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Discussion Paper on
Sharp v Thomson

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NOTES

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¹ Amended by the Scotland Act 1998 (Consequential Modifications) (No 2) Order 1999 (S.I. 1999/1820).

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ABBREVIATIONS

1985 Act

Bankruptcy (Scotland) Act 1985

1986 Act

Insolvency Act 1986

Fletcher, *Insolvency*

Ian F Fletcher, *The Law of Insolvency* (2nd edn, 1996)

Gretton, *Inhibition and Adjudication*

G L Gretton, *The Law of Inhibition and Adjudication* (2nd edn, 1996)

Gretton & Reid, *Conveyancing*

G L Gretton and K G C Reid, *Conveyancing* (2nd edn, 1999)

McBryde, *Bankruptcy*

William W McBryde, *Bankruptcy* (2nd edn, 1995)

McDonald, *Conveyancing Manual*

A J McDonald, *Conveyancing Manual* (6th edn, by Stewart Brymer, Douglas J Cusine and Robert Rennie, 1997)

McKenzie Skene, *Insolvency Law*

Donna W McKenzie Skene, *Insolvency Law in Scotland* (1999)

Registration of Title Practice Book

Ian Davis and Alistair Rennie (eds), *Registration of Title Practice Book* (2nd edn, 2000)

Reid, *Property*

Kenneth G C Reid *et al*, *The Law of Property in Scotland* (1996)

Scot Law Com DP No 107

Scottish Law Commission, *Discussion Paper on Diligence against Land* (Scot Law Com DP No 107) (1998)

Scot Law Com No 68

Scottish Law Commission, *Report on Bankruptcy and Related Aspects of Insolvency and Liquidation* (Scot Law Com No 68) (1982)

Scot Law Com No 183

Scottish Law Commission, *Report on Diligence* (Scot Law Com No 183) (2001)

St Clair & Drummond Young, *Corporate Insolvency*

J B St Clair and J E Drummond Young, *The Law of Corporate Insolvency in Scotland* (2nd edn, 1992)

PART 1 INTRODUCTION

Our remit

1.1 On 27 September 2000 we received a reference¹ from the Deputy First Minister and Minister for Justice, Mr Jim Wallace QC MP MSP, in the following terms:

"To consider the implications of the decision of the House of Lords in *Sharp v Thomson* 1997 SC(HL) 66 and to make recommendations as to possible reform of the law."

We understand that one reason for the reference was concerns expressed by the Law Society of Scotland and by Mr Fergus Ewing MSP.

Facts of *Sharp v Thomson*

1.2 The facts of *Sharp v Thomson* were these. In 1989 the Thomsons (a brother and sister) concluded missives to purchase a flat in a new development owned by Albyn Construction Ltd. Entry was taken on or about 12 June 1989, against payment of the price. No disposition seems to have been available at that time, contrary to normal conveyancing practice.² At any rate none was delivered to the Thomsons' solicitors for a further period of 14 months. In the absence of a disposition, the Thomsons were not in a position to become owners. Thus for an initial 14-month period, Albyn held both the purchase price (£40,000) and ownership of the flat, while the Thomsons possessed without a title.

1.3 Albyn had previously borrowed money from the Bank of Scotland and the loan was secured by a floating charge over their whole property and undertaking. A floating charge, unless or until it crystallises,³ "floats" over the assets of the debtor without encumbering any of them with a real right. For as long, therefore, as the charge continued to float, there was no danger to the Thomsons. On 10 August 1990 the Bank of Scotland appointed receivers to Albyn, with the result that the floating charge crystallised. The terms of the relevant legislation, section 53(7) of the Insolvency Act 1986,⁴ are:

"On the appointment of a receiver under this section, the floating charge by virtue of which he was appointed attaches to the property then subject to the charge; and such attachment has effect as if the charge was a fixed security over the property to which it has attached."

The legal question to be determined was whether the Thomsons' flat was caught by the crystallised floating charge; and that in turn depended on whether, on 10 August 1990, the flat could be said to form part of the "property then subject to the charge" – or in other

¹ Under the Law Commissions Act 1965 s 3(1)(e).

² Normal conveyancing practice is for the disposition to be delivered in exchange for payment of the price. In this respect the facts of *Sharp* are close to those of *Gibson v Hunter Home Designs Ltd* 1976 SC 23.

³ "Attaches" in the language of statute.

⁴ The 1986 Act contains separate rules on receivers for Scotland (see s 50). Thus s 53 applies to Scotland alone.

words, the property of Albyn⁵ – within the meaning of section 53(7). In fact by then the disposition had finally been delivered to the Thomsons' solicitors. That happened on the previous day. But it had not been registered in the Register of Sasines, and registration did not take place until 21 August, 11 days after crystallisation.

***Sharp* in the Court of Session**

1.4 The Court of Session, both at first instance⁶ and on appeal,⁷ applied to the facts of *Sharp* the ordinary principles of property law. The case, on this view, raised the simple but fundamental question of when ownership of land passes under the law of Scotland. In the First Division this question was examined in considerable detail, and with an almost exhaustive citation of authority. Unsurprisingly, the position was found not to be in doubt. The accepted and long-established rule was that ownership passes only on registration of the disposition or other conveyance in the property registers (ie either the Land Register or the Register of Sasines). Until registration, ownership remains with the transferor. Delivery of the disposition, although important for other reasons, does not change the location of ownership. Furthermore, it is not possible for ownership to be fragmented, in the sense that the transferor is owner for some purposes while the transferee is owner for others. The system of property law is "unititular". If A is owner, B is not. Only one right of ownership can exist at any one time.⁸ The implications of this analysis for *Sharp* were clear. On 10 August 1990, the day of crystallisation, the Thomsons' disposition had yet to be registered. The flat, therefore, continued to be the property of Albyn and hence fell under the floating charge.

1.5 This approach proved controversial. *Sharp v Thomson* provoked more debate and discussion than possibly any case in modern times. For some, the decision⁹ of the Court of Session was the inevitable and welcome result of the application of first principles, and was greeted as a powerful analysis and reaffirmation of the basic rules of the law of property.¹⁰ Others were less convinced.¹¹ While, for the most part, accepting the rules of property law as set out by the court, they doubted whether these rules ought to be applied in so rigid a manner in the context of floating charges and in circumstances where the result was manifestly unjust. For the effect of the decision of the Court of Session was to allow Albyn's receivers to take both the price and, through the floating charge, the property. The Thomsons were left with nothing except a possible claim against their solicitors.

⁵ As is normal, the charge had been granted "over the whole of the property (including uncalled capital) which is or may be from time to time, while this instrument is in force, comprised in our property and undertaking". The wording here echoes that of s 462(1) of the Companies Act 1985 which provides that a floating charge may be created by a company "over all or any part of the property (including uncalled capital) which may from time to time be comprised in its property and undertaking".

⁶ 1994 SLT 1068. The Lord Ordinary was Lord Penrose.

⁷ 1995 SC 455, 1995 SLT 837, 1995 SCLR 683.

⁸ Although naturally the right can be shared, as in the case of *pro indiviso* ownership.

⁹ Or more properly decisions. Much of the commentary in fact was in respect of the decision of the Lord Ordinary.

¹⁰ G L Gretton, "Sharp cases make good law" 1994 SLT (News) 313; K G C Reid, "*Sharp v Thomson*: a civilian perspective" 1995 SLT (News) 75; N R Whitty, "*Sharp v Thomson*: identifying the mischief" 1995 SLT (News) 79; K G C Reid, "*Sharp v Thomson*: property law preserved" (1995) 1 SLPQ 53.

¹¹ R Rennie, "Dead on delivery" 1994 SLT (News) 183; A J McDonald, "*Sharp v Thomson*: feudal purism – but is it justice?" (1995) 40 JLSS 7; A J McDonald, "*Sharp v Thomson*: what now?" (1995) 40 JLSS 256. And see also correspondence published at 1994 SLT (News) 371, 1995 SLT (News) 22, 1995 SLT (News) 91 and 1995 SLT (News) 101.

1.6 In reaching its decision, the First Division was aware of the competing views.¹² But it saw its task as being to apply the law as it found it. Law reform was for the legislature. According to Lord President Hope:¹³

"The result is unsatisfactory, but it is the consequence of the introduction by Parliament of a concept [ie the floating charge] which is alien to Scots law with a view to its commercial advantages but without sufficient regard to the protection which may be needed to avoid hardship to the purchaser. There are some features of the present case which suggest that it would be unwise to draw any conclusions from its particular circumstances. No explanation has been offered as to why the certificate of non-crystallisation which the bank was willing to give was not delivered to the first defenders' solicitor or for the long delay in presenting the disposition for recording in the appropriate register. But it has revealed a defect in the law which can only now be corrected by the introduction of appropriate measures by the legislature."

Sharp in the House of Lords

1.7 On appeal, the House of Lords was more disposed to correct what it perceived as an obvious wrong.¹⁴ The decision of the Court of Session could, it thought, be characterised as "unattractive and unfair".¹⁵ Certainly it produced "a most inequitable result".¹⁶ The solution proposed by the House of Lords was to use and develop "beneficial interest", a concept previously familiar mainly from the law of trusts. The starting point was the proposition that a person who has made delivery of a conveyance and accepted payment of the price can no longer be said to have any beneficial interest in the property. Until the conveyance is registered he remains owner in the technical sense of that word, but he holds only on a bare title and the beneficial interest is in the purchaser. Although no doubt the seller could give a good title to a second purchaser buying in good faith, or to a heritable creditor, to do so would be in fraud of the purchaser, and "the ability to commit such a fraud does not amount to a beneficial right of property".¹⁷ The next step was then to apply this analysis to section 53(7) of the Insolvency Act 1986 (which provides that, on the appointment of a receiver, the floating charge attaches to the "property" of the debtor).¹⁸ In construing this provision, it was said, regard should be had to the "substance and reality of the debtor's interest",¹⁹ and to commonsense:²⁰

"There is in my view no principle which requires that the word property occurring in relation to crystallisation of a floating charge must be given the restricted meaning sought by the respondents. There is on the other hand everything to be said for giving it a practical, commonsense meaning which is likely to produce fair and equitable results between the parties affected by the crystallisation."

¹² 1995 SC 455 at 476 *per* Lord President Hope.

¹³ 1995 SC 455 at 481D-E.

¹⁴ 1997 SC(HL) 66, 1997 SLT 636, 1997 SCLR 328.

¹⁵ 1997 SC(HL) 66 at 82G *per* Lord Clyde.

¹⁶ 1997 SC(HL) 66 at 70D *per* Lord Jauncey.

¹⁷ 1997 SC(HL) 66 at 77C *per* Lord Jauncey.

¹⁸ Lord Clyde preferred to focus on the wording of the floating charge and hence, indirectly, on s 462(1) of the Companies Act 1985. See p 79H. But this too required an interpretation of the word "property".

¹⁹ 1997 SC(HL) 66 at 81G *per* Lord Clyde.

²⁰ 1997 SC(HL) 66 at 76F *per* Lord Jauncey.

On this approach it was plain that "property" in the sense of section 53(7) was lost with beneficial interest. In *Sharp* the disposition had been delivered on 9 August 1990. Hence, by the time that the floating charge crystallised on the following day, the flat had ceased to be the "property" of Albyn and so escaped the floating charge. The receivers could keep the price (paid a year earlier) but the flat itself went, unencumbered, to the Thomsons.

1.8 That those who welcomed the decision of the Court of Session should be unhappy with the decision of the House of Lords was of course to be expected. But what was less expected was the absence, by and large, of support for the new decision. As at earlier stages in the litigation, the decision attracted a substantial body of published commentary.²¹ Almost always it was hostile to the approach taken by the House of Lords. Further, as the implications of the decision became more apparent over time, there were signs of an emerging consensus among those whose views had previously been divergent. The consensus, if such it be, has two aspects. It is recognised that the facts of *Sharp* highlight a problem which needs to be solved; but it is accepted that the solution adopted by the House of Lords is flawed, and probably damaging. The disease is harmful, but the cure more harmful still. In part 2 we set out the various difficulties which are thought to affect the decision of the House of Lords. In summary it is said that, by withdrawing property law from insolvency law, the decision disrupts existing rules without proposing a coherent alternative; that the decision leaves much that is uncertain in an area of critical financial and economic importance; that it offends the doctrine of faith of the registers; that it creates practical problems for sales on insolvency; and finally that it is, at best, only a partial solution to the problem identified by the case. The matter has recently become more urgent with the decision of the Sheriff Principal in *Burnett's Tr v Grainger*²² extending the principle of *Sharp* from receivership to sequestration, and hence, by implication, to other insolvency processes also.²³

Our proposals in summary

1.9 The proposals made in this paper are intended to give effect to what appears to be a growing consensus on the issue of *Sharp v Thomson*.

²¹ K G C Reid, "Jam today: *Sharp* in the House of Lords" 1997 SLT (News) 79; J G Birrell, "*Sharp v Thomson*: the impact on banking and insolvency law" 1997 SLT (News) 151 (commented on in a letter published at 1997 SLT (News) 171); R Rennie, "*Sharp v Thomson*: the final act" (1997) 42 JLSS 130; D P Sellar, "Commercial law update: rights in security and insolvencies" (1997) 42 JLSS 181; D Guild, "*Sharp v Thomson*: a practitioner's view" (1997) 42 JLSS 274; K G C Reid, "Equity triumphant: *Sharp v Thomson*" (1997) 1 Edin LR 464; D J Cusine, "*Sharp v Thomson*: the House of Lords strikes back" (1997) 26 Greens Property Law Bulletin 5; G L Gretton, "Scots law in shock: real rights and equitable interests" (1998) 6 Eur Rev of Private Law 403; D L Carey Miller, "Transfer of Ownership", in K Reid & R Zimmermann (eds), *A History of Private Law in Scotland* vol 1 (2000); G L Gretton, "The Integrity of Property Law and of the Property Registers" 2001 SLT (News) 135. The decision has also attracted international interest: Ralf Michaels, "Sharp Distinctions and Floating Transitions – a German view of *Sharp v Thomson*" (1998) 6 Eur Rev of Private Law 407; E G Dacornia, "*Sharp v Thomson* and the principle of publicity according to Greek Law" (1998) 6 Eur Rev of Private Law 413; Anya Fenge, "Englisches Kreditsicherungsrecht versus schottisches Sachenrecht" (1999) 98 Zeitschrift für vergleichende Rechtswissenschaft 410; Anya Fenge, "Floating Charge im schottischen Sachenrecht" 2000 Zeitschrift für europäisches Privatrecht 342.

²² 2000 SLT (Sh Ct) 116.

²³ The decision has not been well received and is to be appealed. See: R Rennie, "To *Sharp v Thomson* – an Heir" 2000 SLT (News) 247; S C Styles, "*Sharp* pains for Scots Property Law: The Case of *Burnett's Tr v Grainger*" 2000 SLT (News) 305; G L Gretton, "Equitable Ownership in Scots Law?" (2001) 5 Edin LR 73. See also the correspondence published at 2000 SLT (News) 312 and 334 and 2001 SLT (News) 7.

1.10 In part 2 we propose that the decision of the House of Lords be reversed by statute. The suggested mechanism is a rule that in determining whether, for the purposes of insolvency (broadly construed), something is still the property of the debtor, the question of beneficial interest should be disregarded. The intended effect is to reverse *Sharp v Thomson*, no more and no less. In the future, as prior to *Sharp*, insolvency law is to have regard to the normal rules of property law; but the proposal is not intended to affect other areas of law – taxation, for example – where, for good reasons, the conclusion of a contract or delivery of a conveyance is regarded as a significant event.

1.11 In reversing *Sharp* it then becomes necessary to confront the problem that the decision of the House of Lords was intended to solve. This is the risk faced by a person seeking to acquire ownership or other real right in land from the insolvency of the grantor. In certain, rather unusual, circumstances an acquirer may receive nothing in return for the price, despite having proceeded with normal expedition and care. Two situations may be identified. One is where, unknown to the acquirer, the grantor was already insolvent at the time of delivery of the deed and payment of the price. The other is where, as in *Sharp* itself, insolvency occurs after delivery of the deed but before registration in the property registers. These issues are considered in parts 3 and 4. In relation to the first, we propose better publicity of insolvency coupled with special protections in cases where publicity remains inadequate. In relation to the second, we propose that an acquirer should have a priority period of 14 days in which to register the deed. Insolvency within that period would have no effect on the acquirer's title.

Which Parliament?

1.12 Legislation to give effect to our proposals would, in our view, fall within the legislative competence of the Scottish Parliament.²⁴ The main topics covered are property law, bankruptcy, liquidation, floating charges and receivership, and diligence. With one exception these are not matters specially reserved to the United Kingdom Parliament;²⁵ and insofar as they touch on reserved matters (such as intellectual property)²⁶ they do so in the context of private law²⁷ so as to achieve consistency in that law and without disturbing any special rule of a reserved matter.²⁸ The exception is liquidation. Section C2 of schedule 5 part II of the Scotland Act 1998 reserves to the United Kingdom Parliament:

"In relation to business associations –

- (a) the modes of, the grounds for and the general effect of winding up and the persons who may initiate winding up,
- (b) liability to contribute to assets on winding up,
- (c) powers of courts in relation to proceedings for winding up, other than the power to sist proceedings, and
- (d) procedures giving protection from creditors."

²⁴ Scotland Act 1998 s 29.

²⁵ For floating charges and receivers, see the exceptions to 1998 Act sched 5 part II s C2.

²⁶ 1998 Act sched 5 part II s C4.

²⁷ Defined in s 126(4) of the 1998 Act to include the law of property and diligence.

²⁸ 1998 Act s 29(4) and sched 4 para 2.

Our proposals on liquidation,²⁹ however, are confined to methods of completion of title – a matter of property law – and to notice provisions which would fall within the exception to section C2 allowed for

"the process of winding up, including the person having responsibility for the conduct of a winding up or any part of it, and his conduct of it or of that part ..."

