the register is open for:
 - (i) registration, and
 - (ii) searches,
- (l) requiring there to be entered in the statutory pledges record or the archive record such data as may be specified in the rules, or
- (m) regarding other matters in relation to registration, being matters for which the Scottish Ministers consider it necessary or expedient to give full effect to the purposes of the draft Bill.

(Paragraph 35.38; Draft Bill, s 114)

193. A statutory pledge granted by a company should be registered in both the Register of Statutory Pledges and the Companies Register, but the possibility of an order being made under the Companies Act 2006 section 893 should be kept under review.

(Paragraph 36.28)

194. The creation of a statutory pledge over a financial instrument should require either:
- (a) registration in the Register of Statutory Pledges and compliance with the ordinary rules for creation of statutory pledges, or

(b) in a case where a constitutive document or amendment document evidences a security financial collateral arrangement in respect of the instrument, the satisfaction of the following criteria:

- (i) the financial instrument to be the property of the provider,
- (ii) the financial instrument to have come into the possession of, or under the control of, the collateral-taker or a person acting on the collateral-taker's behalf, and
- (iii) identification of the financial instrument as one to which the constitutive document or amendment document relates.

(Paragraph 37.5; Draft Bill, s 50(1)–(3) & (6))

195. Where a statutory pledge over a financial instrument is created without registration:

- (a) there should be no requirement for it to be executed or signed electronically, and
- (b) the constitutive document and any amendment document may be evidenced by writing transcribed by electronic or other means in a durable medium, or as sounds recorded in such a medium.

(Paragraph 37.5; Draft Bill, s 50(4) to (6))

196. Where a statutory pledge over a financial instrument is created without registration:

- (a) it may be assigned by an evidenced agreement between the collateral-taker and the assignee, and
- (b) that agreement may be evidenced in writing transcribed by electronic or other means in a durable medium, or in sounds recorded in such a medium.

(Paragraph 37.6; Draft Bill, ss 59(3) and 63)

197. Where a statutory pledge over a financial instrument is created without registration:

- (a) it may be amended by an evidenced agreement between the collateral-taker and the provider, and
- (b) that agreement may be evidenced in writing transcribed by electronic or other means in a durable medium, or in sounds recorded in such a medium.

(Paragraph 37.7; Draft Bill, ss 60(8) and 63)

198. (a) A statutory pledge created as a security financial collateral arrangement without registration in the Register of Statutory Pledges should be:

- (i) extinguished in relation to the financial instrument over which the pledge is created on the financial instrument ceasing to be in the

possession, or under the control, of the collateral-taker or of a person acting on behalf of the collateral-taker, or

- (ii) restricted to only part of the encumbered property by means of an evidenced statement of the collateral-taker.

(b) Such a statement may be evidenced in writing transcribed by electronic or other means in a durable medium, or sounds recorded in such a medium.

(Paragraph 37.10; Draft Bill, ss 62 and 63)

- 199. Nothing in the enforcement rules for pledge should be taken to derogate from such rights as a secured creditor may have by virtue of Part 4 of the Financial Collateral Arrangements (No. 2) Regulations 2003 (right of use and appropriation).

(Paragraph 37.14; Draft Bill, s 84)

- 200. The recommendation of the Murray Report that sole traders and ordinary partnerships should be able to grant floating charges should not now be taken forward.

(Paragraph 38.4)

- 201. Floating charges should continue to be capable of encumbering immoveable/heritable property.

(Paragraph 38.6)

- 202. The ranking rules of Scottish floating charges in relation to negative pledge clauses should not be reformed.

(Paragraph 38.9)

- 203. It should no longer be competent for agricultural charges to be created.

