Scottish Law Commission

CONSULTATIVE MEMORANDUM NO. 72

Floating Charges and Receivers

OCTOBER 1986

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The Commission would be grateful if comments on this Consultative Memorandum were submitted by 31 March 1987. All correspondence should be addressed to:-

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Note In writing its Report with recommendations for reform, the Commission may find it helpful to refer to and attribute comments submitted in response to this Consultative Memorandum. Any request from respondents to treat all, or part, of their replies in confidence will, of course, be respected, but if no request for confidentiality is made, the Commission will assume that comments on the Consultative Memorandum can be used in this way.

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PART I - GENERAL INTRODUCTION AND SCOPE OF CONSULTATIVE MEMORANDUM

1.1 In this Consultative Memorandum we consider criticisms of, and possible reforms in, the legislation relating to floating charges in Scotland. We are concerned in particular with the statutory basis upon which a floating charge is enforced on its attachment as a fixed security and with the statutory procedures originally enacted in the Companies (Floating Charges and Receivers) (Scotland) Act 1972 ("the 1972 Act") for the enforcement of an attached floating charge through the mechanism of a receiver. We are not concerned in this Consultative Memorandum with the provisions for the registration of floating charges and other charges with the Registrar of Companies. We have for practical reasons which we explain below approached the reform of the present statutory provisions on the basis that the concept of the floating charge as such should be retained and that the particular mechanism of receivership should similarly be retained.

1.2 In December 1976 we issued a Consultative Memorandum on the Registration of Charges in Scotland as a result of a proposal by Dr Enid Marshall that we should consult on that topic. Dr Marshall's proposals were made in the context of apprehension as to the appropriateness, in a Scottish context, of proposals made in a Companies Bill introduced in the 1974 Parliament but which subsequently

lapsed, for amendments of a technical nature to the registration provisions contained in the then Companies Act. The provisional proposals which we set out in our Consultative Memorandum were similarly concerned with rather particular drafting aspects of the statutory provisions relating to registration.

1.3 Although our Consultative Memorandum in 1976 was primarily concerned with the registration of charges we took the further opportunity to invite our consultees to comment on any difficulties which had arisen in relation to floating charges as a whole and we received some useful comments from consultees on that wider issue. In 1982 a further initiative was taken as regards those wider issues when an expert Working Party was set up to examine and report to us on the operation of the receivership provisions in the 1972 Act. The immediate background to that initiative, which arose out of one of the regular series of meetings which we have with the Law Society of Scotland and the Faculty of Advocates, was concerned with the outcome of the two initial cases in which the Courts had been required to interpret a competition between a receiver appointed by a floating charge holder and other creditors claiming rights against the assets attached. The concern with the decisions in the relevant cases, each of which was concerned with a competition involving set off of charged book debts, arose because it was thought that they were not only inconsistent with each other but might not properly give

effect to the fundamental "statutory hypothesis" underlying the whole legislation whereby a floating charge on its attachment operates as if it were a fixed security under the general law. Although it was appreciated that subsequent case law might give (as we think in the event it has done) a clear and authoritative interpretation of the working of this statutory hypothesis it was thought appropriate to set up a Working Party which could also investigate the practical working of the provisions of the 1972 Act generally against the background of the first decade of its operation: a decade in which, by virtue of the widespread use of general floating charges as a security instrument, receivership had become the dominant procedure for the conduct of the affairs of insolvent companies. The membership of the Working Party ("the Joint Working Party") was made up of representatives of the Law Society of Scotland, the Faculty of Advocates and the Institute of Chartered Accountants, from whose members receivers are in practice invariably drawn. Professor R B Jack, who had also acted as a Scottish observer on the Cork Committee (to which we refer below) acted as its Chairman. In this Memorandum we have drawn to a considerable extent on the Joint Working Party's work on the current law and practice and we are most grateful to it for this work. We have also drawn upon the results of the previous consultation on the Consultative Memorandum issued in 1976 and on the extensive learned literature on the topic of floating charges.

1.4 In 1977 the Secretary of State for Trade set up a Departmental Committee under the chairmanship of Sir Kenneth Cork ("the Cork Committee") with wide terms of reference which comprised a review of the whole law and practice relating to insolvency and receivership in England and Wales. The Cork Committee reported in 1982[1] and the Department of Trade and Industry subsequently issued a White Paper entitled "A Revised Framework for Insolvency Law"[2] in which it set out proposals for legislation to implement certain recommendations of the Cork Committee. Although the latter had been concerned solely with England and Wales the White Paper stated that certain legislative proposals relating to corporate insolvency, and the introduction of a new procedure for administration orders relating to companies, should extend, subject to appropriate modifications, to Scotland. The Insolvency Act, which received the Royal Assent on 31 October 1985[3], accordingly contains certain provisions relating to the conduct of receiverships in Scotland and introduces the new administration orders to Scotland. The provisions in the Act relating to receivership are of a procedural nature. The provisions relating to administration orders are quite distinct from receivership as such, although they provide a useful point of comparison with receivership as a process.

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1 Cmnd. 8558.

2 Cmnd. 9175.

3 Although we make references throughout the Memorandum to the Insolvency Act 1985 the majority of its provisions are not yet in operation. See section 236(2) for the commencement provisions.

1.5 The Cork Committee made some significant proposals in relation to floating charges which were not in the event developed in the White Paper. We think however, in view of the publicity which the Cork Committee proposals received and the influence which they may continue to have in any general discussion of floating charges, that we should emphasise the distinction between the objectives of the Cork Committee and our own objectives in this Memorandum. The Cork Committee was concerned to review insolvency provisions and creditors' rights generally and it considered security instruments in that very wide perspective. Our concern is solely with a particular type of security, namely the floating charge, and its operation in a Scottish context. Moreover, we think it is only realistic to deal with the issues prompted by the legislation on the basis that the floating charge concept should continue to be accepted and that the receivership concept should similarly continue to be accepted. We think it significant that the Cork Committee, although it had much to say about floating charges in the context of its wider concern with the economic effects of security instruments, nevertheless came to the conclusion that the floating charge "had become so fundamental a part of the financial structure of the United Kingdom that its abolition cannot be contemplated". The Joint Working Party for their part reached the conclusion that it was similarly not realistic to envisage the removal of the power presently available to the holder of a floating charge in Scotland to appoint a receiver. We have therefore approached our task on the basis that any change to the legislation should be consonant with the retention of the integrity of the concepts of a floating charge and receivership.

We have accordingly sought to avoid criticism of the existing legislation which can on analysis be seen to be criticism of the floating charge concept rather than of the legislation itself.

1.6 Since we proceed in the Memorandum on the basis that the concepts of the floating charge and of the receivership as its enforcement mechanism should be accepted, it may be helpful if we explain at the outset and in a very summarised fashion what in essence we believe to be implicit in that acceptance. We think it entails acceptance of the following three propositions.
First, the introduction of the floating charge into Scots law means that Scots law recognises the existence of a security instrument which, as created, cannot usefully be analogised to anything in the general law of securities but which, when it is given operative effect following its attachment, operates so as to confer on the charge holder the incidents and privileges of the holder of a fixed security under that same general law.
Second, the potential rights which are so conferred on the holder of a floating charge may extend over the whole assets, present or future, corporeal or incorporeal, of a debtor company, or over any part of those assets.
Third, although the rights of the holder of a floating charge which has attached cannot be directly enforced by the security holder at his own hand, they are enforced by a procedure which operates at his behest and which is in no sense an insolvency process carried out on behalf of creditors generally.
It will be seen, from what we say above, that we recognise that although the rights accorded to the holder of an attached floating charge will be equivalent <u>in kind</u>

to those of the holder of a fixed security under the general law they may be very different in degree to those available to the holder of a security which is constituted as a fixed security ab initio. The rights may, for example, extend over the whole range of the assets and undertaking of a company, and they may extend to assets, such as corporeal moveables or the generality of a company's debts receivable, which, as a practical matter, could not normally be comprised within a fixed security. We also recognise that the mechanism by which this comprehensive form of fixed security is enforced, though it may supplant insolvency processes for practical purposes, is not designed to be a substitute for or equivalent to insolvency processes such as liquidation or the new administration order procedure.

1.7 In describing the broad incidents of the operation of a floating charge following its attachment we emphasise the extent to which it operates in a manner analogous to a fixed security under the general law. The emphasis may seem unnecessary, but we think it worth making if only to counter the view that acceptance of the floating charge concept means, in a Scottish context, acceptance of a concept which by its nature cannot be made to co-exist with the general law. It can indeed be said that a floating charge, while it subsists as a floating charge prior to its attachment, cannot properly be analogised to any security known to the general law. But the question of practical significance is not what a floating charge is but how a floating charge operates; and when it operates, following attachment, it does so, by virtue of a statutory deeming provision, in a way which can be analogised to, and interpreted by, the

general law on fixed securities. This point has been robustly reaffirmed in Forth and Clyde Construction Co. Ltd. v. Trinity Timber and Plywood Co. Ltd.[1] ("the Forth and Clyde case") in which the court was concerned to explain the basis upon which the statutory deeming provision works. It is true that in that case the court was careful to explain that because of the sophistication arising from the statutory agency of a receiver for the debtor company itself an attached floating charge cannot be equiparated in a literal way to a fixed security; but at the same time the court quite clearly rejected the argument that the rights conferred upon the holder of an attached floating charge in competition with other creditors were rights of a different kind to those conferred upon the holder of a fixed security under the general law.

1.8 We recognise however that if the statutory scheme for floating charges is to hinge upon the concept that such charges when they attach operate as if they were fixed securities, the legislative techniques used to express this concept must be such as will give clear guidance as to how this statutory hypothesis should operate, in all the circumstances where the holder of a floating charge may come into competition with the claims of other creditors. We are therefore particularly anxious to receive, in response to the specific questions expressed below, views from consultees on whether the existing statutory language gives sufficiently clear guidance as to the basis upon which such competition should be resolved.

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1 1984 S.L.T. (Reports) 94.

1.9 When we refer above to a floating charge being worked out in the context of the general law we have in mind the general law relating to security rights. It should however be remembered that the working out of a floating charge in the course of a receivership impinges upon matters which go far beyond the law of security rights. Receivership will usually involve the management of the whole undertaking of a company, and the disposal of its whole assets. It may very well involve a preliminary restructuring of a company in order to facilitate that disposal. Such activities will necessarily have consequences for the employees of the company and for all who contract with it or have claims against it. The activities of a receiver, accordingly, must be set in the context of commercial law as a whole and in particular the provisions, sometimes extremely technical, of fiscal and employment law. The possibility always exists that reform of the statutory provisions relating to receivership as such may be important in areas such as taxation or redundancy. We may perhaps illustrate this aspect by reference to the statutory agency of a receiver under the existing legislation. That statutory agency is in some respects a complex and elusive concept. But reformulation of the existing statutory language could have consequential effects in relation to the working of other provisions such as the Transfer of Employment Regulations or the provisions of the Taxes Act relating to the reconstruction of a trade which would be of immense economic significance to receivers. Receivership may without exaggeration be described as an industry as well as a procedure and we have borne this factor in mind.

1.10 The Consultative Memorandum is divided into two parts. The first Part (Part II) concerns the floating charge, and consequently the provisions of Part I of the 1972 Act. It covers the basic statutory deeming provisions as judicially interpreted; their application in relation to property which may be acquired by a debtor company subsequent to the attachment of the charge ("acquirenda"); and competition generally between the floating charge holder and the other creditors. We also put forward in this section miscellaneous proposals for the purpose of clarifying the nature of a floating charge, and for overcoming certain drafting difficulties arising from the current statutory provisions. The second part (Part III) identifies problems which have arisen with the introduction of receivers into our law by Part II of the 1972 Act. We consider whether the receiver owes any duty to others in the fulfillment of his functions. We examine also his relationship to the directors or the liquidator of the debtor company and once again we submit miscellaneous proposals for the clarification and expansion of the existing statutory provisions. We conclude our Consultative Memorandum with a Summary of Questions and Options on which we would welcome observations.

1.11 The Companies Act 1985 ("the 1985 Act"), except as provided by section 243(6) thereof, came into operation on 1 July 1985, and consolidated the greater part of the earlier Companies Acts, including the Companies Act 1948 ('the 1948 Act') and the 1972 Act. The existing case law relating to floating charges and receivers, however, to which we make frequent reference throughout the Consultative Memorandum, reviews the provisions of the

1948 Act and the 1972 Act. Accordingly, where we refer in the Consultative Memorandum to statutory provisions relating to floating charges and receivers, for the assistance of consultees we have added where appropriate in square brackets reference to the corresponding provision of the 1948 Act, the 1972 Act, or 1985 Act, as the case may be.

1.12 The Insolvency Act 1986, consolidates inter alia certain provisions of the 1985 Act and the Insolvency Act 1985. As the 1986 Act only received Royal Assent at a very advanced stage of this exercise and is not yet in force we have made no reference to its provisions in this Memorandum.

PART II - THE FLOATING CHARGE

1. The effect of attachment of the floating charge

(i) Introduction

2.1 In the introductory chapter, we identify the two fundamental innovations in the floating charge concept as being:-

1. The notion that what is created as a floating charge comes to be regarded as a fixed security on its attachment and enforcement.
2. The nature of a floating charge as a global security which can extend to future as well as presently identifiable assets.

2.2 We think it appropriate therefore to begin by considering, against the background of the case law, how the legislation has succeeded in its task of giving expression to those innovations in such a way that they can co-exist with the general law. We are concerned in this context to analyse the legal characteristics which the case law has attributed to the security interest which arises on the attachment of a floating charge. We are also concerned to analyse how the enforcement mechanism of receivership, a further innovation superimposed in its turn upon the previous innovations, affects those legal characteristics. In this connection, we look first at the Forth & Clyde case in which the "statutory hypothesis" on which the floating charge creditor's security interest depends received, for the first time, an authoritative judicial analysis. We then

consider the recent decision in Ross v. Taylor[1] which examines the scope of a floating charge as a global security and, more particularly, the capacity of a floating charge to attach to assets which may not come into existence until after its attachment. Consideration of the latter aspect then leads us to consider special categories of assets such as reduced preferences and diligences which may be thought to have characteristics which suggest that they cannot, or ought not to, be attached even by a global security such as a floating charge.