1.13 For completeness it should be added that our proposals do not raise issues concerning the European Convention on Human Rights or Community law.³⁰

Acknowledgments

1.14 A number of people have helped us in various ways in the preparation of this paper. In particular we wish to express our thanks to Mr Alan Barr, University of Edinburgh; Mr Stewart Brymer, Thorntons WS; Mr Brian Chrystal, First Title; Professor George Gretton, University of Edinburgh; Mr Jim Henderson, the Registrar of Companies; Sheila Inglis, Companies House; Professor W W McBryde, University of Edinburgh; Professor A J McDonald; Mr Alistair Rennie, Registers of Scotland; and Mr Stephen Woodhouse, the Accountant in Bankruptcy.

²⁹ Set out in paras 4.19 to 4.26 below.

³⁰ 1998 Act s 29(2)(d).

PART 2 A DISCARDED SOLUTION: BENEFICIAL INTEREST

Introduction

2.1 The approach taken by the House of Lords in *Sharp v Thomson* was described in part 1.¹ Our primary concern, however, is not with the manner in which the decision was arrived at but with its effect on law and practice. We begin this part by setting out the main difficulties that are said to arise from *Sharp v Thomson*. Next we consider whether the difficulties are sufficiently serious to require that *Sharp* be reversed and the solution it proposes replaced. Finally, we consider the manner in which such a reversal might be effected.

Five difficulties

2.2 From the substantial, and largely critical, literature on *Sharp v Thomson*, it is possible to identify five main difficulties to which the decision may give rise.² The arguments are first summarised and then evaluated.

The arguments summarised

2.3 **(1) Coherence.** "Beneficial interest" is familiar from the law of trusts as a useful, if non-technical, label for the right of a beneficiary. Outside trusts it is largely unknown. In borrowing beneficial interest from the law of trusts, the House of Lords did nothing to explain its meaning in the new context. It may be assumed that beneficial interest is not a real right. Only registration, it was accepted by the court, could constitute such a right.³ But beyond that, even the most elementary questions remain unanswered. If beneficial interest is not a real right, does it follow that it is a personal right? Or is it a right *sui generis*, neither personal nor real but lying somewhere between the two? If so, what are its characteristics, and in what respects does it differ from rights falling into one of the established categories?

2.4 Then there is the difficulty of separating "property" from real right. If A disposes to B but B does not register, the analysis of the House of Lords requires that, while A has a real right, B alone has "property", at least for certain purposes.⁴ This implies a division of ownership. Both A and B have an ownership right, but the right is not the same in each case. A's right is real but residual. B's right is personal but proprietary.⁵ Neither the principle of divided ownership, nor the balance of power as between the "owners", is

¹ Para 1.7.

² The literature is listed at note 21 on page 4. For an earlier analysis of the difficulties, see paras 2.31 and 2.32 of Scot Law Com DP No 107.

³ See, for example, 1997 SC(HL) 66 at 75E *per* Lord Jauncey.

⁴ In fact, the House of Lords does no more than decide that A does *not* have property. But if A is not owner, then B must be owner – unless neither is owner, in which case the land is ownerless (and falls to the Crown).

⁵ Lord Clyde's analysis was this (1997 SC(HL) 66 at 83-4): "While in terms of a strict legal analysis the holder of an unrecorded disposition still only has a personal right to the lands disposed, he has personally acquired such rights as make it reasonable to use the language of ownership in relation to him though there has been no alteration to the quality of his right".

discussed by the House of Lords. But the unattributed model seems to be the legal/equitable duality of English law.

2.5 A related question is whether more than one beneficial interest can exist in the same property at the same time. Suppose that, after conveying to B, A grants a second disposition to C. Do *both* B and C have beneficial interest, so that both would have "property" in the sense of the Insolvency Act? If C were to register first, he would become owner in the strict sense, on established principles. That suggests that he too must have beneficial interest. But if so, it is hard to discover its source. For A, having first disposed to B, would have no beneficial interest to transmit to C. It is hard to discern in any of this a coherent body of law.⁶

2.6 Perhaps that would not matter very much if the principle established in *Sharp* were confined to floating charges and receivership. It would then be seen as a peculiarity existing within an area of law which is itself recognised as not readily compatible with Scots law. In all other respects property law would be unaffected. That seems to have been the view of Lord Clyde:⁷

"As the argument before this House developed, it became clear that no challenge was being made of the careful analysis made by the judges of the First Division of the basic concepts of Scottish law which apply in the area of heritable property. A basic distinction between real rights and personal rights was not questioned. It was not suggested that there is any kind of hybrid right somewhere between a real right and a personal right. It was accepted that Scottish law holds to a unitary theory of ownership by which only one right of ownership can exist in respect of any one thing at any one time."

However, the other speech in the House of Lords, by Lord Jauncey, does not suggest so narrow a view, and indeed it has recently been held, in *Burnett's Tr v Grainger*,⁸ that the principle of *Sharp* extends to sequestration, and therefore by implication to other insolvency processes also. If that is correct, the doctrine can hardly be dismissed as peripheral and unimportant. As one experienced commercial lawyer has observed of *Sharp*:⁹

"If its reasoning does ... apply to a winding up, it is unrealistic to say that the decision does not affect Scots property law very significantly. The most important practical context in which property law applies is that of insolvency. To say that there are rules of property law which do not apply in insolvency is as useful as saying that a person is healthy except for a serious illness."

The result is unattractive and unwelcome. On the one hand there is the system of property law as it applies to insolvency, a system which mimics the equitable rights, divided ownership, and relative title of English law. And on the other hand there is the residual

⁶ Thus Lord Coulsfield in the First Division (1995 SC 455 at 504D-E): "[I]t seems to me that it would be inconsistent with principle to regard the holder of an unregistered disposition as enjoying any kind of property right in any sense recognised by the general law of property. There is no clear definition of any such right or of its incidents and consequences. It is conceptually difficult to understand what such a right might be, particularly if there were at any given time more than one personal right or personal title in existence."

⁷ 1997 SC(HL) 66 at 80B.

⁸ 2000 SLT (Sh Ct) 116.

⁹ Mr D P Sellar QC, at (1997) 42 JLSS 181.

system of property law, civilian and unititular, and built on the distinction between real and personal rights. The collision of two such radically different theories is unlikely to meet even minimum standards of coherence and certainty.

2.7 **(2) Certainty.** That conclusion leads on to the next. For people to be able to arrange their affairs in an orderly manner, the rules of property law must be clear and predictable; and that is as important in business as in private life. In property law, certainty is prized above all other virtues. Of course any new departure in case law is likely to lead to a period of uncertainty, but the scope of *Sharp v Thomson* is uncertain to an unusual degree. The debate as to whether it applies to all insolvency processes, or merely to receivership, has already been mentioned. The decision of the Sheriff Principal in *Burnett's Tr v Grainger* took the former view but is to be appealed.¹⁰ Other uncertainties abound. Is *Sharp* confined to land, or does it apply to other property also? Might, for example, it apply to incorporeal property? Like land, incorporeal property is transferred by delivery of a deed (an assignation) followed by a further act (intimation). Is beneficial interest lost on delivery of the deed, so that an unintimated assignation prevails on the cedent's insolvency?¹¹ And if *Sharp* applies to incorporeal moveables, might it not also apply to corporeal moveables? One commentator has explored the possible interaction of *Sharp* with clauses of retention of title.¹²

2.8 Then there is the issue about type of real right. *Sharp* was a case of transfer of ownership, and indeed it is not clear that a principle of loss of beneficial interest is readily applicable to the creation of subordinate real rights, such as security or lease. Nonetheless, one recent decision seems to carry the suggestion that *Sharp* applies to standard securities.¹³

2.9 There is also uncertainty as to the trigger events for the doctrine to come into effect. A study of other legal systems shows that ownership passes either on the making of the contract or on registration of the conveyance, both being verifiable by written evidence.¹⁴ The rule proposed by *Sharp* is different. In that case the transaction had proceeded beyond the contract but without reaching registration. There had been payment of the price and delivery of the disposition but nothing more. Nonetheless beneficial interest passed. The decision leaves open the question of whether *both* payment and delivery are necessary, or one only and, if so, which. Nor is the position clear in a case where payment is to be made in stages, on the occurrence of stipulated events, and perhaps over several years. Whether *Sharp* applies to gratuitous transactions or whether, if consideration is required, it must be

¹⁰ 2000 SLT (Sh Ct) 116. Compare Lord Caplan in *Fleming's Tr v Fleming* 2000 SLT 406 at 412H: "In the House of Lords (1997 SC(HL) 66) the Inner House was overturned on a speciality relating to the legislation governing floating charges but the Lord President's analysis of the general rights affecting property was not attacked."

¹¹ The view has been expressed that it does, at least in a competition with a receiver: see text by R B Wood in Freddy Salinger, *Factoring: the Law and Practice of Invoice Finance* (1999) paras 7-51 and 7-52. If correct it is contrary to long-established law. See eg *Strachan v McDougle* (1835) 13 S 954 at 958 *per* Lord Balgray: "nothing can be clearer in our law than that an unintimated assignation is ineffectual in competition with an arrestment". For a review of the earlier authorities, see Klaus Luig, "Assignation", in K Reid and R Zimmermann (eds), *A History of Private Law in Scotland* vol 1 (2000) pp 399-419.

¹² J G Birrell, "*Sharp v Thomson*: the impact on banking and insolvency law" 1997 SLT (News) 151.

¹³ *Halifax plc v Gorman's Tr* 2000 SLT 1409, discussed in K G C Reid and G L Gretton, *Conveyancing 2000* (2001) pp 98-101.

¹⁴ Most European systems follow either the French model (where ownership passes with the contract) or the German model (where ownership passes on registration).

full consideration, are both unknown.¹⁵ Another area of doubt is whether good faith is needed on the part of the acquirer.

2.10 It seems hardly acceptable that such uncertainty should affect the most fundamental question of all in the law of property, namely when ownership passes; and remarkable that, after hundreds of years of legal development, the point should now be a matter of dispute.

2.11 **(3) Faith of the registers and the publicity principle.** Rights in property should, so far as possible, be attended by publicity. This is partly to alert third parties who may be affected by the rights, and partly in the interests of certainty so that a right cannot be left latent, to be produced or not produced at the convenience of its holder. This "publicity principle" is a commonplace in legal systems;¹⁶ and in respect of land, publicity usually means either registration or possession. In Scotland registration has long held a central role.¹⁷ The preamble to the act of 1617¹⁸ which, in setting up the Register of Sasines, established what was in effect a system of compulsory registration, emphasised the dangers of fraud:

"considering the gryit hurt sustened by his Majesties lieges by the fraudulent delaing of pairties who having annaliet thair Landis and reisavit gryit soumes of money thairfore, yit be thair unjust conceiling of sum privat right formalie made by thame rendereth the subsequent alienation done for gryit soumes of money altogidder unprofitable which cannot be avoyded unless the said privat rights be maid publict and patent to his Majesties lieges ..."

When the Land Register was set up in 1981, the principle that "privat rights be maid publict" was retained and enhanced. None of the principal real rights – ownership, security, proper liferent, and long lease – can be constituted without registration; and a person acquiring land has the statutory assurance of knowing that his title is subject only to "any matter entered in the title sheet ... and to any overriding interest ..."¹⁹

2.12 *Sharp* pays too little regard to this principle of faith of the registers. In order for beneficial interest to pass, registration is neither necessary nor sufficient. Registration is not necessary because beneficial interest passes by a private act of the parties (delivery of the conveyance)²⁰ which is not "maid publict". And registration is not sufficient because the subsequent completion of title by a trustee in sequestration or liquidator would carry no rights. The position is illustrated by the facts of *Burnett's Tr v Grainger*.²¹ In October 1990 Mr & Mrs Grainger concluded missives to buy a house from Mrs Burnett. On 8 November 1990 the disposition was delivered against payment of the price, and the Graingers took entry. The disposition, however, was not registered. Subsequently Mrs Burnett was sequestrated, and on 10 December 1991 her trustee sought to complete title by registering a notice of title in the Register of Sasines. As of that day, the position was as

¹⁵ Of course, and depending on the circumstances, a transfer at undervalue might be set aside as a gratuitous alienation.

¹⁶ See eg the comparative discussion in L P W van Vliet, *Transfer of Movables* (2000) p 30.

¹⁷ See generally L Ockrent, *Land Rights: An Enquiry into the History of Registration for Publication in Scotland* (1942).

¹⁸ Registration Act 1617 c 16.

¹⁹ Land Registration (Scotland) Act 1979 s 3(1)(a).

²⁰ Here we assume that delivery of the conveyance is the key requirement for transfer of beneficial interest. See para 2.9. But payment of the price is equally a private act.

²¹ 2000 SLT (Sh Ct) 116.

follows. Two different parties – the Graingers and Mrs Burnett's trustee in sequestration – were in competition for the same property. Both held a delivered conveyance (respectively the disposition and the judicial act and warrant). Only one (the trustee) had registered. An application of the normal principles of property law would give the property to the party who registered. The facts would be analysed as involving a race to the register, a race in which the trustee was the victor.²² But, following *Sharp*, the Sheriff Principal in *Burnett's Tr* awarded the property to the party who did *not* register,²³ for on delivery of the disposition beneficial interest had passed to the Graingers.

2.13 The absence of publicity would be unimportant if beneficial interest were only a matter for the two parties concerned. But it is not. The whole purpose of the doctrine in *Sharp* is to defeat the claims of third parties, that is to say, of the receiver, trustee in sequestration and liquidator, and the creditors that they represent. Indeed the matter goes further still, because to recover the debt the receiver must sell the property, a point to which we return below.

2.14 If creditors are defeated by the mere delivery of a conveyance, the main incentive to register disappears. A grantee who is protected against the grantor's insolvency has little to fear from anything else.²⁴ And non-registration may be attractive for other reasons. It avoids publicity. It reduces the need to pay stamp duty, leading to the possibility of substantial savings. And it opens the door to collusive arrangements between grantor and grantee, in relation to the claims of creditors and other matters. In short, the decision in *Sharp* represents a move in the direction of non-registration of rights in land.²⁵

2.15 **(4) Sale on insolvency.** An immediate casualty of *Sharp* was sales by receivers. This too was a consequence of the breach of the doctrine of faith of the registers. For if the right of a receiver can be defeated by an unregistered conveyance, no receiver can be sure of his title, and no acquirer from a receiver can determine as a positive fact that the receiver has title to sell. The negative – that there is no unregistered conveyance – is, naturally, unprovable. If the rule in *Sharp* extends to other insolvency processes, the disability affects trustees in sequestration and liquidators as well. Once again the facts of *Burnett's Tr v Grainger* provide a ready illustration.²⁶ A person searching the Register of Sasines in December 1991 would have discovered the deed in favour of the trustee but not the deed in favour of the Graingers. Yet, the beneficial interest having passed to the Graingers more than a year earlier with the delivery of the disposition, the trustee had no title to sell.

2.16 **(5) Incomplete solution.** Finally, the solution proposed by *Sharp* is in any case incomplete. It protects acquirers from insolvency occurring after delivery of the conveyance, but gives no protection against insolvency occurring before.²⁷ In *Sharp* the sequence of events was (i) delivery of the disposition on 9 August and (ii) crystallisation of the floating charge on 10 August. If the sequence had been reversed, the flat would have been caught by

²² See Scot Law Com DP No 107 para 2.16 and the authorities there cited.

²³ Or rather had not registered first. In fact the Graingers did eventually register, on 27 January 1992, although this did not affect their claim one way or the other.

²⁴ In theory the grantor might make a second grant in fraud of the first, but the risk in practice is slight.

²⁵ George L Gretton, "The Integrity of Property Law and of the Property Registers" 2001 SLT (News) 135.

²⁶ See para 2.12.

²⁷ At least that appears to be the position. Note may be taken of Lord Clyde's comment (1997 SC(HL) 66 at 81-2) that, if the debtor has merely contracted to sell land, without delivering a disposition, the land "may well remain within the property of the debtor". Any other view would be contrary to the result reached in *Gibson v Hunter Home Designs Ltd* 1976 SC 23. See also para 2.9 above.

the floating charge. Yet the Thomsons would be as worthy of protection in the second case as in the first. A proper solution must deal with pre-settlement insolvency.²⁸ It should also deal with the creation of subordinate real rights such as securities and leases – another omission from *Sharp*.²⁹

The arguments evaluated

2.17 Not everyone would accept all of the arguments set out above, or at least concede them full weight. Coherence, for example, may seem an aspiration merely, and one which should not stand in the way of legal development.³⁰ The uncertainty produced by *Sharp* will lessen over time as the case law develops. The difficulty posed for sale by receivers is met, for the time being at least (and in relation to land only), by the willingness of the Keeper to register the acquirer's title in the Land Register without exclusion of indemnity; though presumably a pattern of claims might cause him to revise this practice.³¹ No doubt there are other factors which might also be mentioned. Nonetheless, in our view none of the five arguments is without merit; and cumulatively, they amount to a formidable case against the decision in *Sharp*. Our proposal, therefore, is that:

- 1. The decision of the House of Lords in *Sharp v Thomson* should be reversed by statute.**

A replacement solution for the problems highlighted by *Sharp* may be left over until parts 3 and 4, but the reversal of *Sharp* requires immediate attention.

Reversing *Sharp v Thomson*

2.18 The effect of *Sharp* was to suspend the ordinary rules of property law in the case of receivership and, it may be, in the case of other insolvency processes also.³² To reverse *Sharp* is to restore those rules.³³ Only a short legislative provision would be required, for rules which already exist need not be re-expressed. Indeed they are given authoritative expression in the opinion of the Lord President in *Sharp*.³⁴ Depending on the type of property, the rules may be common law or statutory. For example, in the case of land it is provided by section 4(1) of the Abolition of Feudal Tenure etc. (Scotland) Act 2000 that³⁵

²⁸ Para 3.4.