(Paragraph 38.15; Draft Bill, s 115)

Appendix

List of Respondents, Advisory Group members and those who have provided assistance

I. RESPONDENTS TO THE DISCUSSION PAPER

We received written comments on the Discussion Paper (DP No 151) from the following (whose titles and affiliations are given as at the time of the response)

Aberdeen Law School (Professor David Carey Miller and Malcolm Combe)

Dr Ross Anderson, University of Glasgow

Asset Based Finance Association

Dr Jan Biemans, De Brauw Blackstone Westbroek

Begbies Traynor (Ken Patullo CA and Paul Dounis CA)

Brodies LLP (Bruce Stephen, Michael Stoneham)

Professor Stewart Brymer, Brymer Legal Ltd

Civil Aviation Authority

David Cabrelli, University of Edinburgh

Colin Campbell, University of Edinburgh

Committee of Scottish Clearing Bankers

CBI Scotland

Department for Business, Innovation and Skills

Professor Eric Dirix, KU Leuven

Chris Dun, Maclay Murray & Spens LLP

Dundas & Wilson LLP (Andrew Hinstridge, Claire Massie, Caryn Penley, Stephen Phillips, Dawn Reoch)

Faculty of Advocates

Federation of Small Businesses

David Gibson, Burness LLP

David Hill CA, BDO Stoy Hayward

Tom Hughes CA, Gerber Landa Gee Ltd

Institute of Chartered Accountants of Scotland and R3: Association of Business Recovery Professionals

Judges of the Court of Session

Keeper of the Registers of Scotland

Andrew Kinnes, Shepherd & Wedderburn LLP

Law Society of Scotland

John MacLeod, University of Glasgow

Alisdair MacPherson, Trainee Solicitor, DLA Piper Scotland LLP

Professor Gerry McCormack, University of Leeds

McGrigors LLP (Gillian Frew, Iain Macaulay, John Macfarlane, Michael Watson)

Donald McGruther CA, Mazars LLP

Jim McLean, Solicitor

Dr Hamish Patrick, Tods Murray LLP

Magdalena Raczynska, University of East Anglia

Dr Andreas Rahmatian, University of Glasgow

Michael Royden, Thorntons LLP

Scottish Council for Development and Industry

Professor Susan Scott, University of South Africa

WS Society

Scott Wortley, University of Edinburgh

II. RESPONDENTS TO THE DRAFT BILL CONSULTATION

We received written comments from the following in response to our consultation on our draft Moveable Transactions (Scotland) Bill of July 2017.

Dr Craig Anderson, Robert Gordon University

Professor Hugh Beale QC, University of Warwick and Professor Louise Gullifer, University of Oxford

Burness Paull LLP

Richard Calnan, Financial Law Committee of the City of London Law Society

Faculty of Advocates

Professor George Gretton, University of Edinburgh

Institute of Chartered Accountants of Scotland

Law Society of Scotland

Dr Hamish Patrick, Shepherd & Wedderburn LLP

R3: Association of Business Recovery Professionals

III. ADVISORY GROUP MEMBERS

As the project progressed, additional members joined the group, which ultimately consisted of:

Dr Ross Anderson, Advocate

Grant Barclay

Morag Campbell, Dentons

Neil Campbell, Shepherd & Wedderburn LLP

Chris Dun, Brodies LLP

The Rt Hon Lord Drummond Young, Court of Session

Gillian Frew, Pinsent Masons LLP

David Gibson, BTO Solicitors LLP

Professor George Gretton, University of Edinburgh

Andrew Hinstridge, Clydesdale Bank

Andrew Kinnes, Shepherd & Wedderburn LLP
Dr John MacLeod, University of Glasgow
Alisdair MacPherson, University of Edinburgh
Scott McGeachy, DWF LLP
Dr Hamish Patrick, Shepherd & Wedderburn LLP
Stephen Phillips, CMS Cameron McKenna Nabarro Olswang LLP
Bruce Stephen, Brodies LLP
Bruce Wood, Morton Fraser LLP
Scott Wortley, University of Edinburgh

IV. OTHERS WHO HAVE PROVIDED ASSISTANCE

Dr Orkun Akseli, University of Durham
Professor Hugh Beale QC, University of Warwick
Richard Calnan, Financial Law Committee of the City of London Law Society
Professor Neil Cohen, Brooklyn Law School
Martin Corbett, Registers of Scotland
Matthew Davies, UK Finance
Selma de Groot, University of Amsterdam
Professor Eric Dirix, KU Leuven
Professor Mike Gedye, University of Auckland
Simon Goldie, the Finance and Leasing Association
Professor Louise Gullifer, University of Oxford
Dr Dewi Hamwijk
Professor Phillip Hellwege, University of Augsburg
Chris Kerr, Registers of Scotland
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