The Forth and Clyde case

2.3 In his book "The Law of Scotland Relating to Debt", which was published in 1981, Professor W.A. Wilson observed that the "statutory hypothesis" (his own phrase which we have adopted in this Memorandum) by which a floating charge on its attachment is made to take on the character of a fixed security had received little examination.[2]

2.4 He went on to point out that it remained to be seen how the incidents of a fixed security could be made to attach to corporeal assets despite their not having been delivered, or could be made to attach to incorporeal rights despite their not having been assigned. Those unanswered questions were considered in the Forth and Clyde case.

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1 1985 S.L.T. (Reports) 387.

2 P. 142.

2.5 The precise issue which fell to be decided in that case was a competition between the claim of a floating charge creditor to attach a debt due to the debtor company at the date of appointment of a receiver and the claim of an arrester who had arrested the same debt after the date of appointment of the receiver.

2.6 The argument for the arrester took as its starting point the fact that the receiver's statutory status was that of an agent for the company and that the title to the relevant debt must be taken to have remained with the company. Against that background, it was argued that any security interest in the debt arising on attachment could not have the characteristics, in a competition with another creditor such as an arrester, of an assignation in security created under the general law. While, it was said, it might be characterised as a fixed security right sui generis, it could not be characterised as a security right equivalent to an intimated assignation in security, and hence it could not displace the claim of an arrester to a debt of the company. The argument by the arrester was not related to any specific characteristic of arrestment of debts but was quite general in its terms:-

> "All that section 13(7) [now section 469(7) of the 1985 Act] does is to grant to the holder of the floating charge a new kind of security in a wholly general form known as a 'fixed security', the effect of which is not to be measured, in the case of any particular form of property which has been attached, by reference to the kinds of 'effective securities' which would be recognised by the law as appropriate to that form of property."

2.7 This argument that the statutory fixed security right arising on attachment of a floating charge should not be regarded as having the effect of an actual fixed

security under the general law was firmly rejected by the court. The court held that a floating charge creditor must be given the same privileges in respect of his attached charge as he would have received had he been the holder of a fixed security over the relevant debt under the general law. At the same time, however, the court took pains to emphasise that such recognition of the floating charge creditor's priorities did not involve any literal equiparation of the statutory fixed security to an actual fixed security. The court accepted that the legal title to the debt remained in the company (which was in fact the petitioner in the case); that the receiver appointed by the creditor in the floating charge was a statutory agent for the company; and that no actual assignation or other divestment of the debt to the receiver or the creditor had occurred. The court explained its acceptance of those factors in the following way:-

> "It is, of course, the case that the Act has not expressly provided that book debts shall be regarded as having been assigned in security to the holder of the floating charge on the date upon which it attaches to them but the language of s. 13(7) makes it quite clear that the attachment is to have effect 'as if' such an assignation in security had been granted and intimated by the company. From the date of the appointment of a receiver the company, no doubt, retains the title to demand payment of the debt but no longer for its own behoof."
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> "The interest in the recovery of the debt is that of the holder of the floating charge, and a receiver who seeks recovery in name of the company does so in order to secure the application of the recovered sum towards the satisfaction of the company's debt due to the creditor in the floating charge."

2.8 The significance of the Forth & Clyde case in our view is twofold. First, it explains the statutory hypothesis against the particular background of the statutory mechanism, whereby a floating charge creditor enforces his security through a receiver who acts as agent for the company. Second, it provides a foundation whereby a general scheme of priorities can be constructed for application as between a receiver and a creditor seeking to assert a diligence, or claim of set off. It can be seen in the light of the case that although the statutory fixed security which emerges on attachment of a floating charge does not involve an assignation (in the case of an incorporeal moveable) or delivery (in the case of a corporeal moveable) it can nonetheless be made to work as an effective security because the receiver is deemed to be in the same position as he would have been had he been an assignee, or a pledgee, or the grantee of a heritable security. As Lord Emslie put it:-

> "By the language of s. 13(7) one is, in my opinion, driven to ask, in attempting to define the effect of the attachment of particular property, what kind of security over that property, other than by way of diligence, would be treated by the law of Scotland on the winding-up of the company in this jurisdiction as an 'effective security' ... It follows, accordingly, that in the case of an attached book debt one can only reasonably discover the effect of the attachment by treating it as if there had been granted in relation to it the only relevant 'effective security' known to the law, namely an assignation in security, duly intimated. To adopt any other approach would in my opinion deprive the holder of the charge of the advantages which would be enjoyed by the holder of an 'effective security', recognised by the law, over each and every form of property attached by the charge."

2.9 It can be seen therefore that the statutory hypothesis to which Professor Wilson referred is not merely a convenient phrase but is an exact reflection of the legal process whereby what is created as a floating charge changes in its effect to the equivalent of a fixed security.

2.10 The incidents of the floating charge on its conversion, however, are conferred not by any disposition to or vesting in the receiver or the floating charge holder but by deeming the latter, as a creditor, to have the same priorities as he would have done had there been an appropriate form of fixed security in his favour over each category of charged asset. As we point out below, the early case law on the competition between a receiver and a creditor of the insolvent company did not succeed in explaining the apparent conflict between the claim of a floating charge holder on the one hand to have a fixed security over assets, and the actuality on the other hand that the company was not divested of the legal title to those assets. The Forth & Clyde case however now serves in this context as a general point of reference and we revert to it below in considering the various kinds of competitions between a receiver and third parties on the enforcement of a floating charge.

2.11 Commentators such as Mr. G.L. Gretton have argued with some trenchancy that the present legislation does not provide a satisfactory basis for the co-existence of floating charges with the general law.[1]

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1 See for example Mr Gretton's Articles in 1984 S.L.T. (News) 172 (where he refers to "genetic incompatibility") and in 1984 J.B.L. 344.

This type of criticism, however, appears to us on analysis to be directed against the introduction of the floating charge as such rather than at the legislative techniques used to effect that introduction. We, on the other hand, as pointed out in the introductory part of this Memorandum, seek to criticise the legislation from the standpoint that as a practical matter the floating charge concept should be retained. We think it important also to emphasise that criticism of the judicial interpretation of the legislation must, if it is to be fair, have regard to the nature and objectives of the legislation which the judges are obliged to interpret. In particular it must have regard to the fact that the relevant legislation is specifically designed to create, by statutory deeming provisions, situations which the common law itself could not accommodate. One may take, as an example, the criticism which has been made by Mr Gretton himself of the court's description of the debtor company in the Forth & Clyde case as continuing to hold the title to its assets in trust for behoof of the floating charge creditor.[1] That description has been criticised for being impliedly at odds with conventional notions. But the court was not concerned to produce a formulation in terms of conventional notions. It had to paraphrase a wholly unconventional statutory concept: the concept that a receiver is an agent, not for the floating charge creditor, but for the debtor company itself.

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1 G.L. Gretton "Receivers and Arresters" 1984 S.L.T. (News) 177.

2.12 While we offer in the Memorandum many particular suggestions for change or clarification in the legislation we do not think that there is evidence of any fundamental problem as regards the ability of the legislative techniques to co-exist with the surrounding general law and we think that the courts have been able to provide a robust and workmanlike explanation of the legislation where it confronts this problem. We think that Professor Halliday's comment on the root and branch criticism of the legislation is a just one:

> "It is entirely understandable that judges, vexed by the extremely awkward problems thus devolved upon them, should criticise the structure of the legislation, but, although there may be room for difference of view upon particular decisions, I think it has been a difficult task which on the whole has been ably discharged by our judiciary and that justice has probably been achieved in individual cases with more certainty than would have resulted from an ab ante attempt by parliamentary draftsmen to provide for all possible problems of integration. If I may quote a relevant testimonial from one of my Glasgow[1] clients of many years ago: 'Judges are no' daft'."

The Ross v. Taylor case

2.13 The facts and the reasoning in Ross v. Taylor provide a striking illustration of the import of the floating charge as a global security, capable of extending to future assets however and whenever arising. The background facts in the case were rather special. A receiver, appointed to a company under a typical general floating charge which was expressed so as to comprise "the whole of the property from time to time comprised in the company's undertaking" ("an all assets floating

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1 1984 S.L.T. (News) 190.

charge") discovered that the company had, some time previously to his appointment, sold part of its stock in trade to a loan creditor and that the purchase price had been set off against what was then due to that creditor. The receiver persuaded the loan creditor to return the relevant stock to the company, and allowed the debt to the creditor to be correspondingly reinstated. The receiver then realised the assets of the company, including the restored stock in trade. Thereafter, in accordance with a familiar pattern, a liquidator was appointed to wind up the company. The liquidator sought to argue that the stock in trade repurchased by the receiver after the attachment of the floating charge should not have been regarded as attached by the charge.

2.14 The argument for the liquidator hinged upon the wording of section 13(7) of the 1972 Act [now section 469(7) of the 1985 Act] whereby, upon the appointment of a receiver, a floating charge is deemed to attach to the property then comprised in the company's property and undertaking. The liquidator maintained that the restored stock in trade, could not be comprised within the assets attached by the charge because it had not been comprised in the company's undertaking at the date of attachment of the charge. The court, however, held that it was not relevant to enquire whether particular assets were or were not comprised in the company's undertaking at the date of the receiver's appointment. The true question to be asked was what was the property subject to the charge on the date of the receiver's appointment; and the answer to that question had to be found in the instrument creating the floating charge.

2.15 Since the instrument of floating charge in the case was expressed to cover assets whenever they came into existence, the court found no difficulty in coming to the conclusion that the restored stock became, on its re-acquisition following attachment, comprised within the charged assets. On that basis, the court was able to state as a general principle that in the case of an all assets floating charge:-

> "Any property which comes into the Company's hands after the appointment of a receiver will be attached and be available, if need be, for realisation by a receiver."

2.16 There was a secondary argument advanced on behalf of the liquidator. This was that on the assumption that assets fell to be excluded from attachment by virtue of their not having been in existence at the date of appointment of a receiver they could never become attached thereafter on the subsequent occurrence of a winding up under section 1(2) of the 1972 Act [now section 463(1) of the 1985 Act].

2.17 Given the basis on which the court had decided the primary issue this secondary argument did not require to be answered, but the court made it clear that it would indeed have regarded the subsequent winding up as providing a second opportunity for any requisite attachment of the floating charge. This potential "double attachment", as it has come to be called, does not seem to us to be important in itself, given that the appointment of a receiver under a general floating charge of the type discussed in Ross v. Taylor will in itself

enable the charge to attach to post attachment assets. We mention the liquidator's secondary argument, however, because a comparison of section 1(2) of the 1972 Act [now section 463(1) of the 1985 Act] (which is concerned with attachment on a liquidator's appointment) and section 13(7) of the 1972 Act [now section 469(7) of the 1985 Act] (which is concerned with attachment on a receiver's appointment) reveals a possible drafting anomaly which we take up below. We should perhaps add that we make a brief reference in paragraphs 2.84-2.90 below to the fact that a winding up following a receivership may also create a second opportunity for the making of claims by preferential creditors.

2.18 The emphasis which the court placed in Ross v. Taylor upon giving effect to the nature of the floating charge instrument itself seems to us to be a correct one and to produce a result which is in keeping with the policy objectives of the legislation. It is of the essence of a floating charge that it should be capable of attaching future assets in general and it would we think be arbitrary to exclude any assets from that generality merely on the ground that they had come into existence after the date of attachment. We would, however, be interested to hear from consultees whether they have any different views on this aspect.

2.19 Is it agreed that a floating charge expressed so as to comprise assets both present and future should as a matter of general principle be capable of attaching assets within its scope whether those assets subsist as

assets of the company at the date of attachment or do not come into existence as such until after the date of attachment? (Question 2.1).

2.20 We have paused upon the decision in Ross v. Taylor for two reasons. First, because the court's emphasis on the need to give effect to the express wording of individual floating charge instruments is an appropriate background against which to consider how effect should be given to a floating charge in relation to special examples of acquirenda such as reduced diligences or reduced fraudulent preferences. (The special characteristics which distinguish reduced diligences and reduced preferences from other types of acquirenda in this context is, as we explain below, that assets are thereby restored to the undertaking of a company, and hence restored to the scope of a floating charge, by virtue of the operation of general insolvency rules which were themselves devised at a time when a security such as a floating charge did not exist.) The second reason for considering Ross v. Taylor is that the argument advanced by the liquidator as to the respective attachments on a winding up and on a receiver's appointment draws attention, as an incidental matter, to an aspect of the drafting of the relevant sections in the Act. We deal with this drafting point first.

2.21 Section 13(7) of the 1972 Act [now section 469(7) of the 1985 Act] provides that on a receiver's appointment a floating charge attaches to the property then comprised in the charge.

2.22 Section 1(2) of the 1972 Act [now section 463(1) of the 1985 Act] provides by contrast that on a winding up a floating charge attaches to the property comprised in the company's undertaking at the date of commencement of the winding up.

2.23 It follows, therefore, that in a case where there is a winding up but no other process, a floating charge will attach only to those assets in existence at the date of the winding up, whereas on a receivership it will attach, as was shown in Ross v. Taylor, to assets whether in existence at the date of the receiver's appointment or not.

2.24 We do not think this distinction can have any importance as a matter of business, because a floating charge creditor can, and no doubt invariably does, appoint a receiver to protect his interests where a winding up has occurred. On the appointment of such a receiver, the charge will attach, for the reasons set out in Ross v. Taylor, to all assets present and future. It seems to us, however, that the discrepancy between the drafting in the two sections (which no doubt reflects the superimposition in the 1972 Act of a "receivership" section on the original "winding up" section derived from the Companies (Floating Charges) (Scotland) Act 1961 ("the 1961 Act")) should be removed and consultees views are sought on this proposal.