²⁹ Scot Law Com DP No 107 para 2.31(1).

³⁰ Thus Lord Coulsfield (1995 SC 455 at 505-06): "In approaching this final question, it seems to me that, although weight should be given to the arguments that the purity of Scots law, as a system based on the civil law, should be maintained and the unitary conception of ownership preserved, these arguments should not be overemphasised or treated as in themselves decisive. The ultimate question in this case is a practical and limited one, concerned with the operation of a particular form of security and, as some of the authorities referred to above show, exceptional situations have been accommodated within the system in the past". But naturally the force of this point will depend on the extent of the disruption threatened by the innovation.

³¹ *Registration of Title Practice Book* para 5.37. The current policy is based on the view that "the risk of a latent unregistered disposition surfacing once registration has been completed is too small to justify a policy of blanket indemnity exclusion for all sales by receivers".

³² Para 2.6.

³³ And also to restore the decision of the First Division. Thus Lord Coulsfield (1995 SC 455 at 494B): "It seems to me ... that the statutory words must be construed in the context of the system of property law within which floating charges are designed to operate."

³⁴ 1995 SC 455.

³⁵ See also s 3(1) of the Land Registration (Scotland) Act 1979.

"Ownership of land shall pass –

- (a) in a case where a transfer is registrable under section 2 of the Land Registration (Scotland) Act 1979 (c 33), on registration in the Land Register of Scotland;
- (b) in any other case, on recording of a conveyance of the land in the Register of Sasines."

If *Sharp* is reversed, this provision (once it comes into force)³⁶ will automatically govern cases of insolvency. Thus land conveyed by a debtor would remain the debtor's property unless or until the conveyance was registered by the grantee, and as such would be available to his creditors.

2.19 A difficulty with formulating a suitable provision is the uncertainty about what *Sharp* decided,³⁷ and the only safe course is to take the decision in its widest possible sense. A provision which is over-inclusive will merely be unnecessary in part, whereas one which is under-inclusive will leave the law in a more confused state than before. Thus, for the purposes of framing a provision it seems prudent to assume (i) that *Sharp* applies to all property, whether heritable or moveable, corporeal or incorporeal (ii) that it applies to all insolvency processes, including sequestration and liquidation (iii) that it applies to adjudication and to all other diligences, and (iv) that it applies to donees as well as to purchasers. For convenience we include all cases of winding up, although recognising that a company which is wound up may sometimes be perfectly solvent.

2.20 The potential variety of affected property makes it unwise to focus, in any provision, on particular transfer procedures such as delivery of a conveyance. Corporeal moveables, for example, are transferable without writing. So, often, are negotiable instruments. This suggests that any provision should seek to isolate the principle behind the rule in *Sharp*. Fortunately, that principle is clear from the speeches of both judges. According to *Sharp*, a thing ceases to be the property of a debtor if beneficial interest is lost;³⁸ and in the case of sale of land (the particular case considered by *Sharp*), beneficial interest is lost by delivery of a conveyance and payment of the price. The possibility is left open that beneficial interest can be lost in some other way, at least in the context of other types of property. To reverse *Sharp*, therefore, it is necessary to provide that absence of beneficial interest is not a determinant of ownership of property. On this approach it does not matter that the concept of beneficial interest may be novel and uncertain, for whatever beneficial interest may be supposed to mean, it simply ceases to apply; and in removing this criterion, there is restoration of the normal rules of property law.

³⁶ On the "appointed day" for the abolition of the feudal system: see s 77(2).

³⁷ Paras 2.7 to 2.10.

³⁸ Thus Lord Jauncey (1997 SC(HL) 66 at 77H-I): "My Lords, I summarise the position. At the time when the floating charge crystallised by the appointment of the respondents, Albyn held the recorded title to the flat but had no beneficial interest therein. The ability to grant deeds in fraud of the disposition to the Thomsons did not amount to a right of property in law. The effect of sec 53(7) of the Act of 1986 was to make available as security all the property in which Albyn had a beneficial interest. Since Albyn had no such interest in the flat at the date of crystallisation, it follows that the floating charge did not attach thereto." Similarly, Lord Clyde thought (p 82B) that the interpretation of "property" in the context of receivership required "a less strict construction which may take account not only of title but of beneficial interest".

2.21 Reversing *Sharp* would have no effect on the attachability of the *acquirer's* interest, as an example shows. Suppose that A grants a disposition of land to B. B pays the price but does not register the disposition. On the analysis provided by *Sharp* A has no beneficial interest, and hence no "property" in the land. His creditors cannot attach. But they can attach B's right to the land. If *Sharp* is reversed, B's position is unaffected. B's right continues to be available to his creditors.³⁹ But the difference is that A's right is also so available. Naturally the two rights are not the same. The property held by A is the land itself, whereas B has merely the right (power) to complete title to the land by registration of the disposition.⁴⁰ If there were to be simultaneous attachment both by a creditor of A and by a creditor of B, the land would fall to whichever creditor was first to register. There would in other words be a race to the register.

2.22 Any provision which discounted beneficial interest would need to except trusts. It was established in a series of decisions that trust property cannot be attached by the personal creditors of the trustee, and in the case of sequestration the rule has now assumed statutory form.⁴¹ The principle should not be disturbed as part of this exercise but may merit reconsideration in respect of latent trusts of registered land.⁴² Our present intention is to return to this subject as part of our forthcoming review of the law of trusts.⁴³

2.23 Even on the widest view, *Sharp* is concerned only with diligence and insolvency. In restoring property law in those areas, therefore, care must be taken to avoid trespassing on other areas of law. In some contexts the law chooses to regard as economic "owner" a person who holds under missives or under a delivered conveyance. The former occurs in capital gains tax and in value added tax.⁴⁴ The latter is found in Stamp Duty,⁴⁵ in the Matrimonial Homes (Family Protection) (Scotland) Act 1981,⁴⁶ and in the rule that confers jurisdiction, in relation to a person not domiciled in the United Kingdom, on courts of any place where there is situated immovable property in which that person has a beneficial interest.⁴⁷ In other contexts, while the position of the formal owner is acknowledged, certain rights may be extended to the holder of a delivered conveyance, such as the right to dispose of land under deduction of title.⁴⁸ Such cases are both exceptional and also unobjectionable. Formalism must have regard to economic reality. Nothing in our proposals is intended to interfere with the established examples of that principle.

³⁹ Thus the proposed new diligence of land attachment (replacing adjudication) would be available. See our *Report on Diligence* (Scot Law Com No 183, 2001) paras 3.42 to 3.46.

⁴⁰ This is the "right ... to take any steps necessary for making up or completing title to any interest in land" which is rendered imprescriptible by sched 3(h) of the Prescription and Limitation (Scotland) Act 1973.

⁴¹ Bankruptcy (Scotland) Act 1985 s 33(1)(b). For the common law, see G L Gretton, "Trusts" in K Reid and R Zimmermann (eds), *A History of Private Law in Scotland* (2000) vol 1, pp 499-500.

⁴² The rule that even latent trusts of registered lands should prevail in the insolvency of the trustee was established in *Heritable Reversionary Co Ltd v Miller* (1892) 19 R(HL) 43, a decision much relied on in *Sharp v Thomson*. This breaches the principle of faith of the registers, as well as causing difficulties for sales by trustees in sequestration, liquidators and receivers, and thus has a number of parallels with *Sharp*.

⁴³ For which see our *Sixth Programme of Law Reform* (Scot Law Com No 176, 2000) paras 2.25 to 2.34.

⁴⁴ Taxation of Chargeable Gains Act 1992 s 28(1); Value Added Tax Act 1994 s 31 and sched 9, group 1 item 1. And see also Lord Coulsfield (1995 SC 455 at 497A-B): "There is ... no reason why a personal right to lands, or indeed a *jus crediti* in respect of lands, should not be treated as property for taxation purposes ..."

⁴⁵ Stamp Act 1891 s 122(1A).

⁴⁶ Section 6(3)(e).

⁴⁷ Civil Jurisdiction and Judgments Act 1982 sched 8 rule 2(8)(b). For a discussion, see A E Anton, *Private International Law* (2nd edn, 1990) pp 193-4. In *Sharp* some reliance was placed on *Bowman v Wright* (1877) 4 R 322, one of the leading cases in this area.

⁴⁸ Conveyancing (Scotland) Act 1924 s 3.

2.24 Finally, it is necessary to consider transitional arrangements. The change should not, we think, be retrospective in effect.⁴⁹ But if the change is to be prospective only, it is necessary to decide when it should take effect. Here there are two broad possibilities. One is to link the change to the date of the particular diligence or insolvency process. The other is to link it to the loss of beneficial interest, so that *Sharp* would continue to apply in cases where, for example, the conveyance had been delivered prior to the coming into force of the provision. The second is simpler, as well as having the advantage of introducing the change at the earliest possible moment.⁵⁰ Transitional arrangements organised with reference to the commencement of different diligences and insolvency processes would be complex, as well as facing the difficulty that some of these processes are retroactive in effect.⁵¹

2.25 These various points may be drawn together in the form of the following proposal, on which we invite views:

2. (a) **Absence of beneficial interest should not, of itself, exclude property from the property or estate of a debtor for the purposes of diligence and insolvency.**

- (b) **But this is without prejudice to any enactment or rule of law which excludes from the property or estate of the debtor any property which is held in trust for another person.**

- (c) **In this proposal "insolvency" includes sequestration, winding up, receivership and administration.**

⁴⁹ Although the decision in *Sharp*, insofar as it changed the law, was of course retrospective.

⁵⁰ This is because, for the rule in *Sharp* to operate, the loss of beneficial interest must always precede the insolvency.

⁵¹ For example, s 31(1) of the Bankruptcy (Scotland) Act 1985, which backdates the vesting in the trustee to the date of sequestration (defined in s 12(4)).

PART 3 A NEW SOLUTION: IN PRINCIPLE

Introduction

3.1 Reversing the decision in *Sharp v Thomson*, as proposed in part 2, would be to reintegrate insolvency law with the normal principles of the law of property. That in turn would provide "a secure platform" for any further reform that may prove to be necessary.¹ In this part of the paper we give detailed consideration to the issue of further reform. What is the nature of the problem highlighted by *Sharp* and by the subsequent case of *Burnett's Tr v Grainger*?² Does it give rise to practical difficulties? Can it be solved by ordinary conveyancing procedures or is legislative intervention necessary? And finally, if such intervention is required, what form should it take?

The problem

3.2 The problem highlighted by *Sharp* is not, of course, novel. In a perfect system of sale, payment of the price and transfer of ownership would be simultaneous events. At one moment, the seller would have the property and the buyer the price. At the next the position would be reversed. There would be no time at which one of the parties had *both* the price and the property. Unfortunately, this ideal is often not realised in practice. A buyer who is not yet in funds may receive the property without paying the price, although in commercial contracts for the sale of goods the link between property and price is likely to be preserved by a clause of retention of title. Conversely, a seller who is not yet willing or able to complete the transfer may receive the price without, for the time being, yielding up more than possession of the property. That was the position in *Sharp*, as it had been 20 years earlier in *Gibson v Hunter Home Designs Ltd*.³ The risks involved in such cases are obvious. For as long as the same party holds both the property and the price, the other party to the transaction is vulnerable to the first party's insolvency or to the activity of his creditors. If the first party becomes bankrupt, the second will at best receive a dividend on his estate and at worst will receive nothing at all. If, instead of bankruptcy, the property is attached by the first party's creditors by a process of diligence, the second party may again lose everything, or receive the property encumbered by the diligence.

3.3 *Sharp* concerned the sale of land. Conveyancing practice here is long-established. Following conclusion of missives, the price is paid on an agreed date against possession and delivery of the deed of conveyance. But the deed does not, of itself, transfer ownership. Transfer requires the further act of registration in the property register (the Land Register or, in areas where it remains operational, the Register of Sasines). And before the buyer can register, it is necessary to add a testing clause to the deed and, in many cases, to pay stamp duty and have the deed duly stamped. In practice, therefore, there is likely to be an interval of several days between delivery of the conveyance and its registration. During this short period, buyers are at risk. Further, this risk is not voluntarily assumed. This is not a case where payment and property are separated for commercial or other reasons, following a process of negotiation. Rather, the risk arises from the "structural" (and justifiable) fact that

¹ Here we paraphrase the comments of Lord President Hope in *Sharp v Thomson* 1995 SC 455 at 476H-I.

² 2000 SLT (Sh Ct) 116.

³ 1976 SC 23.

in the transfer of land the final act of the seller – execution and delivery of a deed of conveyance – is not sufficient by itself to bring about a change in ownership.

3.4 *Sharp* raises the issue of *supervening* insolvency. The seller is solvent at the time of delivering the conveyance but becomes insolvent before the conveyance is registered. But the buyer is also at risk if the seller was *already* insolvent at the time of delivery.⁴ Indeed in one important respect the risk is greater. Post-delivery insolvency is not always fatal to the buyer's position. That depends on the nature of the diligence or insolvency process in question. While in some processes the creditor (or trustee or other person representing all creditors) obtains an immediate real right,⁵ in others further steps are required so that there is a race to the register with the buyer. If so, the buyer almost always wins.⁶ Pre-delivery insolvency, however, will usually nullify the buyer's title. In circumstances where, in post-insolvency cases, there would be a race to the register, the buyer is disqualified from running because his conveyance is void. For a person who is sequestrated has no power to grant conveyances or otherwise deal with property;⁷ and if the granter was a company, the effect of liquidation, receivership, or administration is to suspend the powers of the directors, with similar results.⁸ Only diligence presents no problem of capacity, at least if the missives pre-dated the diligence. Of course none of this causes difficulty if the buyer knows of the diligence or insolvency at the time of payment, as usually he will. He can then decide whether to proceed with the transaction. Usually he will not proceed for the time being but will open negotiations with the trustee in sequestration, liquidator, receiver or creditor. But sometimes the buyer will not know, for although all insolvency processes and diligences affecting land are registered in a public register, the process may sometimes take effect prior to the registration. In that case the buyer pays the money in good faith and receives nothing in return. As before, there is no voluntary assumption of risk, and the buyer's loss is attributable to structural causes.

Reform: for and against

3.5 **The case for reform.** Security of title to land is a fundamental and long-established principle in the law of Scotland. It is for that reason that there is a Register of Sasines, a Land Register, and a Register of Inhibitions and Adjudications. A separate Companies Register also exists. To acquire ownership of land it is necessary to register. To encumber land with securities, proper liferents, long leases⁹ and real burdens, registration is also necessary. Sequestration, liquidation, receivership and administration must all be registered. The same is true of inhibition and adjudication, the two diligences capable of affecting land. The registers are open to the public and readily searchable. This system allows – and is intended to allow – a person acquiring land, or a right over land, to obtain proper reassurance as to the granter's title. If the title is defective, the defect will be revealed by the register, whether directly (by an entry on the register) or indirectly (by making available the deeds on which the title is founded).

⁴ As almost happened in *Sharp* itself: see para 2.16.

⁵ As with the crystallised floating charge in *Sharp*.

⁶ *Burnett's Tr v Grainger* 2000 SLT (Sh Ct) 116 is the only reported case to the contrary, but there the buyer took 14 months to register the disposition.

⁷ With some exceptions. See Bankruptcy (Scotland) Act 1985 s 32(8),(9).

⁸ Insolvency Act 1986 ss 91, 103 and 127. And see generally McKenzie Skene, *Insolvency Law* chap 23.

⁹ Except in the few remaining registration counties not yet operational for the Land Register. See Land Registration (Scotland) Act 1979 s 3(3).

3.6 In relation to insolvency and diligence, however, the principle of security of title is imperfectly realised. Insolvency processes may not be discoverable from a public register until they have already taken effect. And insolvency or diligence may strike during the period after the register was searched and payment made but before registration of the acquirer's title. Of course it is true that all unsecured creditors run the risk of insolvency, and the principle of parity of creditors may seem to argue for equality of suffering.¹⁰ But special treatment seems merited if, in a standard conveyancing transaction, a person pays the price yet receives nothing in return. There was no intention to extend credit. The risk of insolvency was not voluntarily assumed. The difficulty is structural and not personal. Under our law a buyer can conduct his affairs with all due prudence – by searching the registers immediately before payment, by paying only against delivery of the conveyance, and by registering the conveyance with expedition – and yet still fail to receive the property, or receive it only encumbered by a crystallised floating charge or diligence. That is a situation which merits reform.¹¹

3.7 **The case against reform.** There are counter-arguments. In the first place, the risk to the buyer is slight. If the seller is sequestered *before* delivery of the conveyance, the fact of sequestration will almost always appear from a search of the Register of Inhibitions and Adjudications or Register of Insolvencies.¹² If the seller is a company which goes into receivership, administration or liquidation, the directors (and their law agents) will be left in no doubt that their powers have been superseded. It is improbable that they would then continue to act by granting a disposition and receiving the price. That would be similar to, and no more likely than, impersonation in the case of a grant by a natural person. The heritable diligences of inhibition and adjudication both appear on the register at the time when they take effect. The risk from *supervening* (ie post-delivery) diligence or insolvency is even smaller. Both sequestration and liquidation involve a race to the register which, in practice, would always be won by a buyer who registered with even moderate speed.¹³ It is true that receivership – the situation in *Sharp* – leads to immediate crystallisation of the floating charge, but the charge itself was previously registered so that the buyer had notice and could take the standard precautions.¹⁴ An inhibition has no effect on a conveyance which has already been delivered,¹⁵ while adjudications, rare in practice, are usually preceded by registration of a notice of litigiosity.¹⁶ In short, a buyer who registers promptly has little to fear from diligence or insolvency. The point is illustrated by the three reported cases in this area. The interval between payment of the price and registration of the conveyance was 15 months in *Sharp* and 14 months in *Burnett's Tr.* In *Gibson* there was no registration at all because no conveyance was ever received. Prompt registration would have avoided the difficulties in all three cases; and no workable reform could, or probably should, protect a buyer who delays to register.