2.25 Should there be any distinction between the scope of an attachment under section 463(1) of the 1985 Act as compared with the scope of an attachment under section 469(7) of the 1985 Act? (Question 2.2).

(ii) The effect of attachment on two special types of acquirenda

(a) The fraudulent preference

2.26 The reduction of a fraudulent preference in the course of winding up proceedings taken subsequent to the appointment of a receiver provides an example of how an asset of a company which was not in existence, or was not available, at the date of attachment of the floating charge may come into existence subsequently and accordingly increase, according to the principle applied in Ross v. Taylor, the assets attached by the relevant floating charge. We consider in the following paragraphs whether there are any special considerations which suggest that an asset of a company which comes into existence in that particular way should not be permitted to qualify for attachment by a floating charge.

2.27 We distinguish two quite separate issues in this context. The first issue is whether, as a matter of principle, the benefit of the reduction of a fraudulent preference is something which ought to accrue for the benefit only of the general body of creditors and not for the benefit of a particular secured creditor such as a floating charge creditor. The second issue is one of procedure, namely, whether, if it is considered that the benefit of a reduced fraudulent preference should properly be caught by an all assets floating charge, a receiver should have title to sue for reduction of such a preference as well as a liquidator or a creditor.

2.28 If Ross v. Taylor stood alone as an authority then we do not think there could be any doubt that the benefit of a reduction of a fraudulent preference, in so far as

it operated to increase the assets of a company, would go to increase the charged assets comprised within an all assets floating charge. Ross v. Taylor, however, does not stand alone as an authority where fraudulent preferences are concerned. The practitioner has to take into account the English case of Re Yagerphone[1] which has long stood as authority for the proposition that the benefit of a reduced preference is something which is to be received for the exclusive benefit of the unsecured creditors. In that case Bennett J. said that "the right to recover a sum of money from a creditor who has been preferred is conferred for the purpose of benefiting the general body of creditors" and he described moneys recovered following the setting aside of a fraudulent preference in a winding up as being "received by the liquidators impressed in their hands with a trust for those creditors amongst whom they had to distribute the assets of the company".

2.29 Re Yagerphone was cited to the court in Ross v. Taylor but the aspect of fraudulent preference was not relevant in that case and the court contented itself in the event with observing that the decision in Re Yagerphone could be said to depend upon the particular terms of the relevant debenture. Nevertheless, as we understand it, Scottish insolvency practitioners have hitherto regarded the decision in Re Yagerphone as establishing an effective special rule regulating the right to benefit from reduced preferences and (given that the facts in Ross v. Taylor did not involve a fraudulent

1 [1935] Ch. 392.

preference) they may continue to do so. We consider below, therefore, whether as a matter of principle there ought to be a special rule for fraudulent preferences.

2.30 The Cork Committee which considered this issue, thought that the benefit of reduced fraudulent preferences should not go to increase the assets attached by a floating charge. The basis of their reasoning appears to have been that since a company is permitted to deal freely with its assets while a floating charge remains unattached, and since a dealing which is later seen to have created a fraudulent preference is none the less a permitted dealing, the floating charge creditor can claim no relevant title to the assets which are the subject of such a dealing if those assets are subsequently restored by virtue of the dealing being reduced.[1]

2.31 In common with the Joint Working Party we are not persuaded by this reasoning. It seems to us, as it did to the Working Party, that the status of the original dealing should not affect the question whether the assets comprised in the floating charge can be increased as a consequence of the subsequent reduction of that dealing. If there had never been a disposal of or dealing with the assets their attachment by the charge would have been automatic. The effect of a reduction is to restore the position to what it would have been had the disposal or dealing never taken place. Moreover as we suggest in paragraphs 2.93-2.95 below, the freedom which a company has to dispose of assets subject to a floating charge while it is a going concern should not extend to a

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1 Cmnd. 8558 para. 1265.

freedom to make disposals other than in the ordinary course of business. A disposal which constituted a fraudulent preference could not we think fairly be said to be a disposal of the latter kind.

2.32 The status of a reduced preference may however require particular consideration because references in the institutional authorities might, taken out of context, seem to support the notion that the general body of creditors has some special claim to the benefit of a reduction. One can find for example in Bell a statement that "the true principle of the law is, that all the creditors at the time of the bankruptcy form a community, to which the estate of the debtor belongs, - not to be alienated to particular creditors, but preserved for equal distribution among them".[1]

2.33 It must be remembered, however, that Bell was not concerned to deny the competing claim of a creditor holding a security interest over an asset and could not of course have comprehended the possibility of a security interest extending, as a floating charge does, to the whole undertaking present and future of a company.

2.34 The object of reducing a fraudulent preference is, as Mr D.P. Sellar has put it, to restore the just rights of creditors.[2] It seems to us that those just rights of creditors ought, in the case where there is a secured creditor holding a floating charge, to admit of the

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1 Commentaries ii, 216 (7th edn.).

2 "Floating Charges and Fraudulent Preferences" 1983 S.L.T. (News) 253.

possibility that an asset restored by a reduction of a preference, will come to be attached by the floating charge together with the other assets of the company.

2.35 We should perhaps add that if, contrary to the view we advance above, it were thought that the benefit of a fraudulent preference should accrue solely to the general body of creditors, the exclusion of the floating charge holder might not in itself be sufficient to achieve this objective.

2.36 This is because the rights of the general creditors are complicated by the special position of the preferential creditors to whom the receiver under a floating charge has to account. The practical effect of the co-existence of a receiver and preferential creditors can be illustrated as follows:

> An all assets floating charge attaches on the winding up of the company. The company's assets are valued at that time at £2,000 and are subsequently increased to £2,500 by the reduction of a fraudulent preference. The liabilities of the company consist of the following debts:- £1,000 due to preferred creditors; £2,000 due to the floating charge holder; and £500 due to ordinary creditors. If the liquidator makes over to the preferred creditors the reduced preference of £500 as a part payment of their claims of £1,000 the balance of £2,000 will be distributed on the basis of £500 to preferred creditors, and £1,500 to the floating charge holder. If, on the other hand, the preferred creditor's claim is discharged from the assets valued at £2,000, the floating charge holder will only receive £1,000 and the ordinary creditors £500.

In the first situation described above, the floating charge holder has benefited from the reduction of the fraudulent preference. Accordingly, if a floating charge holder were to be excluded as a general principle from the benefit of a reduced fraudulent preference it would seem to follow that legislation would need to provide that the debts of the preferential creditors should require to be met in the first instance so far as possible from assets other than the assets representing the reduced preference.

2.37 If the view is taken that a floating charge holder should benefit from a reduced preference it remains necessary to consider the procedural issue of whether his receiver should himself have a title to sue for reduction of the preference.

2.38 While it is conceivable that a receiver could obtain a title to reduce a fraudulent preference by taking a specific mandate so to do from the floating charge holder creditor we understand that in practice this is not done. Instead a winding up is procured so that the liquidator can take the necessary steps to reduce the preference in the winding up.

2.39 The Joint Working Party concluded that it would be advantageous if a receiver himself could take any action necessary for the reduction of a fraudulent preference, thereby avoiding the need to procure a winding up for that purpose. We think this suggestion should be adopted, and that a receiver should be able to take the necessary action for reduction of a preference if that reduction can operate to increase the assets attached by the charge.

2.40 (1) Do consultees consider that, if the value or amount of assets within the scope of a floating charge is increased by virtue of the operation of the rules for reduction of fraudulent preferences, the relevant increase should operate to benefit the floating charge holder or should he be excluded from such benefit so that it can enure for the exclusive benefit of the general creditors?

(2) If consultees consider that a floating charge holder should not be excluded from benefiting from a reduction of a fraudulent preference should a receiver be given express statutory powers to reduce a fraudulent preference?

(3) If it is considered that a floating charge holder should be excluded from the benefit arising from the reduction of a fraudulent preference and that such reduction should operate exclusively for the benefit of the general creditors is it agreed that in order to achieve that end it is necessary to provide that the claims of preferential creditors must be met by a receiver so far as possible in the first instance from assets other than the assets which result from or represent the benefit of the reduced preference?

(Question 2.3).

(b) Reduction of diligences under section 623 of the 1985 Act [formerly section 327 of the 1948 Act]

2.41 Section 623(1) to (3) of the 1985 Act (as substituted by paragraph 21 of Schedule 7 to the Bankruptcy (Scotland) Act 1985) [formerly section 327(1)(a) of the

1948 Act[1]] provides inter alia that in the winding up of a company registered in Scotland:-

> "... no arrestment or poinding of the estate of the company ... executed -
>
> (a) within the period of 60 days before the commencement of the winding up of the company and whether or not subsisting at that date; or
>
> (b) on or after the commencement of the winding up of the company,
>
> shall be effectual to create a preference for the arrester or poinder; and the estate so arrested or poinded, or the proceeds of sale thereof, shall be handed over to the liquidator."

2.42 In the paragraphs which follow we consider whether the capacity of a floating charge to attach to assets, as they arise, creates any problems in the situation where moveable assets (corporeal or incorporeal) comprised in the charged assets have been encumbered with diligences and those diligences are subsequently rendered ineffective by the operation of section 623 in the course

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1 Subsection (1)(a) of section 327 of the 1948 Act became the subject of interpretation by the court in Johnston v. Cluny Trustees 1957 S.C. 184 where it was held that the provision did not apply to an arrestment effected within the 60 day period which was superseded prior to liquidation by payment of the principal debt. In these circumstances the liquidator could not recover the sum paid to the arrester. The Lord President observed that the object of the subsection was to prevent a creditor from claiming a preference where he had arrested within 60 days but had not received payment of his claim by the date of liquidation. However, section 37(4)(a) of the Bankruptcy (Scotland) Act 1985 incorporated by reference into section 623 of the 1985 Act by paragraph 21 of Schedule 7 to the Bankruptcy (Scotland) Act 1985 enables the liquidator of a company, to recover the sum paid to the arrester in the circumstances described above.

of a winding up of the company. Should the automatic release of such diligences in the winding up operate to the benefit of a floating charge creditor whose charge extends to the assets which are thereby disencumbered?

2.43 This question is likely to be academic under the law as it stands, for, as we point out below, the legislation relating to floating charges and receivers operates so as to render nearly all diligences ineffective in a question with a receiver, quite apart from their potential ineffectiveness in a question with a liquidator in a subsequent winding up. We assume, however, for the purpose of argument, in the following paragraphs, that a given diligence has succeeded in achieving priority over a receiver under section 471(2)(a) of the 1985 Act [formerly section 15(2)(a) of the 1972 Act] and has been rendered ineffective only because of the operation in a subsequent winding up of section 623 of the 1985 Act. The question is whether the disencumbering of a charged asset in the winding up should benefit the charge holder.

2.44 We think this question must be considered in the light of the fact that a floating charge is designed to be capable of attaching all future assets of a company without distinction on the grounds of their origin. Against that background, it seems to us, (though here we depart from the Joint Working Party), that the same considerations should apply in the case of reduced diligences as we have suggested should apply in the case of reduced fraudulent preferences. If an asset would have been subject to the charge had it not been encumbered by a diligence then there is no reason why it should fall outside the scope of the charge once the diligence is removed by operation of law.

2.45 We also think it important that the rule for equalisation of diligences in a winding up should itself be put in its proper historical context. That rule was devised to create an equality as amongst the unsecured creditors as a class. It was not devised to deprive a secured creditor such as a floating charge creditor of his prior claims; and it must be borne in mind that a security capable, (as a floating charge is), of attaching the corporeal and incorporeal moveables of a company which are liable to diligence, could not have been in contemplation when the equalisation rule was devised.

2.46 For the reasons suggested above we favour the view that a floating charge holder should be entitled to the benefits of a reduced diligence if the disencumbered assets would otherwise have been caught by the charge.[1] If it is considered, however, that a floating charge holder should not be so entitled it would seem to follow on the argument put forward in paragraphs 2.35-2.36 above that the debts of preferred creditors would require to be met so far as possible in the first place from assets other than those made available by the reduction of diligence if the unsecured creditors are to have the appropriate benefit from the exclusion of the floating charge holder.

2.47 (1) Do consultees consider that the reduction, in a winding up, of a diligence by operation of section 623 of the 1985 Act should be capable of operating so as to increase for the benefit

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1 See para. 2.34 for similar recommendation regarding reduced fraudulent preferences.

of a floating charge holder, the value of the assets attached by his floating charge?

(2) If it is considered that a floating charge holder should be excluded from such a benefit and that the general creditors alone should benefit from the operation of section 623 is it agreed that it would be necessary to provide that the claims of the preferential creditors must be met, so far as possible, in the first instance, from assets other than the assets disencumbered by virtue of the reduction of the diligence?

(Question 2.4).

(iii) The effect of attachment on competition between the receiver (for behoof of the floating charge holder) and unsecured creditors of the debtor company

(a) Diligence

2.48 In paragraphs 2.3-2.11 above we have considered the manner in which priorities may fall to be determined as between a receiver and a creditor levying diligence after the date of attachment of a floating charge. We now turn to consider how such priorities are, or should be, regulated in the case where the levying of the diligence has been commenced prior to the attachment of the floating charge and the appointment of the receiver.

2.49 There is one circumstance relating to such prior levying of diligence where the regulation of priorities simply does not arise. This is where the diligence has been completed prior to the appointment of the receiver. In that event the relevant asset (whether incorporeal or corporeal) will no longer be an asset comprised in the company's assets at the date the charge attaches; and

this possibility must of course be taken to be in the contemplation of a creditor when he decides to take a floating as opposed to a fixed security.

2.50 In many cases, however, having regard to the manner in which diligences such as arrestment or poinding are operated in practice by creditors, a diligence will not have been completed (by a furthcoming or a sale) by the time attachment supervenes. Indeed, in the case of some diligences, (for example an inhibition, or an arrestment on the dependence of an action), the diligence will by its very nature be incapable of being completed prior to attachment. There is, therefore, a likelihood that at the date of attachment unsecured creditors may have levied "bare" arrestments, or may have registered inhibitions, or may have proceeded only to the poinding stage in the case of diligence against corporeal moveables. The question will then necessarily arise of how their claims as diligence holders, as they stand at the date of attachment, are to compete with the claims of the floating charge creditor to the relevant asset.