¹⁰ Niall R Whitty, "*Sharp v Thomson: Identifying the Mischief*" 1995 SLT (News) 79 at p 80.

¹¹ See Scot Law Com DP No 107 para 2.29 for a previous discussion.

¹² Para 4.5.

¹³ Paras 4.8 and 4.23 to 4.25.

¹⁴ A letter of non-crystallisation and/or release. See para 4.33.

¹⁵ Titles to Land Consolidation (Scotland) Act 1868 s 155. For a discussion, see Gretton, *Inhibition and Adjudication* p 97.

¹⁶ Gretton, *Inhibition and Adjudication* p 211. A period of litigiosity would be mandatory in land attachment (the diligence which it is proposed should replace adjudication), thus giving a buyer notice prior to delivery. See Scot Law Com No 183 paras 3.54 to 3.57.

3.8 Secondly, insofar as the buyer is at risk, the risk is usually covered by insurance. A buyer who registers within 14 days is protected by the letter of obligation standardly granted at settlement by the seller's solicitors and underwritten by professional indemnity insurance.¹⁷ A "classic" letter of obligation guarantees freedom from diligences and encumbrances although (to keep the guarantee within reasonable bounds) it is contingent on registration with 14 days.¹⁸ It is thought that almost all deeds comply with the 14-day restriction. A buyer whose deed is not registered within 14 days may have a claim against his solicitor for professional negligence, again underwritten by professional indemnity insurance.¹⁹ Usually the letter of obligation will not extend to matters covered by the Companies Register such as receivership and liquidation. In relation to the former, however, the position is covered by a certificate of non-crystallisation from the charge holder certifying that the charge has not attached and will not attach for a stated period such as seven days. The certificate may also release the property from the floating charge.²⁰ In relation to the latter, a certificate of solvency may be sought from the company's directors.²¹

3.9 Thirdly, the difficulty, if there is one, is a difficulty of practice and not of law. It is caused by the buyer paying against the promise of ownership rather than against ownership itself. If the risk is judged unacceptable, the buyer should pay later, on or after registration. Rather than change the law to accommodate practice, there should be a change in practice to take proper account of the law. In South Africa, for example, payment and registration take place concurrently, the buyer's prior possession being attributed to a temporary tenancy. In Scotland, Register House settlements are a near equivalent. Further, if automated registration of title is introduced, as seems likely, it can be assumed that payment and transfer will coincide.²²

3.10 **Evaluation.** The arguments against change seem over-stated. A person buying land is always at risk to some extent, particularly from floating charges. In that respect *Sharp* "revealed a defect in the law which can only ... be corrected by the introduction of appropriate measures by the legislature".²³ While insurance cover is available, it is procured indirectly, through the letter of obligation granted by the seller's solicitor, and its scope is correspondingly limited. It does not extend to corporate insolvency. A certificate of non-crystallisation protects against attachment by receivership but not against attachment by liquidation. Again it is unrealistic to expect fundamental change in conveyancing practice. The current system has the merit of protecting the seller against the *buyer's* insolvency. To require payment in exchange for the conveyance is a recognition that, once the conveyance is delivered, the transaction is out of the seller's hands. Any method which would allow simultaneous payment and transfer is likely to be unacceptably cumbersome, at least in a Scottish context. Automated registration of title, if introduced, will help in this regard but will probably be available only for straightforward transactions, such as dealings with the whole of the property.

¹⁷ McDonald, *Conveyancing Manual* pp 504-05; Gretton & Reid, *Conveyancing* pp 154-5.

¹⁸ A style for Sasine transactions prepared by Professor Robert Rennie was issued by the Law Society of Scotland on 30 January 1995 and is reproduced in the *Memorandum Book* of the Scottish Law Agents Society. Equivalent styles for the Land Register are given at pp 307 and 333 of the *Registration of Title Practice Book*. A letter without the 14-day restriction would be subject to excess and ultimate loading under the master policy.

¹⁹ Sometimes, of course, there may be good reasons why a solicitor has not registered within 14 days.

²⁰ McDonald, *Conveyancing Manual* pp 602-03; Gretton & Reid, *Conveyancing* pp 408-09.

²¹ Gretton & Reid, *Conveyancing* p 409.

²² Ian Burdon, "Taking a giant step into the future" (1998) 43 JLSS Oct/29; "Automated registration of title to land" (2001) 46 JLSS June/19.

²³ *Sharp v Thomson* 1995 SC 455 per Lord President Hope at 481E.

3.11 Underlying these points is a more fundamental one. The current system works – most of the time – because of a series of improvisations by solicitors. It works because of the letter of obligation, the certificate of non-crystallisation, and the certificate of solvency. That does not seem a satisfactory way of organising the transfer of land. Further, it cannot be assumed that these improvisations will be available forever. In particular, professional indemnity insurance might be withdrawn from the letter of obligation, causing the letter itself to disappear. That the overall risk to buyers is small is an argument that we entirely accept. Any legislative solution, therefore, should be modest and proportionate to the problem. But in our provisional view there is indeed a problem which needs to be solved. Our proposal therefore is that:

3. The problem of the insolvent grantor highlighted by *Sharp v Thomson* requires a legislative solution.

Scope of reform

3.12 If reform is desirable, it becomes necessary to consider its potential scope. Here there are three issues. What type of property should be covered? Which transactions are relevant? And against which forms of diligence and insolvency should there be protection?

3.13 **Type of property.** Naturally, any reform would be concerned mainly with land. However it should include not only ownership of land but also subordinate real rights such as standard securities and leases. In short, the reform should extend to all registered heritable property, whether corporeal or incorporeal. One of the weaknesses of the solution proposed by *Sharp* is that it fails to provide for subordinate real rights.²⁴ Moveable property, however, should generally be excluded from the reform. The principle of security of title, so important in the case of land, has no proper counterpart with moveables. There is no general register of moveable property. Corporeal moveables may usually be transferred without writing.²⁵ So, in theory, may incorporeal moveables,²⁶ although the practice is to have a written assignation followed by a written intimation. It is true that assignations raise some of the same problems as dispositions of land. For in both cases there is a written deed of conveyance which does not of itself achieve a transfer of ownership; and in both cases there is a risk of the seller's insolvency during the period between delivery of the conveyance and completion of title (by intimation or, as the case may be, by registration). But with incorporeal moveables the principle of security of title is largely absent. With some exceptions,²⁷ there is no provision for registration. A person acquiring receivables or other incorporeal property does so at his own risk. The seller's title cannot be properly checked, for there is no register to inspect. The property may be encumbered by a security, or may already have been transferred to someone else. If so, the position may not be discoverable by the buyer. In that context, insolvency is just another risk. The question of whether such a system is satisfactory is a large one, in which security of title must be balanced against commercial expediency, flexibility, informality and absence of publicity. We offer no views

²⁴ Para 2.16.

²⁵ Sale of Goods Act 1979 s 4(1). A small number of exceptions exist, eg registered ships (Merchant Shipping Act 1995 sched 1 para 2).

²⁶ Requirements of Writing (Scotland) Act 1995 s 11(3)(a).

²⁷ Discussed in the next paragraph.

here. But a reform designed to improve an existing regime of security of title founded on registration is inappropriate to a context where security of title is of limited importance.²⁸

3.14 Two qualifications seem necessary. First, some moveable property is in fact registered, most notably shares²⁹ and certain kinds of intellectual property such as patents,³⁰ design rights,³¹ and trade marks.³² The reform should be extended to property of this type insofar as registration is constitutive of the right.³³ Secondly, insofar as the reform involves improved publicity for insolvency, it will be of benefit for property of any kind.

3.15 **Type of transaction.** *Sharp* and the other cases concern the transfer of ownership. But the same issue arises with other juristic acts such as the creation of a new right, or its variation or discharge. A person who advances (or pays) money against the grant of a standard security or the renunciation of a lease is no less vulnerable to the insolvency of the granter than an ordinary purchaser, and no less worthy of protection. The reform should therefore extend to the creation, transfer, variation or extinction of any right in land or other property – provided only that the juristic act is one which requires to be completed by registration.

3.16 **Type of diligence and insolvency.** In order to be effective, the reform should extend to all normal insolvency processes. Thus provision requires to be made for sequestration as well as for the various forms of corporate insolvency – liquidation, receivership, administration, and company voluntary arrangements. Inhibition and adjudication, the diligences affecting land, must likewise be included, and account taken of the proposed new diligence of land attachment recommended in our recent *Report on Diligence*.³⁴ No proposals will be made in respect of arrestment and poinding, on the basis that they affect only moveables (and are consequently unregistered); but it may be mentioned that the competent diligence for intellectual property is adjudication and not arrestment.³⁵

Approaches to reform

3.17 The object of reform is to enable a person proceeding with reasonable expedition, in reliance on the public registers, and otherwise in accordance with good conveyancing practice, to acquire a good title to land (or to a real right in land) in priority to diligence or insolvency.³⁶

²⁸ Paras 3.5 and 3.6.

²⁹ For a discussion, see Paul L Davies, *Gower's Principles of Modern Company Law* (6th edn, 1997) chap 14. Uncertificated shares are transferred under the electronic CREST system. These are mainly, but not exclusively, listed shares. Shares with paper share certificates are transferred by written transfer under the Stock Transfer Act 1963. In both cases registration in the company's register of members is required, although with CREST transfers this occurs electronically (and speedily).

³⁰ Patents Act 1977 ss 32 and 33.

³¹ Registered Designs Act 1949 s 19. Unregistered design rights are allowed under part III of the Copyright, Designs and Patents Act 1988.

³² Trade Marks Act 1994 s 25.

³³ Sometimes registration systems are devised for administrative purposes only and are not constitutive of rights. An example is registration of motor vehicles.

³⁴ Scot Law Com No 183.

³⁵ Gretton, *Inhibition and Adjudication* pp 215-6.

³⁶ Para 3.6. And see also Scot Law Com DP No 107 para 2.36.

3.18 Various approaches are open.³⁷ It would be possible, for example, to provide for the registration of a contingent interest in the land to the effect of establishing a priority against all subsequent rights, including rights arising out of diligence or insolvency. This could be done at any early stage in the transaction, such as on conclusion of missives. On this scheme, which is based on the *Vormerkung* (notation) used in German law,³⁸ there would be two separate acts of registration in the property registers, one to establish priority and the other (as at present) to confer a real right. A variation on this approach would be to continue with a single act of registration but to confer priority against diligence and insolvency for a period *before* registration (such as 14 days). Registration of a disposition or standard security would therefore create a retrospective priority period extending back for 14 days. Both approaches have difficulties. The introduction of a second registration would involve more trouble and expense than would seem justified by the risk sought to be guarded against. To provide for retrospective priority would be to breach the rule, reaffirmed by statute in 1693,³⁹ that priority is governed by date of registration. In some cases there would also be practical difficulties, for example that the 14-day period includes a period before delivery of the deed (and payment of the price), or that the acquirer was aware of the insolvency (for example from a search) but chose to disregard it, or that the whole purpose of the deed was to defeat the claims of creditors. Further, a rule which gives priority over certain rights but not over others runs the risk of circles of priority. Nonetheless the idea has certain attractions, and later we suggest a modified version of retrospective priority in the special context of floating charges.⁴⁰

3.19 A more promising approach will usually be to focus on the potentially competing right of the creditor. Two principles may be suggested. In the first place, the fact of diligence or insolvency should be readily and promptly discoverable from a public register; or insofar as this is not possible, special protections should be provided. A person settling a transaction on the basis of a current and clear search could then do so in the knowledge that the grantor was in a position to confer a good title. In the second place, diligence or insolvency occurring *after* settlement should not affect an acquirer who registered with reasonable expedition. In a race to the register, matters should be so arranged that the acquirer is normally the victor. A solution based on those two principles – the principles of publicity and priority – has a number of advantages. It is based on the existing law, for to a considerable extent both principles are already satisfied. Only modest adjustments would be required. There are gains of simplicity and familiarity. And there is no extra trouble or expense for the acquirer. A solution along those lines was trailed in our *Discussion Paper on Diligence against Land* and was supported by all of those who commented on it.⁴¹ The details may be left over until part 4.

³⁷ Some further possibilities are canvassed, and dismissed, in Scot Law Com DP No 107 paras 2.30 to 2.38.

³⁸ For a discussion, see F Baur, J F Baur & R Stürner, *Sachenrecht* (17th edn, 1999) pp 217-35. The main provision is BGB § 883.

³⁹ Real Rights Act 1693. The principle is *prior tempore potior jure*.

⁴⁰ Paras 4.36 to 4.40.

⁴¹ Scot Law Com DP No 107 paras 2.39 to 2.60. This set out a detailed scheme in relation to sequestration, liquidation and the proposed new diligence of land attachment. The important subject of receivership was beyond the scope of the paper, as was adjudication.

Good faith and value

3.20 Some of the proposals in part 4 are general in nature while others are transaction-based. For the latter a preliminary issue is whether their benefit should be contingent on the acquirer being in good faith and giving value.

3.21 Good faith in this context means an absence of knowledge of the competing right of the creditor (or trustee in sequestration, liquidator or receiver). The existing law does not require good faith in a competition between a voluntary right (such as a right under a disposition) and an involuntary right (such as the right of a creditor arising from diligence or insolvency). The first to be completed prevails, and usually this involves a race to the register; and the winner is not disqualified merely because he knew that a competitor was also running.⁴² We have no proposals to change this long-established rule, although we suggest later that good faith should be relevant for certain purposes at the time of delivery of the deed.⁴³

3.22 The issue of value is more difficult. As a matter of policy it seems clear that a creditor – who, almost always, has given value for the debt – should be preferred to an acquirer who has not. But there is more than one way in which this result could be achieved. One approach would be to rely on the existing law of gratuitous alienation. This would avoid a requirement of value in our proposals, but if the granter was insolvent and the transaction for no value or at an undervalue, the transaction could be attacked as a gratuitous alienation by the creditor who would otherwise stand to lose the property. The results, however, would not always be satisfactory. Unless the challenge were made under the rules of common law (which impose a higher threshold),⁴⁴ the creditor would have to wait until the granter was sequestered or, in the case of a company, went into liquidation.⁴⁵ Further, a creditor who was acting for himself and not (as with a trustee in sequestration or liquidator) for all other creditors might find there was little to gain from a challenge which, if successful, would make the property available for all creditors.⁴⁶ Whether a challenge brought by the holder of a floating charge would benefit the receivership alone or other creditors would depend on whether the wording of the charge was capable of including *acquirenda*.⁴⁷ Finally, as a matter of legal technique it seems better to deny the acquirer a title in the first place than to confer a provisional title which can be set aside by judicial process; and the prolonged litigation in the *Short's Tr* cases shows the potential difficulty of obtaining a suitable remedy in a case where the acquirer's title is registered in the Land Register.⁴⁸ We conclude, therefore, that for the purposes of our proposals an acquirer must give value for the property.⁴⁹ That approach has the merit of articulating the mischief identified by *Sharp* and which our proposals are designed to solve, namely a result which would give to the

⁴² Reid, *Property* para 694. In a competition between two *voluntary* rights good faith is introduced by the offside goals rule: see paras 695-700.

⁴³ Paras 4.7 and 4.35.

⁴⁴ McKenzie Skene, *Insolvency Law* pp 238-9.

⁴⁵ Bankruptcy (Scotland) Act 1985 s 34(2)(b); Insolvency Act 1986 s 242(1)(a).

⁴⁶ Except in cases of receivership, however, a rule that the acquirer must give value might be no more helpful, and for the same reason.

⁴⁷ *Ross v Taylor* 1985 SC 156.

⁴⁸ *Short's Tr v Chung* 1991 SLT 472; *Short's Tr v Keeper of the Registers of Scotland* 1996 SC(HL) 14; *Short's Tr v Chung* 1999 SC 471.

⁴⁹ Paras 4.7, 4.35 and 4.37. The same approach is taken by s 32(9)(b)(ii) of the Bankruptcy (Scotland) Act 1985 (exception for acquirers of goods).

same party both the property and the price.⁵⁰ For if the acquirer is to receive the property, it is a reasonable pre-condition that the creditor is to receive (or have the means of attaching) the price.

The state of the registers

3.23 A final preliminary matter is the state of the registers. It is already the law that insolvency processes, as well as all diligence processes affecting land, must be registered in one of the public registers – in the property registers (the Land Register or Register of Sasines), the personal register (the Register of Inhibitions and Adjudications), the Register of Insolvencies or the Companies Register (including the Register of Charges).⁵¹ But two factors limit the usefulness of this information. In the first place, certain processes are valid without registration or, following registration, are backdated in legal effect. And secondly, the information which can be obtained from the registers is to some extent out of date. The first of those factors is considered in detail in part 4, insolvency process by insolvency process. The second may be dealt with briefly now.

3.24 The registers are for the most part held in computerised form and are readily searchable. Any member of the public may inspect a register on payment of a fee, but in practice most searches are carried out by professional firms of searchers. Registers of Scotland provide searches in respect of the Land Register and personal register. The position is likely to be changed to some extent by a new web-based system for online searching of the personal and property registers known as Registers Direct.

3.25 In the nature of things, registers are always out of date. Before information can be entered on a register, it must be checked and evaluated, and in the case of the property registers that process can be complex and time-consuming. Yet the date of registration is usually the date on which the information is received and not the date on which it first appears on the register.⁵² Due to the fact that in the property registers the interval between registration (in the legal sense) and actual appearance on the register may be weeks or even months, there is also a preliminary record of applications known as the Presentment Book in the case of the Register of Sasines and the Application Record in the case of the Land Register.⁵³ The preliminary record is itself computerised and fully searchable, although a search of applications is more vulnerable to error than a search of the register proper. If the preliminary record is taken into account, the interval between registration and appearance on a register is only a day or two. Thus a search conducted on Friday will disclose the position on Thursday or Wednesday. The time lag for the personal and Companies Registers is comparable. A further time lag is created by the date of the search itself. A

⁵⁰ Para 3.2.

⁵¹ Each company has its own file divided into three parts: the G-fiche for general documents and liquidation and administration orders; the A-fiche for accounts and annual returns; and the M and MR-fiche (the Register of Charges) for securities and receivership. See further Gretton & Reid, *Conveyancing* p 407. Abolition of the Register of Charges has been suggested by the Company Law Review Steering Group: see *Modern Company Law for a Competitive Economy (7): Registration of Company Charges* (URN 00/1213, October 2000) paras 3.74 to 3.77.

⁵² The statement in the text summarises and simplifies a diverse range of rules. See Titles to Land Consolidation (Scotland) Act 1868 s 142; Land Registration (Scotland) Act 1979 s 4(3); Companies Act 1985 s 410(2); Insolvency Act 1986 ss 53(1) and 54(3). A rule which ties date of registration to receipt seems unavoidable if those seeking registration are not to be penalised by administrative delay.

⁵³ For a discussion of the Application Record, see *Registration of Title Practice Book* para 5.2.

person who proposes to settle a transaction on Friday may rely on a search⁵⁴ obtained the previous Thursday or Wednesday. That will then disclose the position on Monday. By the time of settlement the information is already four days old. A more elderly search would increase the time lag. On the other hand, a solicitor who subscribes to the Registers Direct system would be able to make a last-minute search. This situation is already much improved from the pre-computer age of 20 years ago, and further improvements are likely although some time lag seems unavoidable. The position here should be borne in mind in the discussion that follows in part 4.

⁵⁴ Usually known as an "interim report" in acknowledgement of the fact that a final search cannot be prepared until the acquirer's title is also registered. Searches in the Land Register are made on (or in imitation of) the prescribed forms (forms 10 to 13).

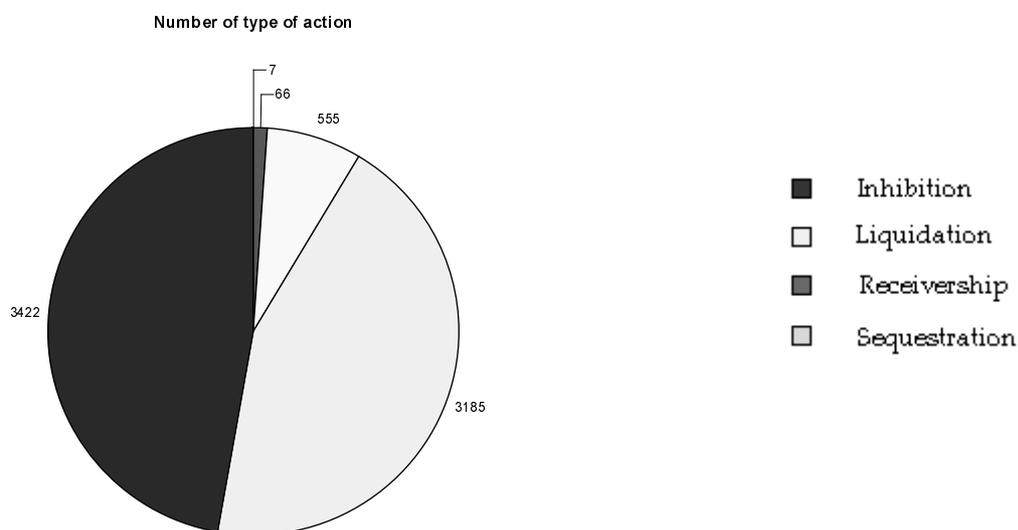
PART 4 A NEW SOLUTION: PUBLICITY AND PRIORITY

Introduction

4.1 The table below shows the relative incidence of diligence and insolvency processes for the most recent period of 12 months for which figures are available.¹

Type of action	Number	Number as percentage
Administration	7	0.1
Receivership	66	0.91
Liquidation	555	7.67
Sequestration	3,185	44.02
Inhibition	3,422	47.3

Table of diligence and insolvency processes 1999/2000



¹ The figures for inhibition cover the calendar year 2000 and were kindly provided by Registers of Scotland. The other figures are for the 12 months from 1 April 1999 to 31 March 2000 and are taken from (i) Department of Trade and Industry, *Companies in 1999-2000* table C2 and (ii) the Accountant in Bankruptcy's *Annual Report 1999/2000*. Only *insolvent* liquidations are included.

4.2 These figures give some idea of the potential size of the problem, and of the relative risks from the different types of process. The figures show that sequestration is overwhelmingly the most common insolvency process in Scotland, being around six times more common than liquidation, its nearest rival. Receivership is uncommon and administration almost unknown. Of the heritable diligences, inhibition is used frequently, and while no figures were available for adjudication the diligence is uncommon.

4.3 In developing proposals for reform it is necessary to examine in some detail the different diligence and insolvency processes.

Sequestration

4.4 **Chronology.** The date of sequestration for the purposes of the Bankruptcy (Scotland) Act 1985 is the date on which the court grants warrant to cite the debtor or, in a case where the petition is presented by the debtor, the date on which sequestration is actually awarded.² In either case this is usually the first order made by the court (and "first order" is used in that sense throughout this part of the paper). For the time being the debtor retains his property. An interim trustee is appointed, and in due course a permanent trustee will be elected by creditors and the election confirmed by the court by act and warrant.³ One effect of the act and warrant is to vest the debtor's property in the trustee, backdated to the date of sequestration;⁴ and this has the consequential effect of triggering section 32(8) of the Act, which is in the following terms:

"Subject to subsection (9) below, any dealing of or with the debtor relating to his estate vested in the permanent trustee under section 31 of this Act shall be of no effect in a question with the permanent trustee."

By implication this too is backdated to the date of sequestration.⁵ The result is awkward, as an example shows. Suppose that in a petition presented by a creditor the court grants warrant to cite on day 1. That is the date of sequestration for the purposes of the Act. And suppose further that sequestration is awarded on day 20 and the act and warrant in favour of the permanent trustee is issued on day 40. As of day 39 there has been no divestiture of the debtor or investiture of the permanent trustee. As owner of property, therefore, the debtor could presumably transfer that property to someone else. But on day 40 the trustee is deemed to have been vested since day 1 and any purported transfer since that date would be ineffective.⁶ The implications for a purchaser are obvious.

² Bankruptcy (Scotland) Act 1985 s 12(4). More petitions are presented by debtors than by creditors. Of the 3,185 sequestrations for the year ending 31 March 2000, 63.6% were brought by the debtor, 35.8% were brought by a creditor, and 0.6% by a trustee under a trust deed. See the Accountant in Bankruptcy's *Annual Report 1999/2000* app 1 and table 2.

³ 1985 Act ss 24 and 25.

⁴ 1985 Act s 31(1): "the whole estate of the debtor shall vest as at the date of sequestration in the permanent trustee ..." It is assumed that "date of sequestration" governs "estate" as well as "vest" – or in other words that there is vested such estate as the debtor held on the date of sequestration. (See the definition of *acquirenda* in s 32(6),(10).) Otherwise property conveyed by the debtor between the date of sequestration and the date of the act and warrant would be excluded.

⁵ *Alliance and Leicester Building Society v Macgregor* 1994 SCLR 19. And see McBryde, *Bankruptcy* paras 9-162 and 9-163.

⁶ The value of retrospective vesting may be open to question. Certainly s 32(8) of the 1985 Act already prevents the debtor from dealing with the property (subject to exceptions) while the interim trustee has statutory powers of management (s 18).

4.5 **Pre-delivery sequestration.** The effect of sequestration on a sale (or other) transaction depends on the stage that the transaction has reached. By section 32(8) of the 1985 Act, as has been seen, a person who is sequestrated loses power to deal with his property.⁷ Consequently, if the date of sequestration occurs before delivery of the conveyance or other deed, the acquirer must deal with (and pay) the trustee and not the debtor. But this presupposes that the sequestration is duly publicised and discoverable. For the most part the publicity arrangements are satisfactory. The first order marks the date of sequestration, and the clerk of court is directed to send a copy "forthwith" both to the personal register and to the Accountant in Bankruptcy.⁸ A search of either the personal register or the Register of Insolvencies will then reveal the sequestration. Later, the actual award of sequestration requires to be published by the interim trustee in the *Edinburgh Gazette*, and a copy sent by the clerk of court to the Accountant in Bankruptcy.⁹ Current conveyancing practice is to search the personal register although not the *Edinburgh Gazette* nor, usually, the Register of Insolvencies.¹⁰ The only difficulty is time lag. The date of sequestration depends on an order of the court and not on registration, so that a sequestration is effective before it is registered. And, as Professor McBryde notes, "[i]nvariably there will be some delay before the register of inhibitions and adjudications records the relevant order in respect of a debtor, and the extent of the delay depends in part on the diligence of clerks of court".¹¹ To the time lag of four or five days noted earlier¹² there must therefore be added some further days to allow for transmission by the clerk of court. As a result, the information in a search might easily be a week or more out of date, allowing a transaction to settle on the basis of a clear search notwithstanding that the granter was sequestrated the previous week.¹³

4.6 A principled solution would be to change the "date of sequestration" under the Bankruptcy Act from the date of the first order to the date on which that order was effectively publicised – for example to the date occurring one week after registration in the personal register.¹⁴ An acquirer could then be sure of the position before parting with the price. But such a change would affect all sequestrations, and not merely the tiny number in which the debtor has granted a conveyance, and might have consequences which were both unintended and undesirable. It could not, we think, be pursued as part of the present limited exercise. A more targeted approach would be to qualify section 32(8) so that, in certain restricted circumstances, effect is given to a post-sequestration conveyance. Indeed

⁷ In addition, once registered in the personal register, the first order has the effect of an inhibition: 1985 Act s 14(2). But this would not affect the usual case of a conveyance granted in implement of prior missives.

⁸ 1985 Act s 14(1). By s 5(6) of the 1985 Act the petitioner must, on the date of the petition for sequestration, send a copy of the petition to the Accountant in Bankruptcy.

⁹ 1985 Act s 15(5)(b), (6). This applies only where the petition was presented by a creditor or trustee acting under a trust deed. Where the petition was presented by the debtor, the award of sequestration is the first order.

¹⁰ Gretton & Reid, *Conveyancing* para 9.17. The conveyancing committee of the Law Society of Scotland is of the view that this Register need not be searched as a matter of course, notwithstanding that an occasional omission by a clerk of court in sending a copy of the first order would mean that the sequestration was not on the personal register. See a note published at (1998) 43 JLSS July/8.

¹¹ McBryde, *Bankruptcy* para 1-48.

¹² Para 3.25.

¹³ Where the petition is by a creditor, the debtor would not actually be sequestrated at the time of settlement, but a warrant to cite would have been issued. Sequestration, if and when eventually granted, is then backdated to the date of the order to cite. See 1985 Act s 12.

¹⁴ We owe this suggestion to Professor W W McBryde.

there is a long-standing precedent. By section 32(9)(b)(ii) (re-enacting a provision found in earlier legislation),¹⁵ section 32(8) is disapplied where it is established

"that the dealing is ... the purchase from the debtor of goods for which the purchaser has given value to the debtor or is willing to give value to the permanent trustee ... and that the person dealing with the debtor was, at the time when the sequestration occurred, unaware of the sequestration and had at that time no reason to believe that the debtor's estate had been sequestrated or was the subject of sequestration proceedings."

The result is to protect a *bona fide* acquirer for value of corporeal moveables.¹⁶ It is thought that the benefit of the protection is lost only by actual knowledge of the sequestration and not merely by its registration in a public register or in the *Edinburgh Gazette*.¹⁷ This acknowledges the fact that acquirers of moveables do not usually search the registers.

4.7 In the review of bankruptcy law which led to the 1985 Act, this Commission considered, but rejected, the idea of extending this protection to acquirers of heritable property. This was because:¹⁸

"a search of the Register of Inhibitions and Adjudications will disclose whether an abbeviat of sequestration or a memorandum of renewal has been recorded there: if either has been so recorded the interested person will know that he must transact with the trustee in sequestration, whereas if it has not he will know that he need not concern himself with a possible sequestration."

But while justified for the most part, this argument overlooks the possible time gap in obtaining information from the register. What seems to be required, therefore, is a rule which allows post-sequestration deeds for a limited period.¹⁹ The period should begin with the date of sequestration itself, for until that date the debtor remains free to deal with the property. And its end should be linked to the date of registration of the first order in the personal register under section 14(1), so that the acquirer is not prejudiced by a delay (or even a complete failure) in registration. However, if proper account is to be taken of the time lag in obtaining information from the register, the period should not end on that actual day but a number of days thereafter.²⁰ We suggest for consideration that the period should end seven days after the date of registration of the first order. As with the existing rule for corporeal moveables, the acquirer should give value and be in good faith at the time of receiving the deed,²¹ so that protection would be withheld where a search disclosed the

¹⁵ Bankruptcy (Scotland) Act 1839 s 85; Bankruptcy (Scotland) Act 1856 s 111; Bankruptcy (Scotland) Act 1913 s 107.

¹⁶ Or rather that is the intended result. A difficulty is that the effect of s 32(9) is merely to disapply s 32(8), leaving open the possibility that a transfer of moveables might be invalid on some other ground. Unfortunately another ground exists. When the act and warrant is issued, its effect is to vest ownership of all moveable property in the trustee retrospectively, from the date of sequestration. See s 31(1), (4). Thus any post-sequestration dealing by the debtor would be void as *a non domino*. Here, as elsewhere, the retrospective nature of vesting seems problematic.

¹⁷ The latter at least was taken for granted in *Minhas's Tr v Bank of Scotland* 1990 SLT 23. And see also H Goudy, *A Treatise on the Law of Bankruptcy in Scotland* (4th edn by T A Fyfe, 1914) p 265.

¹⁸ Scot Law Com No 68 para 11.37.

¹⁹ Compare here the existing rule for moveables which does not have a time limit.

²⁰ In an earlier version of this proposal we suggested that the period should end on the actual date of registration. See Scot Law Com DP No 107 para 2.47.

²¹ See paras 3.20 to 3.22.

sequestration. In view of the shortness of the protection period, however, it seems superfluous to require that the acquirer act in reliance on the register: a person who did not trouble to search would be running an appreciable risk, and not merely from sequestration.²² The protection should apply, not only to a conveyance of ownership, but to the creation, transfer, variation or extinction of any right which requires to be completed by registration – for example, a standard security or a long lease. Further, it should not be confined to rights in land but should include other registrable rights, such as shares and certain types of intellectual property.²³ It may be necessary to amend section 36 of the Bankruptcy Act to make clear that the rules of unfair preferences apply to post-sequestration deeds.²⁴

4.8 Post-delivery sequestration. If the date of sequestration occurs after delivery of the conveyance (or other deed), there is usually no risk to the acquirer. Certainly that is so where, as almost always, the acquirer registers before the sequestration. But even if registration has yet to take place, the acquirer is in no particular danger. The vesting provision in the 1985 Act (section 31) distinguishes, in effect, between (i) property the title to which is completed by registration and (ii) other property. As soon as the act and warrant is issued, the permanent trustee acquires ownership of property falling into the second category, backdated to the date of sequestration.²⁵ In relation to the property with which we are concerned here, however, ownership requires of the trustee the further step of registration.²⁶ The result is a race to the register. Two conveyances are in competition – the voluntary conveyance in favour of the acquirer and the judicial conveyance (the act and warrant) in favour of the trustee. The first party to register will take the property.²⁷ In practice, the race is almost always won by the acquirer – or, more accurately, there is no race at all because the trustee does not choose to take part, the normal practice being for the trustee's title to remain unregistered. But even if the trustee did decide to take part, he could not register until the act and warrant had been issued, and even on the most favourable assumptions – a debtor's petition, the accountant in bankruptcy as trustee,²⁸ no statutory meeting of creditors,²⁹ a certificate of summary administration³⁰ – it is doubtful if the trustee could proceed to registration in much under a fortnight from the first order, by which time the acquirer's title would usually be safely registered. If the object of reform is to ensure that a person proceeding with reasonable expedition and in reliance on the public registers is

²² So far as sequestration is concerned, the protection period would cover only the last two or three days of a typical search. The earlier period would be unprotected.

²³ Paras 3.13 to 3.15.

²⁴ One view is that they are confined to preferences created in the 6 months *before* sequestration. For a discussion, see McBryde, *Bankruptcy* para 12-120. If that is correct, the rules operate anomalously even under the present law, for, in view of the definition of "creation" in s 36(3), a standard security granted before sequestration but registered after would be a post-sequestration right and could not be attacked as an unfair preference.

²⁵ In relation to corporeal moveables there is deemed delivery, and in relation to incorporeal moveables deemed intimation. See s 31(4).

²⁶ The proposition is not stated expressly in s 31 but seems to arise by implication from s 31(4), which provides for a deemed completion of title by delivery and intimation but not by registration. See Scot Law Com No 68 para 11.6; McBryde, *Bankruptcy* paras 9-07 and 9-94. The rule encompasses not merely heritable property, but also such incorporeal moveable property – shares and certain types of intellectual property – for which registration is needed for the creation of real rights.

²⁷ This account presupposes that *Sharp v Thomson* has been reversed, as proposed in part 2. If *Sharp* is not reversed, and if *Burnett's Tr v Grainger* 2000 SLT (Sh Ct) 116 is correctly decided, the mere fact that a conveyance had been delivered prior to sequestration would prevent the property from vesting in the permanent trustee.