2.51 The legislation contemplates the possibility of such a competition and section 471(2)(a) of the 1985 Act [formerly section 15(2)(a) of the 1972 Act] makes express provision for it, by stating that a floating charge is to take effect subject to any diligence which has prior to attachment been effectually executed on the property of the debtor company. The legislation does not however define what stage a diligence must have reached in order to qualify as a diligence "executed on the property" so that it can take priority over an attached floating charge. That further definition has been left to case law.

2.52 In Lord Advocate v. Royal Bank of Scotland ("the Royal Bank case")[1], the court gave a clear indication of where the dividing line fell to be drawn as between the diligences or stages of a diligence which would satisfy the statutory test for priority and those which would not. The case was concerned with a bare arrestment, in the sense that an unsecured creditor had, prior to the attachment of the floating charge, arrested a book debt of the insolvent company in the hands of the common debtor but had not taken any steps to procure a furthcoming. Both Lord Kincraig, as liquidation judge, and the majority in the First Division held that the steps taken by the arrester prior to the attachment were not sufficient to enable the arrestment to be described as having been "executed on the property of the company". The court accepted that a bare arrestment as such might be said to have rendered the arrested debt litigious - but it did not consider that litigiosity as such transferred any right in the subject matter arrested or that the arrester's rights were impressed upon the relevant property. It could not therefore satisfy the statutory conditions for taking priority over the receiver.

2.53 The court was, not surprisingly, pressed to give examples of those stages in a diligence which would be regarded as being executed on the property of a company and to which section 471(2)(a) would apply. The court's view (though expressed obiter) was that the only stages in diligence which could be said to have the particular

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1 1977 S.C. 155.

characteristics of being executed "on the property" of a company were stages such as a decree of furthcoming proceeding upon the arrestment of corporeal moveables and a warrant of sale proceeding upon a poinding. In such cases the relevant assets would be adjudicated to the creditor and hence the diligence could properly be described as having been executed upon property of the company. On that basis the court was satisfied that the statutory priority of a diligence could not be said to be without content, although the possibility of its occurring was admittedly limited to very special situations.

2.54 The effect of the decision in the Royal Bank case is accordingly as follows. In those cases where a diligence has been commenced but has not been completed prior to attachment, the diligence at that intermediate or "inchoate" stage will have to yield to the attached floating charge unless the diligence has reached a stage where, although the legal title to the property has not left the company, the diligence has given an effective real right to the creditor. The only stages of diligence identified which will have that very particular characteristic will be those stages identified by the court referred to above.

2.55 The Royal Bank case has attracted strong criticism from some commentators. The basic thrust of this criticism is that a diligence even at the "inchoate" stage of a bare arrestment operates with such effect that it should be regarded as equivalent to a nexus upon the relevant assets. As we see it, however, the critics of the reasoning in the Royal Bank case are concerned

essentially to criticise the court's analysis in that case of the nature of an arrestment and are concerned only incidentally, if at all, with the question whether as a matter of policy a registered security holder such as a floating charge creditor should expect to be postponed to an unsecured creditor who has commenced diligence.

2.56 For the purpose of this Memorandum we think it is necessary to concentrate in the first instance upon that basic policy issue. This approach is in a sense the reverse of the process which the court followed. The court had, necessarily, to look first at the wording of the statutory priority test for diligence and it could refer to policy considerations only in so far as the latter appeared to support its construction of the statutory wording. It is however, evident from the judgments that the court had a clear view as to what the policy considerations were.

2.57 In identifying the policy considerations which ought to affect the priorities as between a diligence and a floating charge, we think it essential to look at diligence, as the judges did in the Royal Bank case, in the context of insolvency as a whole rather than in the isolated context of receivership. The need to look at the rights of diligence in this way arises because:-

1. Winding up has in itself a very particular effect on the effectiveness of a diligence.
2. Although receivership and winding up are distinct processes, the one can accompany the other and a floating charge creditor can of course himself procure a winding up of the debtor company.

3. If a winding up process intervenes then any reduction of diligences in that winding up process will enure to the benefit of a floating charge creditor if the benefit of a reduction of diligences ought properly to operate for the benefit of the floating charge creditor.

2.58 If one looks to the statutory consequences of a winding up, it will be seen that one of those effects is to render ineffective any diligence effected within a period of 60 days prior to the commencement of the winding up.[1] We refer to that temporal limitation in passing below, but at this stage it is sufficient to note that any winding up within the period can invalidate prior diligences and hence bring about a situation in which a corporeal or incorporeal moveable ceases to be encumbered by diligence and falls, in its disencumbered state, within the assets charged by any applicable floating charge. We think therefore that any practical scheme for regulating priorities as between the holder of a diligence and a receiver must take account of the fact that if the receiver, qua receiver, is to be denied priority he may effectively retrieve his position by the simple expedient of procuring a winding up within the relevant 60 day period. This practical consideration clearly weighed with Lord Kincraig in the Royal Bank case for he considered that the statutory test for a prior

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1 Section 623(1) to (3) of the 1985 Act as substituted by paragraph 21 of Schedule 7 to the Bankruptcy (Scotland) Act 1985 [formerly section 327(1)(a) of the 1948 Act].

diligence should not, unless no other construction was open, be construed so as to give priority to an arrestment which could thereafter be made ineffective in a winding up instigated by the receiver.

2.59 On appeal the same point was made by Lord Emslie when he observed that if the bare arrestment were given priority over a floating charge it would bring about a situation in which "arrestments executed within 60 days of the receiver's appointment in the case of a company not in liquidation would enjoy a preference which would have been denied to them had the receiver's appointment coincided with the commencement of a winding up".

2.60 We think, therefore, that there are very practical reasons for not encouraging a priority scheme in receivership which will merely drive receivers to procure a winding up process in which the priorities can effectively be reversed.

2.61 But, quite apart from those practical considerations, we think that the underlying policy objectives of the floating charges legislation must suggest a scheme of priorities whereby the security interest of a floating charge holder in an asset such as a debt cannot be defeated by an uncompleted arrestment of that debt. We think that a floating charge holder who has taken and registered a security over assets including the receivables of a company should legitimately expect that his security will attach to the receivables as they subsist at the date of attachment and will not have to yield to encumbrances such as arrestments which are neither securities nor registered or to yield to

diligences such as inhibitions which are by their very nature not intended to create a nexus over property. As Lord Emslie put it in the Royal Bank case "it would be surprising if the [diligence priority] were designed to cover rights established subsequent to the date of the floating charge, a public fact because of its registration, by diligences which were not truly comparable with rights of fixed security and were lesser rights of a purely personal character such as arrestment".

2.62 We think that a scheme of priorities which denied the floating charge holder the benefit of attaching the receivables of a company would necessarily be seen as a very serious limitation indeed on the commercial effectiveness of the floating charge as a security instrument. It must be remembered that the willingness of a lender to lend in reliance on a floating, as opposed to a fixed, security will in most cases depend upon the expectation that the charge can effectively secure the future receivables of the company; for those future receivables will be the asset which is of most practical value to a lender. It must also be remembered that it is impracticable for a lender to look at present for any practical form of fixed security over the future receivables of a company. The floating charge has therefore to be relied upon by lenders, who rely (as they increasingly do) on receivables, to fill an important gap in the range of available security instruments.

2.63 It may quite fairly be asked whether recognition in this way of the expectations of the floating charge holder unduly diminishes the options fairly open to an

unsecured creditor. The court in the Royal Bank case thought not. In Lord Emslie's words:-

> "The registration of a floating charge after all gives warning to a creditor who subsequently arrests, that if he does not proceed speedily to a completion of his 'begun' diligence he is at risk of being faced with the appointment of a receiver. The remedy lies is in his own hands."

2.64 We recognise that prior to the introduction of floating charges only diligences laid on within a prescribed period of 60 days prior to the winding up could be adversely affected by the winding up, whereas any diligence, however long standing, may be postponed to a floating charge creditor. We recognise also that the postponing of an arrestment to a floating charge may in certain circumstances lead to a circle of priorities as amongst an arrester, an assignee and a receiver.[1] We are equally aware that the circumstances in which a diligence will enjoy a statutory priority will be very limited in practice; that in the case of some diligences, such as a diligence on the dependence or an inhibition, the opportunity of pursuing the diligence to a stage where it satisfies the court's test may not be available; and that in the case where a floating charge instrument empowers the floating charge creditor to appoint a receiver forthwith upon the levying of a diligence the unsecured creditor will effectively be prevented from enjoying any benefit from using diligence in competition with the floating charge creditor. We accept also that the attribution to unsecured creditors of knowledge of the existence and import of registered floating charges

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1 See Mr. A.J. Sim's Article "The Receiver and Effectually Executed Diligence" 1984 S.L.T. (News) 25.

will in many cases reflect legal theory rather than business reality. But these considerations are not sufficient argument, it seems to us, for giving priority, beyond the limited extent presently available under existing legislation, to diligence levied by unsecured creditors.

2.65 We should emphasise, however, that we attach importance to ensuring that the scheme of priorities which we suggest should be expressed in statutory wording which can so far as practicable be readily understood and applied. In the Royal Bank case the court itself observed that Parliament had not troubled to define a concept which, in the event, required careful and exhaustive analysis both by counsel and the court. We think too that regard must be paid to the force with which it has been argued by some commentators on that case that section 471(2)(a) of the 1985 Act could have been construed so as to extend to further stages in diligence than the limited ones identified by the court as falling within the scope of the section. We would therefore expect consideration to be given in the drafting of any new legislation to the need for precision in the terminology used.

2.66 (1) Do consultees agree that, as a matter of policy, legislation should continue, for the reasons suggested above, to give the holder of an attached floating charge a priority over a diligence which has been begun prior to attachment but which remains "inchoate" in the sense that a bare arrestment or a poinding or an inhibition is an "inchoate" diligence?

(2) If consultees do not agree that the general policy objective should be as suggested above what in their view should the overall policy objective be as regards the effectiveness of a diligence against a receiver taking into account the potential ineffectiveness of any such diligence in a subsequent winding up?

(3) If consultees agree that the policy objective of the legislation should be as suggested above do they consider that the technique presently used in the legislation (namely the limitation of the priority to those stages in diligence where the diligence can be said to have been "executed upon the property" of the company) is appropriate to distinguish between the special categories of diligence which ought to have priority and the general category of "inchoate" diligences which ought not to have priority?

(4) In particular are consultees of the view that legislation should specifically itemise those stages in diligence which are to have priority on the ground that they are equivalent in effect to a real right of security or does the present expression "executed upon the property" enable the characteristics of such diligences to be identified with sufficient clarity?

(5) If consultees are of the view that there should be an express itemisation of the diligences which are to have priority as being equivalent to real rights are there any diligences other than those identified for the purpose in the

Royal Bank case, namely a furthcoming proceeding upon the arrestment of corporeal moveables and a warrant of sale proceeding upon a poinding, which should be itemised as being equivalent in effect to a real right in security?

(Question 2.5).

(b) Compensation or set-off

2.67 We have examined in the previous paragraphs how the statutory hypothesis operates to determine the competing priorities between a receiver and a creditor who has either done diligence or has procured the reduction of a preference. We now turn to consider the situation which arises where the assets comprised in a floating charge include the benefit of a debt due to, or obligation owed to, the relevant company and the receiver is met by a plea from the debtor in the obligation that he is entitled to set off a claim which he has against the company in reduction or extinction of the obligation.

2.68 The factual situations in which there will be such a competition between a receiver and a third party pleading such a right of compensation, set off or retention can be exemplified as follows:-

1. At the date of attachment there is a debt due to the relevant company which becomes subject to the attached charge. The debtor claims that he is entitled to withhold payment of the debt to the company because he has himself a claim against the company, either under the same or another contract.

2. At the date of attachment of the charge the relevant company is itself a debtor to a third party. That party in turn comes, as a result of events occurring subsequent to attachment, (such as, for example, the kind of events which occurred in Rother Iron Works Limited v. Canterbury Precision Engineers Limited[1]) to owe a debt to the company under the same or another contract. At that stage, he claims to set off his creditor's claim against the debt which he has come to owe.

2.69 The availability of a valid right of set off will depend upon whether in a particular situation there is the requisite decree of mutuality (concursus crediti et debiti) between the claims of debtor and creditor on either side. The debt due on one side must be matched by a debt due on the other side which is due in the same capacity and which is a liquid debt. In some circumstances, however, the latter requirement is relaxed so as to allow a liquid claim to be offset against an illiquid claim. This relaxation will be available where there is an insolvency of a party, in which event the plea of compensation becomes expanded into a wider right of "balancing accounts in bankruptcy" which enables a liquid claim to be set off against an illiquid or contingent claim. It will also be available outwith an insolvency situation where two counterbalancing claims arise under a single contract.

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1 [1973] 1 All E.R. 394.

2.70 The particular question which the enforcement of a floating charge poses for set off claims is whether the attachment of the charge and the consequent working out of the statutory hypothesis alters the mutuality between the parties to such an extent as to bar a plea of compensation. It is important to bear in mind in this context that although a charged debt due to a company at the date of attachment of a floating charge will thereby become due to the company for behoof of the floating charge creditor it will remain a debt due to the company as legal title holder and the receiver, when he collects the debt, will act as statutory agent for the company. This may call for a rather elaborate analysis before it can be established whether in any individual case the requisite degree of mutuality between a debt and a claim exists either at the date of attachment or thereafter.