²⁸ 1985 Act s 2.

²⁹ 1985 Act s 21A.

³⁰ 1985 Act s 23A.

able to acquire a good title to land in priority to sequestration,³¹ then it seems that this is substantially achieved by current law and practice.

4.9 **A theoretical risk.** A theoretical risk remains, however. As has been seen, an acquirer must settle a transaction on the basis of a search which is not completely up-to-date. If sequestration had occurred shortly before settlement, a permanent trustee, taking advantage of this modest start, might be able to complete title ahead of the acquirer.³² The risk seems too small to justify legislation on its own, but if there is to be legislation on other matters there is something to be said for attending to this matter as well. The solution is straightforward. To the practical handicaps which already affect the permanent trustee there should be added a formal one. The trustee should be barred from completing title for a period which is sufficiently long to allow an acquirer, acting with expedition and in accordance with normal conveyancing practice, to register his deed.³³ A standard ("classic") letter of obligation allows 14 days for registration, but to this must be added a further period – 7 days seems sufficient – to allow for the possibility that the granter was already sequestrated at settlement but that, owing to the time lag in searches, this was unknown to the acquirer.³⁴ That makes a total period of 21 days (7 attributable to the time before settlement and 14 to the time after settlement). The period would begin with the date of registration of the first order in the personal register.³⁵ The 21-day freeze would apply to all property for which a title is completed by registration. Thus shares and certain types of intellectual property would be included as well as land.³⁶ Further, it would affect not only a trustee in sequestration but any person acquiring from a trustee, thus covering the case in which the trustee sold without first completing title.

4.10 **Proposals.** We invite comment on the following proposals:

4. (a) **Section 32(9)(b) of the Bankruptcy (Scotland) Act 1985 (dealings of the debtor permitted after sequestration) should be extended to include the creation, transfer, variation or extinction of a right in land or other property during the period beginning with the date of sequestration and ending seven days after the registration under section 14(1)(a) of the first order in the personal register, provided that –**

³¹ Para 3.16.

³² Here we presuppose that s 32(8) is amended, as suggested above, to the effect of validating the deed in favour of the acquirer.

³³ This is similar in effect, though not in concept, to the freeze of 30 working days given to an acquirer of registered land in England and Wales following an official search of the Land Registry. See eg Robert Abbey and Mark Richards, *A Practical Approach to Conveyancing* (2nd edn, 2000) p 244.

³⁴ This additional 7 days was not included in the earlier version of this proposal which appeared in Scot Law Com DP No 107 paras 2.53 and 2.54.

³⁵ It will be seen that the first part of the priority period (date of registration of first order + 7 days) is also the final part of the protected period: see para 4.7.

³⁶ Para 3.14. With uncertificated shares transferred under the CREST system, the transferor holds on a constructive trust for the buyer as from the time an Operator-instruction is generated requiring the issuer to register the transfer. See The Uncertificated Securities Regulations 1995 (SI 1995/3272) reg 25(2). This is the broad equivalent of delivery of a conveyance, and protects the acquirer from that point. An equivalent protection exists for transfers under designated systems used in the financial markets, although without the device of a constructive trust. Such transfers may or may not involve registration. See The Financial Markets and Insolvency (Settlement Finality) Regulations 1999 (SI 1999/2979) regs 2 (meaning of "transfer order"), 14 and 20.

- (i) the dealing was for value;
 - (ii) the acquirer was unaware of the sequestration at the time of the dealing; and
 - (iii) the dealing is of a kind which is completed by registration.
- (b) If a dealing is effected by deed, then for the purposes of (a) the date of the dealing is the date on which the deed is delivered.
- (c) During the period beginning with the date of sequestration and ending 21 days after the date of registration under section 14(1)(a) of the first order in the personal register it should not be competent for title to property, vested in the permanent trustee in sequestration by section 31, to be completed by registration –
- (i) by the permanent trustee in sequestration, or
 - (ii) by any person deriving title from the permanent trustee.

Trust deeds for creditors

4.11 Trust deeds are sometimes used as an alternative to sequestration. In both form and substance they are voluntary conveyances by the debtor and need not be discussed further here. Unless or until the trustee has completed title by registration in the property registers, a person is able to acquire a right from the debtor.³⁷

Liquidation

4.12 **Introduction.** The winding up of companies may be either voluntary or compulsory. In 1999/2000 there were 352 voluntary liquidations in Scotland and 356 compulsory liquidations.³⁸ Part IV of the Insolvency Act 1986 provides a uniform legislative code for the winding up of companies registered in Scotland and in England and Wales.³⁹

4.13 Voluntary liquidation is a matter for the company and its creditors and need not involve the court.⁴⁰ The liquidation begins with the passing of a resolution to wind up the company.⁴¹ In around 40% of cases the directors were previously able to make a statutory declaration of solvency and the liquidation proceeds as a members' voluntary winding up.⁴² Otherwise the company is, or may be, insolvent and the liquidation is a creditors' voluntary winding up. In this paper our concern is with insolvent liquidation and we will say nothing further about members' voluntary winding up.

³⁷ McBryde, *Bankruptcy* para 20-39.

³⁸ Department of Trade and Industry, *Companies in 1999-2000* table C2.

³⁹ Subject to minor variations. Some matters of detail are regulated by the Insolvency (Scotland) Rules 1986, SI 1986/1915 (as amended).

⁴⁰ Although the court may become involved for one reason or another: see eg s 112 of the 1986 Act.

⁴¹ Insolvency Act 1986 ss 84(1)(b), (c) and 86. The resolution is either a special resolution or an extraordinary resolution.

⁴² 1986 Act ss 89 and 90.

4.14 A compulsory liquidation is initiated by a petition to the Court of Session or sheriff court by a creditor or by the company or its directors or by a contributory.⁴³ Presentation of the petition marks the commencement of the winding up, although a number of weeks may elapse before a winding-up order is actually made.⁴⁴

4.15 An important difference from sequestration is that, in the normal case, there is no divestiture of property. There is merely a change of management. Until a liquidator is appointed, the company continues to be managed by its directors, although their powers are limited in various ways. Once management is taken over by the liquidator, the powers of the directors cease.⁴⁵ In principle, therefore, a company is able to continue to convey property even after the commencement of winding up; but in order to do so, the appropriate officer must act, and regard must be had to various statutory restraints described below.

4.16 **Pre-delivery liquidation.** The effect of liquidation on a transaction with the company's property depends on the stage reached by the transaction at the date of commencement of the winding up.⁴⁶ Insofar as there are problems, they are likely to occur in a case where the company was already in liquidation at the time of delivery of the conveyance or other deed.

4.17 *Compulsory liquidation.* In a compulsory liquidation, a liquidator (known as an "interim" liquidator) is appointed at the same time as the winding up order is made.⁴⁷ Typically this is some weeks after the initial petition which marks the notional commencement of the winding up. For some or all of the earlier period a provisional liquidator may have been appointed by the court.⁴⁸ The risk, from the point of view of an acquirer, lies in accepting a deed from (and paying money to) the directors at a time when they no longer have power to grant. Once a liquidator has been appointed, any deed granted by the directors would be valueless. But even before⁴⁹ this point is reached, a deed would be affected by section 127 of the Insolvency Act 1986 which provides that:

"In a winding up by the court, any disposition of the company's property ... made after the commencement of the winding up is, unless the court otherwise orders, void."

The wording is sufficiently general to include the creation, variation and discharge of subordinate real rights, such as standard securities or leases, as well as outright transfers.⁵⁰ On the other hand, the case law on section 127 leaves little room for doubt that a grant for full value would be validated by the court.⁵¹

⁴³ 1986 Act s 124.

⁴⁴ 1986 Act s 129. A petition is "presented" in this sense when it is presented in the petition department. See William W McBryde and Norman J Dowie, *Petition Procedure in the Court of Session* (2nd edn, 1988) p 102. If previously a resolution was passed for voluntary winding up, commencement is backdated to the date of the resolution.

⁴⁵ eg St Clair & Drummond Young, *Corporate Insolvency* p 24.

⁴⁶ Reid, *Property* para 648.

⁴⁷ 1986 Act s 138.

⁴⁸ 1986 Act s 135.

⁴⁹ Section 127 does not apply *once* a liquidator has been appointed, because a liquidator has statutory powers (sched 4 para 6) to sell the company's property.

⁵⁰ eg *Site Preparations Ltd v Buchan Development Co Ltd* 1983 SLT 317.

⁵¹ See eg Fletcher, *Insolvency* pp 628-31; R M Goode, *Principles of Corporate Insolvency* (2nd edn, 1997) pp 423-35; McKenzie Skene, *Insolvency Law* pp 174-5.

4.18 The risk to an acquirer is perhaps not very large. For there to be any risk at all it would be necessary both that the directors continued to dispose of property notwithstanding the liquidation and also that the acquirer was unaware of the liquidation at the time of accepting the deed. Neither seems at all likely. The risk of directors continuing to dispose of property seems similar to, and not greater than, the risk that an agent would continue to act in a transaction after his power of attorney had been revoked. A practical deterrent is the statutory provisions on fraudulent and wrongful trading.⁵² But in any event it is improbable that the true position would not be known by the solicitors acting for the company, and, if known, that it would be withheld from the acquirers. Indeed in a case where a liquidator had been appointed, the solicitors would be acting to the liquidator's orders and not to those of the board of directors. Further, the fact of liquidation would often be in the public domain. It is provided by the rules of court that a petition for winding up is to be advertised in the *Edinburgh Gazette* and in one or more such newspapers as the court directs.⁵³ A provisional liquidator must notify his appointment to the Registrar of Companies and to the Accountant in Bankruptcy forthwith, and the information can then be retrieved from the Companies Register and the Register of Insolvencies by a standard search.⁵⁴ An interim liquidator has seven days to notify the Accountant in Bankruptcy of his appointment.⁵⁵ On the making of a winding up order a copy must be forwarded forthwith both to the Registrar of Companies and to the Accountant in Bankruptcy.⁵⁶ Admittedly these provisions are not wholly satisfactory. Solicitors do not search the *Edinburgh Gazette* nor, usually, the Register of Insolvencies. Yet a search in the Companies Register would disclose nothing until the registration of the winding up order, often some weeks after the commencement of liquidation, except in a case where a provisional liquidator was appointed. What is missing from these publicity rules is an equivalent to the requirement, found in sequestrations,⁵⁷ that a copy of the first order be sent to a public register.

4.19 A legislative solution, if one were thought to be required, would face a number of difficulties. As already mentioned, the provisions in the Insolvency Act on winding up form a uniform code for all British companies, whether registered in Scotland or in England and Wales. So far as possible, it seems desirable that uniformity should be preserved. No doubt for that reason the winding up of companies (and other business organisations) is a reserved matter for the purposes of the Scotland Act 1998 and, with some exceptions, could be altered only by the United Kingdom Parliament.⁵⁸ In proposing legislation which otherwise falls within the competency of the Scottish Parliament,⁵⁹ we would be reluctant to include a provision which requires, or may require, legislation at Westminster unless there were

⁵² 1986 Act ss 213 – 215.

⁵³ Rules of the Court of Session (SI 1994/1443) r 74.22.(1)(c); Sheriff Court Company Insolvency Rules 1986 (SI 1986/2297) r 19(6). The question of whether the *Edinburgh Gazette* is an adequate method of publicity is considered at paras 10.58 and 10.59 of the Company Law Steering Group's *Modern Company Law for a Competitive Economy (5): Developing the Framework* (March 2000).

⁵⁴ Insolvency (Scotland) Rules 1986 (SI 1986/1915) (as amended by The Scotland Act 1998 (Consequential Modifications) (No 2) Order 1999 (SI 1999/1820)) r 4.2(1)(a), (aa). Until the amendment the notification was sent to the Registrar of Companies only.

⁵⁵ Insolvency (Scotland) Rules (as amended) r 4.18(4)(a).

⁵⁶ 1986 Act s 130(1) read with Scotland Act 1998 sched 8 para 23(2), (3).

⁵⁷ Para 4.5.

⁵⁸ Scotland Act 1998 sched 5 s C2. The exceptions listed are: "(a) the process of winding up, including the person having responsibility for the conduct of a winding up or any part of it, and his conduct of it or of that part, (b) the effect of winding up on diligence, and (c) avoidance and adjustment of prior transactions on winding up."

⁵⁹ Para 1.12.

compelling reasons to do so. It might also be mentioned that a Scotland-only solution would give no assistance in respect of the many English companies with assets in Scotland.

4.20 If this reasoning is accepted, it argues for a minimum of change, and for change affecting procedure rather than substance. As it happens, a procedural change would go a long way towards protecting the acquirer. In our *Discussion Paper on Diligence against Land* we suggested that, on the presentation of a petition for winding up, a clerk of court should forthwith give notice of the petition to the Registrar of Companies.⁶⁰ This is modelled on the existing rule for sequestration.⁶¹ For consistency with that rule, and with other similar provisions affecting companies, we now suggest that notice should also be given to the Accountant in Bankruptcy. The change could be implemented by amendment to the rules of court and primary legislation would not be required. The proposal was welcomed on consultation.⁶² Even allowing for the time lag in searches, it would mean that an acquirer would have notice of any compulsory liquidation which had occurred up until a week before settlement of the transaction.⁶³ In the unlikely event (i) that a liquidation occurred during the final week (ii) that it was otherwise unknown to the acquirer, and (iii) that the directors executed and delivered a deed without regard to the liquidation, an acquirer could have recourse to section 127 of the Insolvency Act.⁶⁴

4.21 *Voluntary liquidation.* In a creditors' voluntary winding up, the liquidator is appointed at a creditors' meeting, which must occur within 14 days of the meeting of the company at which the resolution for winding up was proposed.⁶⁵ Once a liquidator is appointed, the directors cease to have power to act;⁶⁶ but even during the short period between the start of the liquidation (marked by the passing of the winding up resolution) and the appointment of the liquidator, the directors are subject to section 114 of the Insolvency Act which provides that

"The powers of the directors shall not be exercised, except with the sanction of the court ... during the period before the appointment or nomination of a liquidator of the company".

Exceptions are, however, admitted

"(a) to dispose of perishable goods and other goods the value of which is likely to diminish if they are not immediately disposed of, and

⁶⁰ Scot Law Com DP No 107 para 2.52.

⁶¹ Bankruptcy (Scotland) Act 1985 s 14(1). However the notice to be given is of the presentation of the petition and not of the first order, reflecting the different date fixed for the commencement of a winding up: see 1986 Act s 129. Under the 1985 Act (s 5(6)) notice of presentation is given by the *petitioner*.

⁶² The Faculty of Advocates described it as "particularly welcome". A similar solution had previously been suggested in Donna W McKenzie and David O'Donnell, "Intervening Insolvency: How can you know?" (1995-6) 1 SLPQ 173 at 184. The authors emphasise the advantage of providing for notification by a public official rather than a private individual (such as the petitioner) "who may or may not have any interest in complying with his obligation, or even be unaware of it".

⁶³ Para 3.25.

⁶⁴ For reasons given in the previous paragraph we do not now support the suggestion (made in Scot Law Com DP No 107 para 2.51) that s 127 should be amended, for Scotland only, so as to validate deeds by a company granted before the day in which the fact of winding up first appeared in the Companies Register.

⁶⁵ 1986 Act ss 98(1)(a) and 100.

⁶⁶ Except insofar as otherwise sanctioned by the liquidation committee: 1986 Act s 103.

(b) to do all such other things as may be necessary for the protection of the company's assets."

There is an argument, though hardly a conclusive one, that the granting of a deed against payment and in implement of a pre-existing obligation would be an act "necessary for the protection of the company's assets".⁶⁷ Otherwise any disposition granted by the directors would be void, subject to the possibility of approval by the court.⁶⁸ It is thought that, as with section 127 (discussed earlier), approval could be granted after the event.

4.22 Publicity, as usual, plays an important role in the protection of acquirers; and as with compulsory winding up, the existing rules of publicity are inadequate in some respects. Where a resolution for winding up has been passed, a copy must be sent within 15 days to both the Registrar of Companies and the Accountant in Bankruptcy;⁶⁹ and a liquidator must notify the Accountant in Bankruptcy of his appointment within 14 days.⁷⁰ In both cases failure to comply risks a fine.⁷¹ When account is taken of the time lag in searches, there is a three-week blind period prior to settlement of a conveyancing transaction. If during this period the company goes into liquidation, that fact will not be discoverable from a public register (although it may often be discoverable in other ways). We think that the current position can, and should, be improved upon. We suggest that in future a copy of the winding up resolution should be sent to the Registrar of Companies and the Accountant in Bankruptcy forthwith, and that a liquidator should have only 7 and not 14 days in which to notify the Accountant.⁷² The latter change would reproduce the current position in compulsory liquidations, while the former is the equivalent of a proposal for compulsory liquidations made earlier. The changes would not breach the unity of the law of winding up as between England and Scotland because the notification provisions are already different in the two jurisdictions;⁷³ and although they would involve amendment of the Insolvency Act, the changes are to the "process" of winding up (as opposed to "the modes of, the grounds for and the general legal effect of winding up") and so would come within the legislative competence of the Scottish Parliament.⁷⁴ Taken together these changes would largely remove the risk to an acquirer from pre-delivery liquidation.⁷⁵

4.23 **Post-delivery liquidation.** Liquidation *after* the deed has been delivered is most unlikely to cause difficulties for an acquirer. The deed is unaffected by the winding up and, on registration, will confer the right in question. Further, and by contrast with

⁶⁷ After all, failure to do so would often increase the indebtedness of the company by giving rise to a claim in damages.

⁶⁸ By contrast to s 127, there is no express provision that the act would be void; and indeed the express inclusion of a criminal sanction might seem to argue to the contrary. However, a leading text takes the view that an exercise of powers in contravention of s 114 would be invalid: see Fletcher, *Insolvency* p 502.