2.71 That said, however, no particular problem should arise in applying the basic scheme of priorities as between a receiver and a party who claims that a charged debt due by him on attachment to the relevant company is subject to set off. The receiver, on attachment, will be regarded as entitled to claim all rights and priorities which he would have been able to claim if he had been an assignee of the debt under the general law. As a deemed assignee of the company's debt, he will be subject to any pleas of set off which were, at the date of attachment, capable of being taken against the company itself. But, by the same token, he cannot after attachment become subject to any plea of set off which was not pleadable at attachment against the company itself. A debt due at attachment (so that it thereby becomes due to a company for behoof of the floating charge holder) will not be

capable of being set off against a claim against the company acting for its own account. Thus if a debtor to a company were, after attachment, to buy up creditors claims against the company at the date of attachment and were then to seek to set off those claims against his own obligation to pay his debt to the company the plea of set off would fall to be rejected. The purchased claims would be claims against the company as such whereas the debt would have become, on attachment, a debt due not to the company as such but to the company for behoof of the floating charge creditor. The requisite mutuality would not be present.

2.72 Put short, as it has been in the case law,[1] a debt due to the company at attachment so that it becomes due to the company for behoof of the floating charge creditor is a concern of the receiver whereas a claim against the company may be of no concern to the receiver.

2.73 Given that a receiver is to be treated as if he were an assignee of any debts due to a company, and given that the ordinary principles of set off ensure, as explained above, that the receiver as assignee is subject to all pre-existing pleas of compensation pleadable against his cedent (the company) but is not subject to any such pleas manufactured by the post attachment purchase of creditors claims against the company, it might be thought that no problem could have arisen in the case law. Events, however, have turned out otherwise. The cases on set off

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1 By Russell L.J. in Rother Iron Works Limited v. Canterbury Precision Engineers Limited 1973 1 All E.R. at 395.

in receivership are inconsistent both with each other and with the statutory hypothesis; and it was this unsatisfactory state of affairs which in part prompted the setting up of our Joint Working Party.

2.74 The problem in the case law arises out of two cases, McPhail v. Lothian Regional Council[1] ("the Lothian Region case") and Taylor Petitioner[2] ("the Typesetting case"). Each case was decided before the decision in the Forth and Clyde case and in particular before that case explained how the fixed security enforced by a receiver could be reconciled with the retention by a company of legal title to its assets such as its book debts. The background facts in the Lothian Region case were that a debt owed to a company, which had granted an all assets floating charge, was owed by a debtor who was at the date of attachment also a creditor of the company. When the receiver of the company raised (in his own name) an action against the debtor for payment of the debt he was met with two arguments. The first argument was that the debt should be set off against the debtor's counterclaim as creditor. The second argument was that the receiver could have no title to sue in his own name for what was due to the company. Lord Grieve dealt with the set off argument on the basis that the receiver's right to recover the charged debt free of set off depended upon whether the receiver happened to take action in his own name or in that of the company. If he took action in his own name then set off would not be available for want of mutuality, whereas if he took action in the name of the

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1 1981 S.C. 119.

2 1982 S.L.T. (Reports) 172.

company set off could validly be pleaded. This particular distinction can be seen, (as has now been confirmed in the later decision in McPhail v. Cunninghame District Council and William Loudon & Son Ltd v. Cunninghame District Council - "the Loudon case"),[1] to be irrelevant in the light of the explanation in the Forth & Clyde case of how a debt due to a company becomes on attachment due to the company for behoof of the floating charge creditor.

2.75 The background facts to the Typesetting case, (which also involved the attachment of an all assets floating charge) were that a receiver (again suing in his own name) sought to recover debts due to a company at the date of attachment and was met with claims of set off by two creditors of the company who had acquired their respective claims by purchases from other creditors after attachment. In the Typesetting case Lord Ross proceeded on the basis that a receiver could not be treated as having the rights of an assignee of a company debt at all unless and until he obtained an actual assignation of the debt. On that basis he decided that the debtor owing a charged debt could defeat a receiver's claim thereto by setting off the debt against creditors' claims against the debtor company purchased from other creditors after attachment. The basis of the decision in the Typesetting case, no less than the decision in the Lothian Region case, can now be seen to be clearly inconsistent with the

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1 1985 S.L.T. (Reports) 149.

decision in the Forth & Clyde case. For the Forth & Clyde case establishes that a floating charge creditor is indeed to be treated as if he were an assignee of a charged debt.

2.76 If, as we have suggested above, the original case law can now be regarded as superseded by the later authoritative analysis in the Forth & Clyde case, it may be asked whether any further action is now needed. Strictly speaking, it should not be. But we think that having regard to the past confusion and having regard to the particular complexity which the receiver's agency for the company and the company's continuing legal title to debts necessarily introduce in set off questions, it might well be appropriate to have a declaration in the legislation of the basic principles applicable in this particular area. In this connection, our Joint Working Party, who were asked to respond to the difficulties created at the time by the Lothian Region and Typesetting cases, have suggested that the applicable principle be expressly stated in the legislation to reflect the following formulation:-

> "The powers of a receiver to take possession of and realise the property of a company attached by a floating charge shall have effect subject to any rights of compensation or retention which have arisen prior to the attachment of the floating charge, but shall prevail over any such rights which may arise after such attachment."

2.77 The Working Party formulation was devised to clarify the situations which arose in the Lothian Region and Typesetting cases; that is to say situations in which at the date of attachment there was a debt due by X to the company and X sought to set off against that debt a claim

available to him as creditor against the company. It has to be considered, however, whether the Joint Working Party formulation would also operate satisfactorily in the situation where at the date of attachment X has a claim against the company and then seeks to set it off in reduction or extinction of a debt subsequently becoming due by him to the company, either under the same or another contract. The kind of situation which can give rise to a set off claim of that type is well illustrated by the facts in the English case of Rother Iron Works Limited v. Canterbury Precision Engineers Limited to which we have referred above. In that case, a party who had contracted with the company had at the date of attachment of the charge a claim against the company of £124 but the receiver, by continuing to perform the company's part under an existing contract between the company and that same party, brought about a situation in which the company itself came to have a claim as creditor against the contracting party for £159. The contracting party argued successfully that a net payment of £35 should satisfy the latter claim, the claim at attachment being set off against the subsequent claim the other way arising after attachment.

2.78 The legal basis on which the Court of Appeal allowed the set off would we think be equally applicable in a Scottish context. That basis was that had the second contract been a new contract entered into by the receiver after attachment the claims under the two contracts could not have been set off; but where such a second contract (even if performed after attachment) was not on the facts a new contract the receiver qua assignee could not seek to be put in a better position than the company itself

could have been and hence must accept the right of the contracting party to set off a debt due to it at attachment against any debt becoming due by it.

2.79 We think it would be advisable, having regard to the situation in Rother Iron Works Limited v. Canterbury Precision Engineers Limited, to expand the Joint Working Party formulation so as to state that the receiver's powers to take possession should be subject to any liabilities incurred by him in continuing a contract by the relevant company entered into before attachment. Such an expanded formulation would ensure that a receiver (as assignee) was in no better or worse position than the company (as assignor) as regards rights of set off. In a situation where a second contract performed after attachment fell to be regarded on the facts as a "new" contract set off would not be available. Conversely, however, where a second contract did not fall to be regarded as a "new" contract but simply as a pre-existing contract which was performed after attachment, the receiver would have to respect the right of the contracting party to reduce his obligation by setting off the sum previously accrued due to him.

2.80 We have referred in paragraph 2.69 above to the fact that one aspect of mutuality in set off, namely, the requirement that each of the mutual claims must be a liquid claim, is relaxed in cases of insolvency to allow a liquid and an illiquid claim to be set off against each other. We were at one stage in some doubt as to whether the attachment of a floating charge would constitute a circumstance in which these wider set off rules ("balancing of accounts in bankruptcy") could apply. In the Louden case, however, it appears to have been

accepted without difficulty by Lord Kincraig that the relevant rule can and should apply to an insolvent company whose insolvency is evidenced by the appointment of a receiver rather than by a winding up. We have therefore assumed, but subject to consultees' views on the point, that no special provision requires to be made so as to ensure that the capacity to set off a liquid against an illiquid claim is available where the debtor is a company in receivership provided always that it can be established that the company is insolvent.

2.81 We have referred above to a claim of set off arising by way of set off of sums due under one contract against sums due the other way under the same or under a different contract. We do not think that any particular problem arises in applying the Scottish set off rules in receivership to a situation where the two claims arise under separate contracts and the relevant company is insolvent. So long as the requisite conditions for mutuality are satisfied then rights of set off or retention will apply. In the Louden case, for example, rights of set off were held to apply as between different contracts. Difficulties appear to arise in this context in an English receivership, as for example in Business Computers Limited v. Anglo African Leasing Limited,[1] but that may we think be attributable to the requirement of English law that a claim must actually have accrued due before it can be set off. Similar difficulties may also arise in a Scottish liquidation, if Asphaltic Limestone Company v. Glasgow Corporation[2] is to be regarded as

1 [1977] 2 All E.R. 741.

2 1907 S.C. 463.

rightly decided. But, as Professor W.A. Wilson has pointed out in a criticism of the latter case,[1] receivership can be clearly distinguished from liquidation in this context and we do not think, but again subject to consultees' views on the point, that special provision requires to be made for the situation where it is sought to set off a claim under one contract against a claim under another contract.

2.82 It has been well said that "the circumstances in which rights of set off can occur are multifarious and probably not capable of exhaustive enumeration".[2] Accordingly, we would particularly welcome consultees' views as to whether any permutation of mutual claims which we have not considered above causes difficulty or gives rise to anomalies in a receivership.

2.83 (1) Are consultees of the view that the decision reached in the Forth and Clyde case (1) explains and resolves the inconsistencies within the earlier case law and (2) provides a satisfactory general basis for resolving priorities in situations when the rules on set off or retention of debts have to be reconciled with the attachment of the benefit of a debt by a floating charge?

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1 "The Nature of Receivership" 1984 S.L.T. (News) p.106.

2 H.A.P. Picarda, The Law Relating to Receivers and Managers, p.93.

(2) Do consultees agree that it would nevertheless be helpful if an express statement were included in the legislation as to the basis upon which priorities should be regulated as between a receiver and a party claiming a right of set off or retention?

(3) If consultees think that such an express statement would be helpful do they agree that the Joint Working Party formulation referred to in paragraph 2.76 above as expanded in paragraph 2.79 would be an appropriate basis upon which to proceed?

(4) Are consultees aware of any difficulty which arises under the present law, or of any difficulty which could arise under the kind of statutory formulation suggested above, as regards the application of the expanded rules of set off ("balancing of accounts in bankruptcy") where there is a receivership of an insolvent company?

(5) Can consultees identify any situations not dealt with above where the availability or non availability of rights of set off or retention in relation to a receiver could give rise to anomalies?

(Question 2.6).

(c) **Debts due to preferential creditors as identified in section 89 and Schedule 4 to the Insolvency Act 1985 [formerly section 614 and Schedule 19 of the 1985 Act]**

2.84 It has been pointed out to us, that the drafting of Part XVIII of the 1985 Act may lead to different results being reached in England and Scotland as to the scope of preferential claims in a situation where a receivership and a winding up overlap in time.

2.85 The legislation nowhere recognises in its terminology (apart from an oblique reference in section 478(6) of the 1985 Act [formerly section 22(6) of the 1972 Act] that a floating charge ceases to "float" on its attachment. We think that this aspect of the drafting should be re-examined generally but in the paragraphs which follow we identify a particular substantive difficulty which is caused by the present drafting technique.

2.86 The problem in question arises where a receivership is followed by a subsequent winding up and that winding up commences before the receivership is itself completed so that the two processes overlap. Section 89 of The Insolvency Act 1985 [formerly section 614 of the 1985 Act] (the basic statutory provision on preferential claims) provides, as regards Scottish and English companies alike, that in such a situation preferential claims may be asserted by reference to the date of commencement of the winding up and that such claims should take precedence over a floating charge.

2.87 In the case of a Scottish company a floating charge could be considered to retain its status as a floating charge at the date of commencement of the winding up notwithstanding that it would have attached on the previous appointment of a receiver. In the case of an English company by contrast, a floating charge which had previously attached would not be considered to have the status of a floating charge for the purpose of applying the priorities in section 89 of the Insolvency Act 1985. It would be considered to have become a fixed charge by virtue of its previous attachment on the appointment of the receiver. It follows therefore that a claim which is preferential (or pre-preferential) in terms of section 89 can be a prior claim against charged assets in the case of a Scottish company although it would not be so in the case of an English company. Thus, for example, a pre-preferential claim such as a liquidator's claim for his costs will not, (as is illustrated by the decision in Re Christonette International Limited,[1]) be a valid claim against the charged assets of an English company, but such a claim could, as it has been pointed out to us, be a valid claim against the charged assets of a Scottish company. The same position would obtain as regards preferential claims such as the claims which were considered (again in relation to an English company) in Re Griffin Hotel Company Limited.[2]

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1 [1982] 3 All E.R. 225.

2 [1941] Ch. 129. See also R.M. Goode 1981 J.B.L. 475 Note 9.

1972 Act], may contain (a) provisions prohibiting or restricting the creation of securities having priority over or ranking pari passu with the charge, ("a section 464(1)(a) prohibition") or (b) provisions "regulating" the order of ranking of the charge with other securities. Where the order of ranking is not "regulated" by provisions in an instrument, the order of ranking is as laid down in subsection (4) - in terms of which a fixed security under which the creditor has acquired a real right takes precedence over a floating charge that has not attached.

2.97 The drafting of the section has been criticised on a number of grounds. We examine these criticisms below but in an order which reflects the present statutory lay out rather than the relative significance of the points raised.

2.98 (i) The first criticism concerns the drafting of subsection (1)(b) which inter alia provides that an instrument of charge may regulate the order in which the floating charge created thereunder will rank with any other subsisting fixed or floating charges. This subsection might be read as enabling a floating charge holder to purport to rank his floating charge in priority to a prior registered charge or charges. This is clearly not intended because such a result would be absurd in itself and could hardly stand with section 466 of the 1985 Act [formerly section 7 of the 1972 Act] which requires a prior charge holder to consent to any adverse

alteration of his prior charge. We suggest however, that it be made clear for the avoidance of doubt that the ranking of a floating charge can only be regulated under section 464 in a manner which is consistent with the protection conferred upon prior charge holders by section 466. Consultees' views are sought on this proposal. (Question 2.10).