⁶⁹ 1986 Act s 84(3) read with Scotland Act 1998 sched 8 para 23(2), (3).

⁷⁰ 1986 Act s 109(1) read with Scotland Act 1998 sched 8 para 23(4), (5).

⁷¹ Companies Act 1985 s 380(5); Insolvency Act 1986 s 109(2).

⁷² In the interests of simplicity and uniformity, the proposed new rules should apply to all voluntary liquidations, including members' winding up.

⁷³ Thus in England and Wales a copy of the winding up resolution is sent to the Registrar of Companies (only), while the liquidator must notify the Registrar (and not the Accountant in Bankruptcy).

⁷⁴ The "process" of winding up is among the exceptions to winding up as a reserved matter. See Scotland Act 1998 sched 5 part II s C2.

⁷⁵ For reasons given in para 4.18, the practical risks are in any event very small. A further factor is that in a voluntary liquidation the directors could never be ignorant of the onset of winding up – as might occur, in theory at least, with a compulsory winding up initiated by a creditor.

sequestration, there is no *general* vesting of property in the liquidator and hence no rival title which might defeat the acquirer's claim.⁷⁶

4.24 It is true that the possibility of a rival title is left open by section 145 of the Insolvency Act 1986, which allows a liquidator to apply to the court for an order vesting all or part of the company's property in the liquidator's name.⁷⁷ In practice, however, applications under this provision are virtually unknown,⁷⁸ and indeed it is difficult to see what a vesting order would add to the extensive powers of management and disposal already conferred on the liquidator by statute.⁷⁹ But in any event a title under section 145 would not be a threat to an acquirer who had registered his own deed with reasonable expedition. It may be taken for granted that, in a compulsory winding up, a section 145 order would not be made in favour of either a provisional or an interim liquidator, and that only the permanent liquidator could take benefit. This means that the following stages (at least) would have to occur before a title could be completed in the liquidator's name: (i) petition for winding up (ii) intimation, service and advertisement of the petition (iii) a period (normally eight days) for lodging answers⁸⁰ (iv) granting of winding up order and appointment of interim liquidator⁸¹ (v) meeting of creditors and appointment of (permanent) liquidator⁸² (vi) application by liquidator under section 145 (vii) extraction of court order (viii) registration of extract order in Land Register, or a notice of title deducing title through the extract order in the Register of Sasines.⁸³ It is inconceivable that this complex sequence could be completed within the 14 days allowed by the "classic" letter of obligation for registration of the acquirer's deed; and the same seems true even in the case of a creditor's voluntary winding up where stages (i)-(iv) are replaced by a single event, namely the passing of a resolution to wind up the company.

4.25 If there is any risk from a rival title in the liquidator it comes, not from section 145 of the Insolvency Act, but from section 25 of the Titles to Land Consolidation (Scotland) Act 1868.⁸⁴ This curious and little-known provision appears to allow a liquidator to complete title to heritable property merely by virtue of being a liquidator and without special court order – thus avoiding stages (vi) and (vii) set out above.⁸⁵ In theory this would make it possible for a liquidator in a voluntary liquidation, acting with extreme urgency, to complete title ahead of an acquirer. In that case the race to the register would be won by the

⁷⁶ For sequestration see para 4.4.

⁷⁷ Section 145 is applied to voluntary liquidations by s 112 of the 1986 Act.

⁷⁸ And see St Clair & Drummond Young, *Corporate Insolvency* p 23 n 11: "The authors know of no case in which these provisions have been used in Scotland".

⁷⁹ 1986 Act ss 165, 167 and sched 4.

⁸⁰ Rules of the Court of Session 1994 r 74.22(2); Sheriff Court Company Insolvency Rules 1986 r 19(8).

⁸¹ 1986 Act s 138.

⁸² 1986 Act s 139.

⁸³ Conveyancing (Scotland) Act 1924 s 4; Land Registration (Scotland) Act 1979 s 3(6).

⁸⁴ As prospectively re-stated by the Abolition of Feudal Tenure etc. (Scotland) Act 2000 sched 12, para 8(9) this reads: "The liquidator in the winding up of a company shall, for the purposes of sections 3 (disposition etc. by person with unrecorded title) and 4 (completion of title) of the Conveyancing (Scotland) Act 1924 (c 27) (including those sections as applied to registered leases by section 24 of that Act), be taken to be a person having right to any land belonging to the company".

⁸⁵ G L Gretton, "The Title of a Liquidator" (1984) 29 JLSS 357; A J McDonald, "Bankruptcy, Liquidation and Receivership and the Race to the Register" (1985) 30 JLSS 20; G L Gretton and K G C Reid, "Insolvency and Title: a Reply" (1985) 30 JLSS 109. Another possibly relevant provision, the predecessor of which (s 327(1)(b) of the Companies Act 1948) is discussed in these articles, is s 185 of the Insolvency Act 1986. This applies to liquidations s 37(1)(a) of the Bankruptcy (Scotland) Act 1985 (in relation to diligence done, sequestration has the effect of a decree of adjudication in favour of the creditors). The repeal of s 37(1)(a) is recommended in our *Report on Diligence* (Scot Law Com No 183) paras 7.9 and 7.10.

liquidator, and the acquirer's right defeated. If there is a risk here, it can be disposed of by repealing section 25. The provision is so seldom used that its repeal would make little practical difference. A liquidator who wishes to take title to heritable property can apply to the court under section 145. Indeed it seems desirable that he should do so, for it is anomalous that a court order is avoidable in relation some types of (often valuable) property but not in relation to others.

4.26 **Proposals.** The following proposals arise out of the preceding discussion of liquidation:

5. (a) **A petition for the winding up of a company by the court should, on presentation, be notified forthwith by a clerk of court to**
 - (i) **the Registrar of Companies and**
 - (ii) **the Accountant in Bankruptcy.**
- (b) **The period of 15 days allowed by section 84(3) of the Insolvency Act 1986 for the forwarding of a copy of a resolution for the voluntary winding up of a company to the Registrar of Companies and Accountant in Bankruptcy should be replaced by an obligation on the company to forward the resolution forthwith.**
- (c) **The period of 14 days allowed by section 109(1) of the Insolvency Act 1986 for a liquidator in a voluntary winding up to give notice of his appointment to the Accountant in Bankruptcy should be reduced to a period of 7 days.**
- (d) **Section 25 of the Titles to Land Consolidation (Scotland) Act 1868 (deduction of title by liquidator) should be repealed.**

Administration

4.27 Administration is initiated by a petition to the Court of Session or sheriff court.⁸⁶ By contrast with liquidation, provision is made for immediate notification, by the petitioner, both to the Registrar of Companies and also to the Keeper of the Register of Inhibitions and Adjudications.⁸⁷ Publicity thus pre-dates the making of the administration order, and hence the suspension of directors' powers. Until the order is made the directors can continue to grant deeds on behalf of the company, subject only to possible restrictions imposed by the court by way of interim order.⁸⁸ Thereafter the grant must be made by the administrator.⁸⁹ Once an administration order is made, a copy must be sent by the administrator within 14 days to the Registrar of Companies and the Keeper of the Register of Inhibitions and Adjudications.⁹⁰

⁸⁶ 1986 Act s 9. See Rules of the Court of Session 1994 r 74.10.

⁸⁷ 1986 Act s 9(2)(a); Insolvency (Scotland) Rules 1986 (SI 1986/1915) r 2.2.

⁸⁸ 1986 Act s 9(5).

⁸⁹ 1986 Act s 14(4). And see McKenzie Skene, *Insolvency Law* pp 173-4.

⁹⁰ 1986 Act s 21(2); Insolvency (Scotland) Rules 1986 r 2.3(3).

4.28 From the point of view of an acquirer, the position seems broadly satisfactory. If a granter company is in administration at the time of delivery of the deed, that fact will be ascertainable from a search of the Companies Register or personal register. Subsequent administration would neither affect the deed nor (there being no vesting in the administrator) set up a rival title. Administration orders are rare in practice: only seven were made in Scotland during the latest year for which records are available.⁹¹ We make no proposal for reform.

Company voluntary arrangement

4.29 The position is much the same in respect of company voluntary arrangements made under part I of the Insolvency Act 1986. A voluntary arrangement takes effect only where it has been approved by separate meetings of the company and its creditors.⁹² If approval is given, the chairman must forthwith send to the Registrar of Companies a copy of the report of the meeting.⁹³ Depending on the terms of the arrangement, its approval may, or may not, have the effect of suspending the powers of the directors in favour of the supervisor acting under the arrangement.⁹⁴ Again we make no proposal for reform. There were no company voluntary arrangements last year and only five during the previous five years.⁹⁵

Floating charges and receivership

4.30 The relationship between floating charges and land law was examined in *Sharp v Thomson* and found unsatisfactory. In the First Division the result reached by the court (that an attached floating charge should prevail over a delivered disposition) was said by Lord President Hope to be⁹⁶

"unsatisfactory, but it is a consequence of the introduction by Parliament of a concept which is alien to Scots law with a view to its commercial advantage but without sufficient regard to the protection which may be needed to avoid hardship to the purchaser."

That hardship, as Lord Clyde pointed out in the House of Lords, is caused by the fact that a floating charge crystallises, and so becomes a real right, without the need for registration:⁹⁷

"[T]he creation of the floating charge was something alien to Scottish law. Not only is this true of the nature of the security before its attachment but the fact that it can on the event of its crystallisation have the effect of a recorded heritable security without prior recording in a public register cuts across a basic principle of Scots law. The floating charge sits uneasily in a system with whose principles it does not accord."

⁹¹ Para 4.1.

⁹² 1986 Act ss 3 – 5.

⁹³ Insolvency (Scotland) Rules 1986 (SI 1986/1915) r 1.17(5).

⁹⁴ McKenzie Skene, *Insolvency Law* p 172.

⁹⁵ Department of Trade and Industry, *Companies in 1999-2000* table C2.

⁹⁶ 1995 SC 455 at 481D.

⁹⁷ 1997 SC(HL) 66 at 82D-E.

4.31 The difficulties here are well-known. When first created, a floating charge "floats" over the property of the debtor company, so that the company is free to dispose of assets unencumbered by the charge. Only if and when the charge crystallises ("attaches") does the position change. A crystallised floating charge is a real right in security affecting such property as is held by the company at the time of attachment and subject to the charge.⁹⁸ Usually crystallisation occurs as a result of the appointment of a receiver by the chargeholder.⁹⁹ A receiver may also be appointed by the court.¹⁰⁰ The effect is automatic: as soon as the appointment takes effect, the charge attaches. An appointment takes effect on the day on which the instrument of appointment is received by the person being appointed or, in a case of appointment by the court, on the date of actual appointment.¹⁰¹ Crystallisation is not registered as such, but the appointment of a receiver must be registered with the Registrar of Companies within seven days.¹⁰² Non-registration attracts a fine¹⁰³ but affects neither the appointment nor the crystallisation. In practice there is likely to be a delay of several days between appointment/crystallisation on the one hand and registration in the Companies Register on the other; and when to this is added the time lag in searches,¹⁰⁴ the result is a blind period of up to a fortnight during which a company might be in receivership without the fact being publicly available.

4.32 Crystallisation also occurs if the debtor company goes into liquidation.¹⁰⁵ The date of attachment is then the date on which a winding up order is made by the court or, in the case of voluntary liquidations, the date of the passing of the relevant resolution.¹⁰⁶ Both events are publicised, again with some delay. A copy of a winding up order must be sent forthwith to the Registrar of Companies and the Accountant in Bankruptcy.¹⁰⁷ Under a proposal made earlier, notice would in future be given of the original petition for winding up.¹⁰⁸ A copy of a resolution for voluntary winding up must be forwarded to the Registrar and Accountant within 15 days,¹⁰⁹ and earlier we suggested that 15 days might be replaced with an obligation to forward forthwith.¹¹⁰ Crystallisation as a result of liquidation is uncommon because receivership is likely to precede liquidation; but it is not unknown.¹¹¹

4.33 In one important respect the position of the acquirer is more favourable than with other insolvency and diligence processes. Crystallisation does not come out of the blue. The acquirer will already know, from a search of the Companies Register, of the existence of the floating charge.¹¹² He will also know the identity of the chargeholder. It is a simple matter, therefore, to evaluate the risk of a receiver being appointed. In practical terms this translates

⁹⁸ Companies Act 1985 s 463; Insolvency Act 1986 ss 53(7) and 54(6).

⁹⁹ 1986 Act s 53.

¹⁰⁰ 1986 Act s 54.

¹⁰¹ 1986 Act ss 53(6) and 54(5).

¹⁰² 1986 Act ss 53(1) and 54(3).

¹⁰³ 1986 Act ss 53(2) and 54(3).

¹⁰⁴ Para 3.25.

¹⁰⁵ Companies Act 1985 s 463(1). By contrast to England and Wales, a floating charge cannot competently provide for crystallisation on the occurrence of a stipulated event or events. See *Insolvency Law and Practice* (1982, Cmnd 8558) (Cork Committee) para 1574.

¹⁰⁶ Companies Act 1985 s 463(1); Insolvency Act 1986 s 247(2).

¹⁰⁷ 1986 Act s 130(1) read with the Scotland Act 1998 sched 8 para 23(2), (3).

¹⁰⁸ Para 4.20 and proposal 5(a).

¹⁰⁹ 1986 Act s 84(3) read with Scotland Act 1998 sched 8 para 23(2), (3).

¹¹⁰ Para 4.22 and proposal 5(b).

¹¹¹ eg *Commissioners of Customs and Excise v John D Reid Joinery Ltd* 2001 SLT 588.

¹¹² A floating charge must be registered in the Companies Register within 21 days of execution: see Companies Act 1985 s 410. Unless, therefore, a receiver is appointed within the first 21 days of floating charge (which seems fanciful), there will always be prior notice of the charge.

into the certificate of non-crystallisation routinely made available at settlement, warranting by or on behalf of the chargeholder that no receiver has been appointed and that none will be appointed for a specified period such as seven days.¹¹³ This is a functional equivalent for floating charges of a deed of restriction in the case of standard securities, and no more inconvenient.¹¹⁴ Almost always it disposes of the problem. The acquirer registers within the stipulated period; no receiver is appointed; and the acquirer takes the property free of the floating charge. Some difficulties remain, however. The chargeholder may be reluctant to grant a certificate. The floating charge may attach as a result of liquidation and not receivership. Or settlement may be delayed at the last minute so that the certificate becomes out of date. The first would be unusual, at least in current practice; and the chargeholder's consent may in any event be necessary for other reasons, such as a negative pledge clause in the floating charge or a prohibition on alienation. Attachment by liquidation, as already noted, is uncommon. And where settlement is delayed, any difficulty is avoided by obtaining a fresh certificate, or a formal release from the floating charge. Nonetheless, taken together these difficulties reveal a problem which seems worth solving. That is the view expressed to us on behalf of the Law Society of Scotland, and in some of the commentaries on *Sharp v Thomson*.

4.34 In fact there are two distinct problems. One is absence of power in the directors following the appointment of a receiver, so that a deed granted by the directors and not by the receiver would be void. The other is the crystallisation of a floating charge before the acquirer is able to complete title by registration. These are considered in turn below. In a final section we discuss whether registration of the instrument of appointment should be a pre-condition of appointment of a receiver and crystallisation of the floating charge.¹¹⁵ At the outset it should be borne in mind that a legislative solution for Scotland could have no effect on floating charges granted by companies incorporated in England and Wales over property situated in Scotland, and so would be limited to that extent.¹¹⁶

4.35 **Pre-delivery receivership: absence of power in directors.** Once a receiver is appointed, the directors lose power to deal with the affected property.¹¹⁷ Hence if receivership occurs before settlement, the acquirer must take a deed from the receiver and not from the directors. The difficulty here is the two-week blind period mentioned earlier. It is possible to obtain a clear search in the Companies Register and yet for the granter-company to be already in receivership. An acquirer, in ignorance of the receivership, might accept a deed from, and pay, the directors. No doubt the practical risk is no greater than that already noticed in the context of liquidation, for the acquirer is likely to know of the receivership even where the Register is silent.¹¹⁸ In the event that this was not so, however, the position is, or ought to be, retrievable. An application under section 127 of the Insolvency Act (discussed earlier) would often be available where the attachment had occurred as a result of liquidation. In a case of attachment by receivership, the existing law fails to provide, and we suggest an adaptation of a solution already proposed in the context

¹¹³ For a style, see J H Sinclair, *Handbook of Conveyancing Practice in Scotland* (3rd edn, 1995) p 310.

¹¹⁴ The resemblance is stronger still if the certificate incorporates a formal release of the property from the floating charge. See McDonald, *Conveyancing Manual* para 35.18.

¹¹⁵ Paras 4.41 to 4.44.

¹¹⁶ *Gordon Anderson (Plant) Ltd v Campsie Construction Ltd* 1977 SLT 7; *Norfolk House plc (in receivership) v Repsol Petroleum Ltd* 1992 SLT 235.

¹¹⁷ J H Greene and I M Fletcher, *The Law and Practice of Receivership in Scotland* (2nd edn, 1992) paras 2.18 – 2.24; McKenzie Skene, *Insolvency Law* p 174.

¹¹⁸ Para 4.18.

of sequestration.¹¹⁹ During the blind period the directors should continue to have power to grant deeds in relation to any registrable property. More precisely, a deed delivered during this period would not be invalid only on the ground that it was executed or delivered¹²⁰ by the directors and not by the receiver. The period would begin with receivership itself and end seven days after registration of the instrument of appointment in the Companies Register. The seven days allows for the time lag between registration and appearance on a search.¹²¹ The relaxation would operate only in favour of acquirers for value and in good faith,¹²² so that an acquirer who knew of the receivership would have to deal with the receiver and not with the directors. The rule would extend to registrable intellectual property and to shares;¹²³ and in relation to uncertificated shares transferred under the CREST system, delivery of the deed would translate as the generation of an Operator-instruction requiring the issuing company to register the transfer.¹²⁴

4.36 Crystallisation. A floating charge may crystallise without the acquirer's knowledge even before settlement, as has just been seen. But the greater risk is of crystallisation during the period between settlement and registration of the acquirer's title, as occurred in *Sharp v Thomson*. The solution seems to lie in allowing a priority period for completion of title. A floating charge which crystallised during this period would affect third parties but not the acquirer (or those deriving title from the acquirer). The acquirer's deed, in other words, would take effect as if the floating charge had not attached. But the protection would vanish if the acquirer failed to register within the priority period. This is a development of a suggestion originally made by the Law Society of Scotland.¹²⁵ A parallel scheme was proposed earlier in the context of sequestration.¹²⁶ Similarly, English law operates a priority period in respect of the Land Registry.¹²⁷ A key issue is the length of the priority period. A period which is too long would remove the incentive to register and lead to some of the difficulties encountered with *Sharp*. But sufficient time must be given to allow an acquirer, acting with expedition and in accordance with normal conveyancing practice, to register his deed, bearing in mind that the deed may often need to be stamped.¹²⁸ The time must also be sufficient for non-land cases – for company shares or for registrable intellectual property. We suggest for consideration the 14 days allowed for registration by a "classic" letter of obligation. An acquirer who registered within 14 days of delivery would take free of the charge, whether it crystallised during the 14-day period or earlier, before settlement.¹²⁹ If,

¹¹⁹ Para 4.10 and proposal 4(a).

¹²⁰ It is arguable that a deed executed by the directors before receivership remains valid thereafter and could be delivered by the company's law agents. But our suggested rule would apply whether the execution took place before or after the receiver was appointed.

¹²¹ Para 3.25.

¹²² Paras 3.20 to 3.22.

¹²³ Paras 3.13 and 3.14.

¹²⁴ Uncertificated Securities Regulations 1995 (SI 1995/3272) reg 25(2). Other electronic conveyances are likely in the future, not least in relation to land: hence the wide definition of "deed" in proposal 6(d) below.

¹²⁵ More precisely, by a sub-committee set up by the Conveyancing Committee to consider the problems arising out of *Sharp v Thomson*.

¹²⁶ Para 4.9 and proposal 4(b). The nature of sequestration leads to differences of detail, but the underlying policy is the same.

¹²⁷ Following an official search in the Land Registry the acquirer has 30 working days in which to register. Any other entry on the register made during this priority period is postponed to the acquirer's right. See eg Robert Abbey and Mark Richards, *A Practical Approach to Conveyancing* (2nd ed, 2000) p 244.

¹²⁸ For possible delays in the return of deeds from the Stamp Office, see Linsey Lewin & Stewart Brymer, "Stamping of Deeds: Practical Update" (2001) 51 *Greens Property Law Bulletin* 3 and (2001) 46 *JLSS* June/8.

¹²⁹ In *Sharp v Thomson* the disposition was delivered on 9 August and registered on 21 August. The floating charge crystallised on 10 August.

however, it crystallised by receivership¹³⁰ more than a few days before settlement, then, under the proposal made earlier, the deed itself would be void unless it was granted by the receiver (which *ex hypothesi* would not be the case).¹³¹ As with the parallel proposal for sequestration, therefore, the effective protected period is around 21 days (7 days before settlement and 14 after).

4.37 The protection would extend to any right in land or other property (including intellectual property and shares) the title to which is completed by registration; and it would apply to original grants, such as standard securities, as well as to deeds of transfer, variation and discharge.¹³² As usual, the acquirer must give value.¹³³ But there is no reason to insist on good faith once the deed is delivered, for in insolvency every creditor must look out for himself.¹³⁴

4.38 The protection would be deed-based rather than property-based. The property would be duly attached by the charge, but the charge could not then be pled against the grantee of a qualifying deed which was registered during the 14-day period. An example illustrates. Suppose that a company concludes missives for the sale of land. On day 1 the transaction duly settles and a disposition is delivered against payment of the price. On day 7 a receiver is appointed to the company and a floating charge crystallises. On day 9 the disposition is registered in the Land Register. The effect of the rule would be for the charge to attach the land on day 7 but to release it again on day 9, on registration of the disposition. If the disposition had not been registered until day 16 (ie outside the 14-day priority period) there would be no release. The position is much the same if the deed is a standard security. On day 7 the charge would rank as the only fixed security. On day 9 (in the absence of a ranking agreement to the contrary) its ranking would be postponed to the standard security.¹³⁵ A further deed granted in relation to the same property at around the same time but which failed to qualify for protection would be subject to the floating charge from day 7.

4.39 In putting forward this rule we are conscious of its imperfections. A rule which is deed-based and not property-based carries the (largely theoretical) risk of circles of priority in the event that one standard security qualifies for protection and another prior-ranking security does not. Further, the rule supposes that the receiver must wait for 21 days after registration of his appointment before he can be sure that there are no qualifying deeds which would defeat the floating charge. Nevertheless the rule seems better than possible

¹³⁰ If it crystallised by liquidation prior to settlement, the deed would usually be void unless revived by the court under s 127 of the 1986 Act.

¹³¹ Para 4.35. If it was in fact granted by the receiver, the deed would be valid and the acquirer would take free of the floating charge.

¹³² Paras 3.13 to 3.15. Uncertificated shares are held on a constructive trust for the acquirer once an Operator-instruction is generated requiring the issuer to register the transfer. See The Uncertificated Securities Regulations 1995 (SI 1995/3272) reg 25(2). Arguably this would protect the acquirer in the event of supervening crystallisation, although our proposed rule would still be needed if crystallisation pre-dated the Operator-instruction. The constructive trust covers the interval between the instruction being generated and its being given effect to by registration in the issuer's register of members. In due course the system is to be altered to allow the register of members to be part of the CREST records, thus eliminating the delay and the need for a constructive trust. This is known as electronic transfer of title (ETT). See a consultation document by H M Treasury on *Modernising Securities Settlement* (Feb 2001). Note that the equivalent protection for transfers in the financial markets does not extend to floating charges and receivership: see The Financial Markets and Insolvency (Settlement Finality) Regulations 1999 (SI 1999/2979) reg 14(1).

¹³³ Para 3.22.

¹³⁴ Para 3.21.

¹³⁵ Companies Act 1985 s 464(4)(a).

alternatives. A rule which was property-based would give priority in undeserving cases; and a period of waiting for the receiver seems an unavoidable feature of any scheme designed to give priority to an acquirer.

4.40 **Proposal.** We invite views on the following proposal:

6. (a) **This proposal applies where –**
 - (i) **by deed a company creates, transfers, varies or extinguishes a right in land or other property;**
 - (ii) **the deed is granted for value;**
 - (iii) **the creation, transfer, variation or extinction requires to be completed by registration; and**
 - (iv) **prior to registration a floating charge attaches to the property.**
- (b) **A deed delivered during the period beginning with the date of appointment of a receiver and ending seven days after the registration of the instrument of appointment in the register of charges should not be invalid only because it was executed or delivered by or on behalf of the directors of the company; provided that at the time of delivery the acquirer did not know that a receiver had been appointed.**
- (c) **A deed registered within 14 days of delivery and otherwise valid should take effect as if the floating charge had not attached.**
- (d) **In this proposal, "deed" means –**
 - (i) **any written document which creates, transfers, varies or extinguishes rights, and**
 - (ii) **any electronic equivalent of such a document.**

4.41 **Registration and crystallisation.** One aspect of the law of floating charges to attract particular criticism, following *Sharp*, is the rule that receivership, and hence crystallisation, occur without registration. This breaches the principle that real rights are created by registration or equivalent publicity.¹³⁶ It is true that the instrument of appointment or decree is directed to be registered within seven days, but the sanction is a fine and not invalidity of the attachment; and registration does not mark the commencement of receivership.

4.42 The issue of registration was controversial even before the introduction of receivership to Scotland in 1972. In its *Report on the Companies (Floating Charges) (Scotland) Act 1961*, published in 1970, this Commission argued that receivership should depend on registration:¹³⁷

¹³⁶ For this "publicity principle" see para 2.11.

¹³⁷ Scottish Law Commission, *Report on the Companies (Floating Charges) Act 1961* (1970, Cmnd 4336) para 51.

"We think it undesirable that a creditor should be permitted to appoint a receiver and hold the instrument unpublished for a period, even a short period. We consider that an important procedural step such as the appointment of a receiver should be effective when, and only when, it is made available for publication to all who may be affected by it."

Accordingly, in the draft Companies (Floating Charges and Receivers) (Scotland) Bill included in the *Report* provision was made for the Registrar of Companies to issue a certificate of appointment of the receiver following receipt of the instrument of appointment. In terms of clause 13(5):

"... the receiver shall be held to be appointed as such only when the registrar issues a certificate of appointment in accordance with subsection (4) of this section."

This provision was not, however, included in the legislation passed by Parliament in 1972.

4.43 The issue was reviewed again, for England and Wales as well as Scotland, by the Cork Committee in 1982. In its report the Committee agreed with this Commission¹³⁸

"that the present practice is unsatisfactory and gives rise to complaints, but we think that to use the date of registration or filing would introduce an element of uncertainty and would also be unacceptable because speed in appointment is frequently essential."

4.44 We remain of the view that registration should be required for receivership and attachment unless there are compelling reasons to the contrary.¹³⁹ But while such a rule would have the welcome effect of reducing the blind period for receiverships, and hence the scope of our proposal to give protection in the event of pre-delivery receivership,¹⁴⁰ it is not a necessary part of the solution to the problem of *Sharp v Thomson*. We would welcome the views of consultees nonetheless. If, as we imagine, it would be possible to register the instrument of appointment on the day on which it is executed, it is difficult to see why there should be difficulties of uncertainty and delay of the kind described by the Cork Committee. At this stage, however, we make no formal proposal but merely ask:

7. Should receivership (and consequent crystallisation) take effect only on the day on which the instrument of appointment or interlocutor is registered with the Registrar of Companies?

¹³⁸ *Insolvency Law and Practice* (1982, Cmnd 8558) para 472.

¹³⁹ Whether, as originally proposed, the Registrar of Companies should issue a certificate of appointment is a separate matter. This may place an unreasonable burden on the Registrar, as has recently been argued in the context of certificates of registration of charges. See Company Law Review Steering Group, *Modern Company Law for a Competitive Economy (7): Registration of Company Charges* (URN 00/1213, October 2000) paras 3.12 to 3.29.

¹⁴⁰ Proposal 6(b) above. In the event that registration was to be required, the proposal would begin: "A deed delivered during the 7 days following the appointment of a receiver ..."

Inhibition

4.45 With inhibition we move from insolvency processes to diligences affecting heritable property.¹⁴¹ Inhibitions are widely used and are familiar to every conveyancer. In the year 2000 alone there were 3,422 inhibitions.¹⁴² An inhibition takes effect only on registration in the Register of Inhibitions and Adjudications (ie the personal register). Once registered it restrains the person inhibited from granting a voluntary deed in respect of heritable property; but a disposition in implement of pre-inhibition missives of sale is not voluntary in this sense.¹⁴³ In practice, therefore, an acquirer settling a transaction which implements a prior contract will have ample notice, from a search of the personal register, of any inhibition which is capable of affecting the deed being delivered. Our recent *Report on Diligence* contains recommendations to protect a *bona fide* acquirer if a search in the register has failed to uncover a subsisting inhibition.¹⁴⁴ We have no further proposals for reform here.

Land attachment

4.46 One of the main recommendations of our *Report on Diligence* is that adjudication be replaced by a new heritable diligence known as land attachment.¹⁴⁵ The new diligence is designed to avoid the problems exposed by *Sharp v Thomson*. Following an expired charge, the creditor completes his right by registration in the property register of a notice of land attachment. At first the only effect is to make the land litigious, so that the debtor is prevented from granting a voluntary deed such as a disposition or standard security. In substance this is a property-specific inhibition. The prohibition lasts for 14 days. Thereafter the land attachment becomes a real right in security for payment of the debt: the debtor is free to sell, but the property would be subject to the security.¹⁴⁶ This two-stage structure is intended to protect potential acquirers. Almost always the land attachment will appear from a search in the property registers. In that case the acquirer is forewarned and can make the necessary arrangements with both debtor and creditor.¹⁴⁷ If, however, the search is clear the acquirer knows either that there is no land attachment at all (the probable situation), or that any land attachment is so recent that it will be defeated by registration of the acquirer's deed within the 14-day litigiosity period. That deed would not itself be affected by the litigiosity provided that it implemented a prior contract such as missives of sale. A land attachment registered after delivery of the deed but before registration would likewise be defeated by registration during the period of litigiosity.

4.47 In only one respect has our current work caused a reconsideration of the scheme for land attachments. The period of 14 days presupposes that the search exhibited at settlement will be up-to-date whereas in practice, as we have seen, there may be a time lag of up to a week.¹⁴⁸ We suggest therefore that

¹⁴¹ Diligence affecting other types of property is beyond the scope of the present exercise: see para 3.15.

¹⁴² Para 4.1.

¹⁴³ Gretton, *Inhibition and Adjudication* chap 6.

¹⁴⁴ Scot Law Com No 183 paras 6.102 – 6.136.

¹⁴⁵ Scot Law Com No 183 part 3.

¹⁴⁶ Scot Law Com No 183 paras 3.51 – 3.60.

¹⁴⁷ Scot Law Com No 183 paras 3.130 – 3.132.

¹⁴⁸ Para 3.25.

8. **If a new diligence of land attachment is introduced in place of adjudication, the initial period of litigiosity following registration of a notice of land attachment should be 21 days (and not 14 days).**

This would bring land attachments into line with our proposals for sequestration and floating charges.¹⁴⁹

Adjudication

4.48 If land attachment is not introduced, or its introduction is delayed, some provision will be needed for adjudication. Adjudication is uncommon. Adjudication is competent in execution, following a decree of payment or equivalent. The procedure involves a Court of Session action. Once decree is obtained, it is extracted and registered in the property register whereupon the adjudication takes effect as a real right in security for payment of the debt. In practice prior warning is usually given by a notice of litigiosity registered in the personal register,¹⁵⁰ but such a notice is not mandatory and in its absence an acquirer could be caught out by an adjudication which was not disclosed in the search. A possible solution would be to make a notice of litigiosity a mandatory part of the procedure; but this would require careful consideration of issues such as time periods, linkage between the notice and the adjudication, and whether a notice, overlooked earlier, would be competent once decree had been granted. An altogether simpler approach is to follow the rule discussed above for land attachments. This would mean that, for a period of 21 days after registration, an adjudication would merely operate to make the land litigious. Only once that period had elapsed would it become a right in security, as under the present law. Such a rule would help an acquirer without causing undue hardship to the creditor, who would have the protection of litigiosity against any voluntary deeds granted by the debtor. Our proposal therefore is that

9. **If a new diligence of land attachment is not introduced in place of adjudication, registration in the property register of an extract decree of adjudication should –**
 - (i) **render the land litigious for a period of 21 days, and**
 - (ii) **on the expiry of that period (only), confer on the creditor a real right in security.**

¹⁴⁹ Proposals 4(c) and 6(c).

¹⁵⁰ Gretton, *Inhibition and Adjudication* p 211. The notice is known as a notice of summons of adjudication.

- (i) by the permanent trustee in sequestration, or
- (ii) by any person deriving title from the permanent trustee.

(Paragraph 4.10)

5. (a) A petition for the winding up of a company by the court should, on presentation, be notified forthwith by a clerk of court to

- (i) the Registrar of Companies and
- (ii) the Accountant in Bankruptcy.

(b) The period of 15 days allowed by section 84(3) of the Insolvency Act 1986 for the forwarding of a copy of a resolution for the voluntary winding up of a company to the Registrar of Companies and Accountant in Bankruptcy should be replaced by an obligation on the company to forward the resolution forthwith.

(c) The period of 14 days allowed by section 109(1) of the Insolvency Act 1986 for a liquidator in a voluntary winding up to give notice of his appointment to the Accountant in Bankruptcy should be reduced to a period of 7 days.

(d) Section 25 of the Titles to Land Consolidation (Scotland) Act 1868 (deduction of title by liquidator) should be repealed.

(Paragraph 4.26)

6. (a) This proposal applies where –

- (i) by deed a company creates, transfers, varies or extinguishes a right in land or other property;
- (ii) the deed is granted for value;
- (iii) the creation, transfer, variation or extinction requires to be completed by registration; and
- (iv) prior to registration a floating charge attaches to the property.

(b) A deed delivered during the period beginning with the date of appointment of a receiver and ending seven days after the registration of the instrument of appointment in the register of charges should not be invalid only because it was executed or delivered by or on behalf of the directors of the company; provided that at the time of delivery the acquirer did not know that a receiver had been appointed.

(c) A deed registered within 14 days of delivery and otherwise valid should take effect as if the floating charge had not attached.

- (d) In this proposal, "deed" means –
- (i) any written document which creates, transfers, varies or extinguishes rights, and
 - (ii) any electronic equivalent of such a document.
- (Paragraph 4.40)

7. Should receivership (and consequent crystallisation) take effect only on the day on which the instrument of appointment or interlocutor is registered with the Registrar of Companies?

(Paragraph 4.44)

8. If a new diligence of land attachment is introduced in place of adjudication, the initial period of litigiosity following registration of a notice of land attachment should be 21 days (and not 14 days).

(Paragraph 4.47)

9. If a new diligence of land attachment is not introduced in place of adjudication, registration in the property register of an extract decree of adjudication should –

- (i) render the land litigious for a period of 21 days, and
- (ii) on the expiry of that period (only), confer on the creditor a real right in security.

(Paragraph 4.48)