2.99 (ii) A second criticism which also arises from subsection (1)(b) relates to the provision incorporated therein that the ranking of a floating charge with other floating charges or fixed securities may be regulated by the incorporation of a ranking clause in the instrument creating the floating charge. The subsection, however, does not provide that the ranking inter se of fixed and floating charges can be achieved by incorporating the appropriate ranking provisions in any relevant fixed security.

2.100 The potential inconvenience of this omission can be illustrated in the following example. A company may conceivably wish to enter into an arrangement under which it grants a standard security in favour of one creditor on the understanding that a floating charge to be granted subsequently to a second creditor is to rank wholly or to a specified extent ahead of the fixed security. A provision inserted in the standard security to that effect would not be sufficient to achieve the desired objective. The ranking would require to be regulated by incorporating in the floating charge the appropriate ranking clause, and by ensuring that the creditor under the standard security executed the floating charge as a consenter to the agreed ranking.

2.101 We understand that in the situation where the first security to be registered is the floating charge it is believed that the ranking inter se of that floating charge with a subsequently registered standard security can be successfully achieved by incorporating the appropriate ranking clause in the latter document in as much as the latter can (if appropriately worded) qualify as an instrument of alteration under section 466.

2.102 We would be interested to ascertain whether consultees have experienced any real difficulties or inconvenience in situations similar to that described above and invite consultees' views as to whether legislation should specifically provide that the ranking of fixed and floating charges can be regulated by a ranking clause incorporated in the fixed security? (Question 2.11).

2.103 (iii) Section 464(3) of the 1985 Act [formerly section 5(3) of the 1972 Act] is drafted in such a way that the statutory order of priorities in section 464(4) of the 1985 Act [formerly section 5(4) of the 1972 Act] (which may involve, as we note below, the potential subordination of a floating charge to a subsequent fixed security) applies in any case where the priority of a floating charge is not "regulated" so as to have a different effect. The drafting of section 464(3) can be criticised on the grounds that it creates a trap for the unwary. It is possible that a floating charge may prohibit the creation of a later fixed security but may nevertheless not contain any words which expressly "regulate" the ranking of the charge with such a fixed security. If that is so, then despite the express

prohibition the statutory order of ranking under sectic 464(4) may apply (there being no express "regulation") s as to give an (unintended) priority to the fixe security. It seems to us that where there is an expres prohibition it should take effect as if it were itself "regulation" of priorities for the purpose of sectio 464(3). Consultees' views are sought on whether it i desirable to provide that the statutory order o priorities prescribed by section 464(4) can b effectively disapplied by a section 464(1)(a) prohibitio no less than by a section 464(1)(b) regulation o priorities. (Question 2.12).

2.104 (iv) It is a more fundamental criticism o section 464 that it nowhere indicates the consequence which are to follow from the creation of a charge whos ranking or purported ranking is such that it breaches a section 464(1)(a) prohibition imposed in anothe registered charge.

2.105 We think it is helpful in the absence of an direct authority on the point relating to floating charges to look at the analogous position which arises where a right is granted in breach of a condition in a standard security. The consequence of such a breach of condition was considered in Trade Development Bank v. Warriner & Mason (Scotland) Limited[1] ("the Warriner & Mason case").

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1 1980 S.C. 74.

2.106 In that case it was disclosed that a standard security had been granted by Lyon Group Limited ("Lyon") in favour of the Bank over subjects leased to Lyon, whose title was recorded in the appropriate Sasines Register. In terms of the standard security it was narrated that "the standard conditions specified in Schedule 3 to the Conveyancing and Feudal Reform (Scotland) Act 1970 and any lawful variation thereof operative from the time being shall apply", and the standard conditions shall be varied in accordance with a Minute of Agreement. The Standard Security, but not the Minute of Agreement, was duly recorded. Lyon subsequently subleased the security subjects to Warriner & Mason (Scotland) Limited.

2.107 The Bank maintained that the sublease granted to Lyon in favour of the defenders was null and void, having been entered into without the Bank's consent in contravention of standard condition 6 which prohibits the leasing or subleasing of any part of the security subjects without such consent and which had not been varied by the unrecorded Minute of Agreement. Reduction of the sublease was granted at first instance, and the decision was upheld on appeal to the Inner House, the court ruling however that it did not accept that the sublease was void ab initio, which would have prevented the possibility of subsequent homologation, but that it was voidable at the instance of the Bank.

2.108 The Lord President, on the principle that registration in a public register is notice to the world in general of the information recorded therein, took the view, that the defender had entered into the sublease in bad faith since the published terms of the standard

security and its reference therein to the unregistered Minute of Agreement put the defender upon his inquiry to ascertain whether the creditor's consent to the sublease was required.

> "... at the very least the published terms of the standard security put him upon his inquiry and that if he takes a sublease from the granter of that standard security without the prior consent of the heritable creditor, and, indeed, without inquiry, he does so at his peril. ... It follows, in my opinion, that since the defenders took the lease of 1975 from Lyon without the prior consent of the pursuers and without either searching the record or making any other inquiry, they would in law fall to be treated as having taken their lease from Lyon in mala fide and upon that ground the lease is reducible at the instance of the pursuers."

2.109 If the principle underlying the Warriner & Mason case falls to be applied to the situation where a second charge purports to rank prior to or pari passu with another floating charge in breach of a section 464(1)(a) prohibition applicable to that other floating charge and published in the company's register of charges, it is reasonable to expect that a court would rule that the second charge holder had acquired his security from the debtor company in bad faith, and that his security should be reducible at the instance of the holder of the other charge.

2.110 If a section 464(1)(a) prohibition is to be effective it seems to us only reasonable that once the relevant prohibition has been published by registration, the debtor company should not be able to create subsequently a second charge which secures a prior or pari passu ranking with the first charge in breach of that prohibition. The first charge holder's remedy in

:hat event should, however, in our view be limited to a ·ight to reduce the prior or pari passu ranking of the ;econd charge. A right to reduce the second charge as ;uch seems to us too severe a sanction, and to go beyond vhat is intended by the statutory scheme for publishing ›rohibitions. Consultees' views are sought on the ›roblems outlined above, and in particular their responses to the following questions are requested.

Where a charge is registered which purports to rank prior to or pari passu with an existing registered floating charge in breach of a section 464(1)(a) prohibition which of the following remedies should be available to the holder of the existing registered floating charge?

(a) Reduction of the purported prior or pari passu ranking of the offending second charge?

(b) Reduction of the offending second charge as such?

(Question 2.13).

2.111 (v) The situations which we consider above, assume that the relevant prohibition has, by its registration, been published to the second security holder. Circumstances can conceivably arise, however, in which a prohibition imposed by a first creditor which was not so published at the critical time may nevertheless adversely affect the second security holder.

2.112 This possibility arises because of the idiosyncracies of the statutory scheme for registration of floating charges which was adopted when floating charges were introduced into the law of Scotland. It is

fundamental to that scheme, which followed the ther statutory model for charges by English companies, that a floating charge is provisionally valid from the date of its creation and is not merely valid from the date of its registration. Accordingly, registration within the statutory 21 day period can operate to perfect a charge as from its earlier date of creation. A system based upon provisional validity creates, (and this is now recognised and criticised in England no less than in Scotland), a dangerous trap for a prospective creditor if that creditor assumes that he can rely on the ostensible evidence of the register of charges.[1] Such a creditor cannot ascertain from the register whether there is in being an unregistered, but nevertheless provisionally valid charge, which may be capable of being perfected within its applicable 21 day period. He may seek personal undertakings from a company or its directors or its advisers as to the existence of such an unregistered charge but breach of such undertakings, (assuming that they are given), will give rise to claims for damages only. This may create a particular problem in the case where the unregistered but, provisionally valid, prior charge contains a prohibition on the creation of a subsequent security. If (1) the second creditor obtains and registers, say, a standard security in the period between the date of creation by the first creditor of his

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1 See R.M. Goode, Commercial Law, p.771 and the Note by Prentice in 1985 L.Q.R. Professor Goode's analysis, both in this notable book and in a series of contributions by him to 1981 J.B.L., of the underlying concepts of the floating charge and the mechanism of receivership, though written against the background of English law, can also be read with profit by those concerned with those concepts as transplanted to Scotland.

charge and the subsequent perfection by registration of that charge (within its own 21 day period) and (2) the first creditor's charge imposes (as it may well do) a prohibition on the creation of a prior ranking fixed security, then the second creditor will have taken, in good faith (having no knowledge of the first charge at the relevant date) a fixed security which, by virtue of section 464 of the Act, will be deemed to rank in priority to the first creditor's charge and thus to breach its prohibition. Can the second creditor be liable in such circumstances to have his standard security reduced when the prohibition eventually becomes published on its registration? It seems to us that it would be quite inappropriate if it could be so reduced but the question is left unsettled by the present legislation.

2.113 We consider that the present uncertainties could successfully be resolved if the important recommendation put forward in paragraphs 2.137 to 2.139 below, to make the date of creation of a floating charge the same as the date of its registration in the company's register, is implemented. In that event the section 464(1)(a) prohibition in the prior charge referred to above could never be effective except from the date of its registration.

2.114 (vi) The drafting of subsection (5) has been criticised on two counts. First it has been pointed out that the subsection suffers from the same defect as section 13 of the Conveyancing and Feudal Reform (Scotland) Act 1970, namely that the reference to the restriction of "the preference in ranking of the first-

mentioned floating charge" is ambiguous. Does it mean that the preference is restricted absolutely (i.e. in a question with any other interested party, including a liquidator of the debtor company), or restricted only in a question with the giver of the written intimation? There is an argument that the second alternative is to be preferred because what is restricted is not the security but merely the preference. The difficulties of interpretation of this provision have been fully discussed by Mr. G.L. Gretton[1] and Professor J.M. Halliday[2] in Articles published in the Journal of the Law Society of Scotland.

2.115 Consultees' views are requested on the following.

(1) Has the ambiguity arising in section 464(5) caused real difficulty in practice?

(2) If the answer to question (1) is in the affirmative on what basis would consultees consider that the ambiguity should be resolved? (Question 2.14).

2.116 The second criticism of subsection (5) is the difficulty of applying it in a situation where the first floating charge does not secure a current quantifiable amount such as an advance but secures a contingent and unquantifiable obligation under say a guarantee.

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1 "Ranking of Heritable Creditors" "Interpretations" 1980 J.L.S.S. 275 and "A Reply to a Reply" 1981 J.L.S.S. 280.

2 "Ranking of Heritable Creditors" "A matter of interpretation" 1981 J.L.S.S. 26.

Floating charges can, of course, be granted to secure contingent debts due by guarantors no less than to secure debts directly due by borrowers but the terminology of subsection (5) is not well adapted to the former situation. The subsection refers to the security for the first charge being restricted to cover "advances" at the date of intimation of the second charge but it does not specify how such a restriction is to operate in the case where the first charge has not been taken to secure an advance but has been taken to secure a guarantee of an advance. It must, we think, have been the intention that subsection (5) should preserve the first charge holder's security for the maximum contingent amount due to him by the guarantor at the relevant date. We think, however, that subsection (5) should be amended so as to state this in terms.

2.117 Consultees' views are sought on whether legislation should provide that a floating charge securing a contingent obligation such as a guarantee should continue to be available, following intimation of a subsequent floating charge, as security for the maximum contingent amount secured at the date of such intimation. (Question 2.15).

2.118 (vii) The statutory order of priorities which section 464(4) applies in the absence of any conventional regulation to the contrary has the result that a fixed security granted after the date of creation of a floating charge has priority over that floating charge provided that it is constituted as a real right before the attachment of the floating charge. It has been pointed out to us that it is almost invariable practice for the

ranking of floating charges to be specifically regulated in a way which avoids this possibility of a prior ranking for a subsequently created fixed security. It is appropriate therefore to consider whether the present statutory order of priorities under section 464(4) should be altered so as to reflect this practice by giving a floating charge a statutory priority over a fixed security rather than vice versa.

2.119 It seems to us that the practice of creditors contracting out of the statutory order of ranking should not necessarily be taken to indicate that the statutory order is inappropriate as a point of reference. The present statutory provision can, it seems to us, be said to be a correct starting point in that it reflects the underlying theory of a floating charge. The theory is that the floating charge creditor leaves his debtor company free to deal with its assets; and one aspect of that freedom is the freedom to create a fixed security over the assets which can take effect in priority to the floating charge creditor. It may well be that as a matter of business practice creditors withdraw this theoretical freedom from their debtors but that does not displace the basic theory.

2.120 There is, moreover, an important practical point to be borne in mind in considering any recasting of the order of ranking which would give a floating charge statutory priority over a subsequent fixed security. What we have in mind is the position of the preferential creditors. A fundamental characteristic of a floating charge has always been that it ranks postponed to the preferential creditors. Conversely, it is a fundamental

characteristic of a fixed security that it should be unaffected by preferential claims in an insolvency. A statutory rule whereby a floating charge automatically ranked ahead of a fixed security would not cohere with the relative ranking of preferential creditors as against the two types of security.

2.121 There are, therefore, it seems to us, good arguments for leaving the present statutory rule unaltered, leaving creditors to displace the rule by conventional ranking and prohibition provisions as at present.

2.122 Consultees are asked whether it is agreed for the reasons given above that section 464(4) should be left unaltered, disapplication of its provisions being left, as at present, to the initiative of creditors. (Question 2.16).

2.123 (viii)A creditor who takes a floating charge over assets which are already subject to an existing floating charge will take his security interest subject to the prior registered charge. Subsection (5) however, enables such a floating charge holder to limit the extent to which the first charge has priority. If he intimates his floating charge to the prior charge holder then subsection (5) operates to restrict the prior security of the prior charge holder to security for the aggregate of his then advances, plus any further advances which he can be required to make and plus any related interest and expenses.

2.124 Where fluctuating lending such as overdraf lending is secured by way of a floating charge th floating charge holder may well wish to ensure that hi security is not limited at some future date unde subsection (5) by unilateral action on the part of subsequent charge holder.

2.125 It might be thought that subsection (1), (whic enables the holder of a floating charge to regulate th order in which his floating charge is to rank with an subsisting or future floating charge), would enable prior floating charge holder to regulate the extent t which subsection (5) could be operated by a subsequen charge holder.

2.126 It is, however, not clear that subsection (1 can successfully be used to achieve this purpose. Th difficulty arises because the 1985 Act does not specif the relationship, within section 464, between subsectio (1) and subsection (5). If subsection (5) is intended t operate subject to any relevant regulation of the rankin imposed by the first charge holder under subsection (1 then the unilateral operation of subsection (5) at th instance of the second charge holder can be prevented But if subsection (5) falls to be construed as takin effect independently of subsection (1) then th unilateral "freezing" of the security available under a prior charge by subsection (5) will operate regardless o any purported regulation made by the prior charge holder. In the latter event, the only method open to the firs charge holder to ensure that a second charge holder doe not limit his security under subsection (5) will be t persuade that second charge holder (if he can do so) t limit his rights to rely on subsection (5).

2.127 A corresponding point may be made in relation to a prohibition imposed by a floating charge on the creation of a subsequent postponed charge. Section 464(1)(a) enables such a prohibition to take effect as regards the future creation of pari passu or prior ranking securities but it is not expressed so as to enable a prohibition to take effect in relation to the creation of future postponed securities. It is, moreover, doubtful whether a prohibition which purported to do so could be registered in the register of company charges in terms of section 417(3)(e) of the 1985 Act [formerly section 106D(1)(b)(v) of the 1948 Act] since the latter section cross refers to the terminology of section 464(1)(a).

2.128 We think that any dubiety as regards the relation of subsections (1) and (5) should be resolved. It seems to us, but subject to consultees views, that it should be resolved by providing that subsection (5) is to take effect subject to any regulation of ranking duly made under subsection (1) in respect of security for future advances. That would enable a floating charge holder to regulate (as we think subsection (1) intended him to be able to do) the basis on which his charge should rank with any future charge. If no relevant regulation were to be made under subsection (1) then subsection (5) would of course continue to be operable in the normal way.

2.129 We also suggest that section 464 should be amended so as to enable a floating charge holder to impose and register a prohibition upon the creation of future postponed securities and not merely as at present a prohibition upon the subsequent creation of prior and pari passu securities.

2.130 Consultees' views are sought as to whether legislation should make it clear that (1) section 464(5) is to operate subject to any different regulation of priorities imposed under section 464(1) upon the ranking of a postponed floating charge and (2) a prohibition under section 464(1)(a) may extend to include a prohibition on the creation of a subsequent postponed security as well as a prior or pari passu security. (Question 2.17).

D. Section 466(1) and (2) of the 1985 Act [formerly section 7(1) and (2) of the 1972 Act] - Execution of an instrument of alteration

2.131 Section 466(1) of the 1985 Act [formerly section 7(1) of the 1972 Act] provides that any instrument of alteration must be executed by the debtor company who granted the floating charge. In an attempt to simplify the procedures involved in regulating the ranking inter se of securities granted by the company it has been suggested that as such arrangements only concern the security holders involved an instrument of alteration which "varies, or otherwise regulates the order of, the ranking of the floating charge in relation to fixed securities or to other floating charges" should not require to be executed by the company, although it is probably appropriate that as a matter of courtesy the

ranking arrangement should be intimated to it. We understand that in England the normal practice is to confine regulation of priorities to agreement between the lenders. Consultees' views are sought (a) on whether execution of such an agreement by the company causes difficulties in practice, and (b) on the proposal to omit execution by the company. (Question 2.18).

2.132 Section 466(2) of the 1985 Act [formerly section 7(2) of the 1972 Act] regulates the procedure involved in executing an instrument of alteration, and provides that where a company is one of the signatories the document will be validly executed by that company if it is executed "under its common seal or by an attorney authorised for such purpose by the company by a writing under its common seal".

2.133 It has been pointed out, however, that difficulties can arise if the company concerned is a foreign company which does not possess a common seal. This problem will be considered in our work on the execution of writings by companies following on publication of our Consultative Memorandum No. 66 "Constitution and Proof of Voluntary Obligations and the Authentication of Writings".[1]

E. Section 26 of the Companies Consolidation (Consequential Provisions) Act 1985 [formerly section 10 of the 1972 Act] - Amendment to the Industrial and Provident Societies Act 1967

2.134 Section 462(1) of the 1985 Act [formerly section 1(1) of the 1972 Act] provides that it will be competent under Scots law for an incorporated company,

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1 See para. 8.30 of Consultative Memorandum No. 66.

2.139 It is for consideration, therefore, whether these uncertainties could be minimised by providing that the date of creation of a floating charge or an Instrument of Alteration is the date of its registration in the company's register of charges. It is not intended, however, that this proposal should extend to a floating charge or instrument of alteration, affecting assets situated in Scotland granted by a company incorporated outside Great Britain but which has a place of business in Scotland.[1] Consultees' views are sought on this proposal. (Question 2.20).

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1 See section 424 of the 1985 Act [formerly section 106K of the 1948 Act].

PART III - THE RECEIVER

1. Introduction

3.1 In the later paragraphs of this Part, we consider various circumstances in which a receiver may become subject to duties towards third parties. We deal with the statutory duty to the preferential creditors whose prior ranking is an essential aspect of a floating charge, with constraints which may or ought to be imposed on the manner of exercise of the receiver's powers of realisation of assets and with the circumstances in which a receiver may be found to owe duties in delict to those persons who, for the purposes of the law of delict, may be regarded as his neighbours.

3.2 We are aware that some have sought to regard receivership as if it was an insolvency process as well as an enforcement process and have accordingly been tempted to impose on receivers some kind of general duty or responsibility to creditors as a whole. We ourselves believe that it is misleading to regard receivership as an insolvency process and we have not sought to formulate any general statutory duty on the part of a receiver towards creditors or other third parties as such. We think however that it is appropriate, by way of introduction to this Part, to add some explanation of why we do not seek to place receivership in the wider perspective of formal insolvency processes such as a winding up.

3.3 We think that the temptation to assimilate receivership to an insolvency process proper derives from three factors. First there is the tendency of receivership to supplant for practical business purposes full insolvency processes such as winding up. Second there is the nature of the floating charge itself as a global security which potentially involves the taking over of the whole undertaking of a debtor company. Third, there is the fact that receivership in Scotland is wholly a statutory creation and does not originate as it does in England in a private arrangement between a company and its floating charge creditor. This tends to create as it were a "public" aspect for receivership and to divert attention from the fact that a receivership is a procedure for giving effect to the private rights of a floating charge creditor.

3.4 The mechanism of receivership was introduced into the law of Scotland with the deliberate intention of ensuring that a floating charge could be enforced through a process other than a winding up. It is perhaps therefore not surprising that analogies should tend to be drawn between receivership and liquidation, particularly since the latter normally involves (as the enforcement of a fixed security does not) the management and administration of the whole undertaking of a company.

3.5 Nevertheless, we believe that the analogy is misleading and that receivership must be seen as fundamentally distinct from traditional insolvency processes whether those processes are "terminal" processes such as winding up or "rehabilitatory" processes such as the new administration order processes made possible by the Insolvency Act 1985.

3.6 An insolvency process in the proper sense has as its objective the administration of the affairs and assets of a debtor company for the benefit of its creditors as a whole and a liquidator or administrator is someone who represents the general body of creditors. This concern with the general body of creditors forms no part of receivership. A receiver cannot be appointed by a company but only by a particular creditor; a receiver's objective is to enforce that creditor's security; and he enforces subject only to the claims of other security holders, preferential creditors and those who have effected certain diligences. Indeed, but for the need to protect the special priority of preferential creditors and but for the fact that enforcement of a floating charge can involve the management of a business undertaking as well as the mere realisation of a company's assets a floating charge would no more need to have a receivership mechanism than say a standard security would need a receivership mechanism.

3.7 A receivership may well result in an administration and realisation of the whole undertaking of a company and hence may well deprive any subsequent winding up of any substantial purpose. The receivership process does not, however, by supplanting the liquidation process in this way, itself thereby become an insolvency process. Similarly, although the introduction of receivership as a mechanism for enforcement of a floating charge means that there is now an alternative to the "terminal" enforcement process of liquidation it does not follow that it is of the essence of a receivership to seek to maintain the continuance of the goodwill of a debtor company. Receivership offers the potential for the preservation of

the goodwill of the whole or part of a company, but no more than that: and in many cases that potentiality cannot and will not be effectively realised. The introduction of a statutory administration order procedure may help to point the contrast with receivership in this context. The rehabilitation of the debtor company is a basic concern of the former procedure. It is, however, only an incidental effect of the receivership procedure, and the legislation on receivership contains no reference to any rehabilitation function of a receiver.

3.8 It may be thought that our emphasis on receivership as an enforcement mechanism and our caveats above as to its potentialities as a rehabilitation mechanism require to be modified so as to take account both of the statutory concept of the receiver as an agent for the debtor company and of the references in the case law to a receiver having a residual duty to protect the goodwill of a debtor company. It is right that we should say something about those aspects of receivership because we accept that there is danger in making too literal a comparison between the enforcement of a floating charge and the enforcement of an orthodox fixed security.

3.9 The concept of a receiver as an agent of the debtor company itself in relation to the assets comprised in the floating charge is, in Scotland, part of the statutory apparatus of receivership. It is, however, like the contractual agency of an English receiver upon which it was modelled, an agency of a very unusual and very limited kind in that the receiver is appointed by someone other than the principal for whom he is deemed to act as

agent.[1] We touch on some of its unusual aspects below, in considering the effect of a supervening liquidation on the continuance of the agency. For the present it suffices to emphasise the fact that the agency device was devised not to protect the debtor company but rather as a device to protect the floating charge creditor from accepting liability for his own appointee's actings.[2]

3.10 In Re B. Johnson & Co (Builders) Limited[3] it was said by the English Court of Appeal that:-

> "It has long been recognised and established that receivers and managers so appointed are, by the effect of the statute law, or of the terms of the debenture, or both, treated, while in possession of the company's assets and exercising the various powers conferred upon them, as agents of the company, in order that they may be able to deal effectively with third parties. But, in such a case as the present at any rate, it is quite plain that a person appointed as receiver and manager is concerned, not for the benefit of the company but for the benefit of the mortgagee bank, to realise the security; that is the whole purpose of his appointment; and the powers which are conferred upon him, and which I have to some extent recited, are ... really ancillary to the main purpose of the appointment, which is the realization by the mortgagee of the security (in this case, as commonly) by the sale of the assets."

3.11 We think that this comment is no less appropriate to describe the agency of a Scottish receiver and Scottish judges have in fact emphasised that the statutory agency

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1 See, e.g. Milman 1981 M.L.R. 658, for an analysis of the paradoxes of a receiver's agency.

2 See R.M. Goode 1981 J.B.L. 312.

3 [1955] Ch. 634.

does not affect the fact that a receiver acts ultimately for the benefit of the floating charge holder who appoints him.

3.12 The extent to which the preservation of goodwill will be a practical constraint on the actings of a receiver is we think similarly limited in extent. It is true that the preservation of goodwill is a relevant factor in a receivership whereas it cannot be in a process such as winding up which is necessarily terminal. Thus, when a receiver has to decide whether to procure a continuance or a termination of a contract to which the company is a party at the date of his appointment he can and should have regard to the preservation of the company's goodwill in taking that decision. But this consideration will in practice have to co-exist with the receiver's equally well recognised duty to protect the interests of his appointor, the floating charge creditor; and if that latter duty leads him to look for a realisation and not a continuation of the company as a concern then his attitude to the preservation of the company's goodwill as a contracting party will yield to that factor. The point is we think well made by Mr. H.A.P. Picarda,[1] in his recent book on The Law of Receivers and Managers where he comments on the decision in Airlines Airspares Ltd. v. Handley Page Ltd & Another[2] (a case where it was sought, unsuccessfully, to prevent a receiver disposing of the business and goodwill of a debtor company):

> "Any abandonment of a commercial contract will, up to a point, dent the reputation of the company. But it is submitted that only the prospect of a

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1 Picarda, "Law on Receivers and Managers", p.90.

2 [1970] Ch. 193.

significant loss of goodwill should deter a receiver from determining an existing trading contract. In other words if the company is intended to trade in the future the receiver must ask himself: will repudiation seriously affect the trading prospects of the company? If he is directing himself to realisation, he should ask himself whether this repudiation would adversely affect the realisation. Both these questions were raised by GRAHAM J. in Airline Airspares Ltd. v. Handley Page Ltd. where an ex parte injunction was on an interlocutory motion discharged. He found on the facts that future trading was most unlikely and that the receiver's decision to hive off the most economically viable part of the business to a newly formed subsidiary was not impeachable."

3.13 The fact that the essential concern of a receiver is to realise the assets of a company in the interests of his appointor has been clearly affirmed by Scottish judges in interpreting the 1972 Act. Thus, in the Lothian Region case, Lord Grieve remarked of sections 17, 20 and 21 of the 1972 Act [now sections 473, 476 and 477 of the 1985 Act] that:

"It is clear from these sections, considered against the very wide powers conferred on a receiver by s. 15 to which I will shortly refer, that the primary duty of a receiver, under the Act, is to the security holder in whose interests he has been appointed. Counsel for the defenders did not dispute that that was so, but it is a fact which has to be constantly kept in mind when considering a receiver's powers in Scotland in terms of the Act of 1972 which regulates these powers."

3.14 And in the Typesetting case, Lord Ross emphasised the fundamental distinction between the role of an officer such as a trustee in bankruptcy and the role of a receiver.

> "In bankruptcy there is a trustee concerned with the interests of the general body of creditors, whereas in receivership, the primary duty of the receiver is to the security holder in whose interests he has been appointed."

3.15 We think therefore that it should come as no surprise that Chapter II of Part XVIII of the 1985 Act [formerly Part II of the 1972 Act] leaves it to the unfettered discretion of a receiver whether to pursue a "realisation" strategy or a "preservation" strategy and to choose the moment at which he sells any asset in the course of a realisation strategy. The legislation as we see it recognises that a receiver in performing his task on behalf of his appointor requires the same kind of freedom in carrying out that task as the floating charge creditor would do if he were enforcing at his own hand. It does not elevate this task into the kind of role which only a liquidator or an administrator or trustee could perform.

3.16 This is of course not to say that receivers as individuals may not regard the carrying out of their tasks as being quite consistent with protecting, so far as practical, the interests of creditors as a whole. Nor is it to say that delictual responsibilities may not be applicable to a receiver if the specific manner in which he carries out his task does not satisfy those standards of responsibility and carefulness which the common law requires as appropriate to that task.

2. The duties of a receiver

(i) The receiver's common law duty of care

3.17 With the exception of the receiver's statutory duty to account to the creditors including preferential creditors who rank in priority to the floating charge creditor Part XVIII Chapter II of the 1985 Act [formerly Part II of the 1972 Act] does not impose any statutory duties on a receiver or any constraints as to the manner in which he is to exercise his powers of realisation.

3.18 The court has made it clear that it regards the 1972 Act as a self contained code in this area; and that in the absence of express constraints in the legislation the court will not imply any such constraints or apply by way of analogy to receivers duties which common law or statute would impose on the enforcement of a fixed security under the general law.

3.19 Thus the rules which the common law has evolved to ensure equity in relation to catholic and secondary creditors will not be applied to the enforcement by a receiver of a floating charge because, as it was put by Lord Cowie in the Outer House in the Forth & Clyde case:-

> "the legislation has made it clear that the provisions relating to floating charges in the 1972 Act overrule that doctrine in spite of the fact that it is not specifically stated."

3.20 Similarly the obligations which statute[1] imposes upon a creditor enforcing a standard security to advertise the sale of the secured property and to take

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1 Section 25 of the Conveyancing and Feudal Reform (Scotland) Act 1970.

all reasonable steps to ensure that the sale price is the best which can reasonably be obtained have no counterpart in the legislative code relating to enforcement of a floating charge. Indeed, as regards advertisement Part XVIII Chapter II of the 1985 Act expressly excuses a receiver from any duty to advertise charged assets before sale.

3.21 The absence of specific statutory constraints on a receiver does not, as we note below, preclude the possibility that in appropriate circumstances a receiver may be held responsible in delict to third parties including other creditors. Delictual responsibilities are however by their nature a "long stop" and, as we suggest below, delictual duties cannot appropriately or helpfully be expressed in statutory form.

3.22 We think therefore that it is worth considering whether there are any express statutory constraints which it would be appropriate for statute to impose upon a receiver as regards the manner in which he enforces his security. Two possible areas which, it seems to us, might be so regulated are the prior advertising of a sale of heritable property by a receiver and the equitable duties of a floating charge creditor as primary creditor to secondary creditors. In the case of sale of heritable property the current legislation, as we have noted, expressly relieves a receiver from any obligation to advertise prior to a sale.[1] This position contrasts with the obligation to advertise which is imposed on a

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1 Section 471(1)(b) of the 1985 Act [formerly section 15(1)(b) of the 1972 Act].

standard security holder under the Conveyancing and Feudal Reform (Scotland) Act 1970.[1] As regards duties to secondary creditors a floating charge creditor has, as we point out above, no common law duty towards a secondary creditor of the kind which would be imposed on other types of secured creditor.

3.23 (1) Is it agreed that legislation should appropriately impose upon a receiver a duty to advertise the sale of heritable property comprised in the charged assets prior to realising any such property?

(2) Is it agreed that legislation should appropriately impose upon a receiver the same equitable constraints as are imposed on a secured creditor by the common law rules regulating the relation between a catholic creditor and a secondary creditor?

(3) Do consultees think that there are any other duties of a procedural nature which could appropriately be imposed upon a receiver as regards the manner of realisation of assets attached by a floating charge?

(Question 3.1).

3.24 In the Forth & Clyde case the Lord President, although speaking obiter on the point, made it clear that the receiver's discretion as to which assets he realised, and when he did so, did not preclude the possibility of a receiver being subject to common law delictual rules as regards the manner of realisation.

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1 Section 25 of the Conveyancing and Feudal Reform (Scotland) Act 1970.

> "In exercising his powers [the receiver] must nc doubt, for example, exercise care to see that he does not realise company assets for less than the value which might reasonably be expected to be obtained. That, however, is a matter of a different kind with which we are not concerned in this reclaiming motion."

3.25 There is as yet no reported Scottish case which gives a concrete example of the circumstances in which this duty of care may be found to be breached or of the potential categories of persons who may have a delictual claim in that event. We think, however, that the recent decisions of the Scottish courts on delictual liability for causing economic loss indicate that a person in the position of a receiver can be subject to an obligation to exercise an appropriate standard of care and that debtor companies, other creditors, and contingent creditors may all in appropriate circumstances be in sufficient proximity to the receiver to enable them to claim for loss arising from a failure to observe that standard of care.[1]

3.26 Recent case law in England shows that the English courts have been able to establish a firm legal basis both for the standard of care and the identification of those to whom the duty of care can be owed. Thus in the key case of Standard Chartered Bank v. Walker & Another ("the Standard Chartered case")[2] the court held, departing from earlier precedents, that a receiver could be subject, as regards the manner of realisation of

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1 Junior Books Limited v. The Veitchi Co. Ltd. 1982 S.L.T. (Reports) 492.

2 [1982] 3 All E.R. 938.

assets, to duties in tort of the same kind as are imposed on a mortgagee in possession and could owe those duties to a creditor (in that case a contingent creditor in the shape of a guarantor) of the debtor company.

3.27 The circumstances of the Standard Chartered case involved a company which received a loan facility from the Standard Chartered Bank, the repayment of which was secured by a floating charge granted in favour of the Bank and a personal guarantee given by the company directors. A receiver was appointed subsequently under the floating charge. It was alleged that he carried out a sale of the company's machinery in most disadvantageous circumstances, the proceeds of which sale did not realise sufficient money to discharge the floating charge holder's claim, and resulted in the bank seeking payment of the shortfall from the guarantors. The guarantors maintained that the sale was held at the wrong time of the year, was inadequately advertised, poorly attended, and the stock realised considerably less than its real market value.

3.28 The court, equating the position of a receiver with that of a mortgagee in possession, took the view in that case that on the principle of proximity - the proximity of the receiver to the company and the guarantor - the receiver owed a duty to the company and to the guarantor to take reasonable care in the realisation of the company's assets, this duty being simply a particular application of the duty of care owed to any neighbour as laid down in the case of Donoghue v. Stevenson[1]. The

1 [1932] A.C. 562.

court held that while the timing of the sale might be a matter for the receiver he could not choose the worst time possible. Whether the receiver's duty in this respect could be extended to the unsecured creditors did not arise for consideration in the case. In his judgment Lord Denning stated - "I say nothing about creditors. We are not concerned with them today." At the same time however he clearly envisaged a recognition of the receiver's duty to the unsecured creditors when he observed that the duty to exercise a proper degree of care in the conduct of the sale of the company's stock "is owed to all those interested in the proceeds of it".

3.29 The decision in the Standard Chartered case was reaffirmed in the more recent case of the American Express International Banking Corp. v. Hurley[1] where the court held that a receiver was under a duty to a guarantor of the debtor company's indebtedness to take reasonable care to obtain the true market value of certain charged property when he realised the property in the exercise of his power of sale.

3.30 We have given some consideration to whether the delictual duties of a receiver might appropriately be stated in statutory form, so as to form part of a self-contained comprehensive code relating to receivers. We believe, however, that it would be neither practical nor helpful to attempt such a statutory codification.

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1 [1985] 3 All E.R. 564.

3.31 The basis for the common law duties of a receiver must be sufficiently flexible to reflect changes in expectations and sufficiently adaptable to reflect the varying circumstances of individual cases. We think that case law is the only practicable medium through which that flexibility and adaptability can be achieved and we believe against the background of the precedents in the English case law that the law of delict will provide an appropriate basis upon which the Scottish courts can operate.

3.32 Is it agreed that the potential liability in delict of a receiver should continue to be regulated solely by the general law of delict and should not be the subject of any statutory formulation? (Question 3.2).

(ii) The receiver's statutory duty to preferential creditors

3.33 Section 475 of the 1985 Act[1] [formerly section 19 of the 1972 Act] provides that where the assets of the company available for payment of ordinary creditors are insufficient to discharge the preferred debts identified in section 89 and Schedule 4 of the Insolvency Act 1985 (read with Schedule 3 to the Social Security Pensions Act 1975), the receiver has a duty to discharge the shortfall out of any assets coming into his hands in priority to any claims for principal or interest by the holder of the floating charge by virtue of which the receiver was appointed.

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1 As amended by paragraph 20 of Schedule 6 to the Insolvency Act 1985.

3.34 The extent of this duty was considered in the case Westminster Corporation v. Haste[1] ("the Westminster Corporation case"). The case involved the interpretation of section 94 of the 1948 Act [now section 196 of the 1985 Act][2] - the corresponding provision to section 19 of the 1972 Act [now section 475 of the 1985 Act] - and the case might be regarded by a Scottish court as persuasive authority in the interpretation of the corresponding Scottish provision.

3.35 The problem which the court had to consider in the Westminster Corporation case was that which arises where a receiver, wishing to continue the trading operations of a company, uses for that purpose funds which come into his hands and which ought to be utilised under section 475 to meet the prior claims of the preferential creditors, but subsequently finds that the trading operations do not generate substitute funds which can be used to meet those claims in the end of the day.

3.36 In the Westminster Corporation case the court took the view that on a proper construction of section 94 a receiver has an absolute duty to discharge the preferred claims as soon as he is in possession of sufficient funds. If he elects not to do so and finds himself unable to make payment later out of the company's assets he ought to be personally liable to meet the preferred claims. The receiver will be unable to avoid this liability by attempting to justify his delay in payment

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1 [1950] 1 Ch. 442.

2 As amended by paragraph 15 of Schedule 6 to the Insolvency Act 1985.

on the basis that he was seeking to protect the company's trading position. This view was confirmed by Goff J. in I.R.C. v. Goldblatt & Another.[1]

3.37 The Joint Working Party expressed concern that the present rule might work unfairly by inhibiting a receiver from continuing to trade. We do not ourselves think that this is a sufficient reason for altering the rigour of the present rule. The priority of a preferential creditor is a fundamental characteristic of a floating charge and reflects the fact that a floating charge confers a global security over the assets of a company so that preferential creditors may be left with no unsecured assets out of which their own special claims can be satisfied.[2] If a receiver ignores the priorities of the preferential creditors and perils the performance of his obligations to them on the success of his trading operations then it seems to us quite fair, subject to what we say in paragraph 3.38 below, that he should be required to accept personal liability for putting their claims at risk in that way.

3.38 There is, however, one circumstance in which it seems to us that preferential creditors should not expect a receiver to accept personal liability for deferring payment of preferential claims. The circumstance we have in mind is where preferred creditors choose to acquiesce for their own commercial reasons in the deferral and the continued trading. We understand, for example, that the Inland Revenue as a preferential creditor may not in

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1 [1972] 1 Ch. 498.

2 R.M. Goode, "Commercial Law", p.903.

practice insist upon an accounting for its preferential debt at the earliest date and may in many cases be content to await the outcome of the receivership before making a claim. Their attitude, we imagine, reflects the view that continued trading by a receiver in the receivership may not prejudice, and may well enhance, the position of the preferential creditors. When this situation arises we think that the Joint Working Party criticism has more force and that a genuine case can be made out that a receiver ought to be protected against subsequent claims for the loss of funds to meet the preferential claims. A receiver who is impliedly permitted to trade by a preferential creditor should not, we think, be put at risk if, having continued to trade in a commercially reasonable way, he finds that insufficient assets are available to meet the preferential debts at the end of the day.

3.39 Is it agreed that it would be appropriate for legislation to protect a receiver against any liability to preferential creditors under section 475 of the 1985 Act in, but only in, the specific circumstances illustrated above?
(Question 3.3).

3. The powers of the receiver

(i) Proposals for the inclusion of additional section 471 powers[1] [formerly powers under section 15 of the 1972 Act]

3.40 Section 471(1) of the 1985 Act confers upon the receiver the powers given to him by the instrument creating the floating charge under which he was appointed

1 As amended by section 57 of the Insolvency Act 1985.

and the powers specified in the subsection "in so far as these are not inconsistent with any provision contained in that instrument".

3.41 The Joint Working Party have recommended to us that subsection (1) should make it clear that a receiver has the power to sue either in his own name or in the name of the company. The receiver's right to such a power was questioned initially in the Lothian Region[1] case where the receiver sued for a book debt in his own name. Counsel for the defenders submitted a plea of no title to sue contending that the receiver should have instituted proceedings for recovery in the name of the company as he was then empowered to do under section 15(1)(f) of the 1972 Act [now section 471(1)(f) of the 1985 Act], maintaining that although section 15(1)(a) of the 1972 Act [now section 471(1)(a) of the 1985 Act] was widely drafted its terms did not specifically authorise the receiver to sue in his own name. Counsel did concede, however, that any proceedings taken to recover property from the company which a director refused to hand over, or from a liquidator, would have to be taken in the receiver's own name. Lord Grieve held that in seeking to recover property under the powers contained in this subsection, a receiver had discretion to pursue recovery in his own name under section 15(1)(a) or in the name of the company under section 15(1)(f).

> "Once it is conceded, as it must be, that a receiver has power by virtue of the provisions of s. 15(1)(a) of the 1972 Act to raise a claim in his own name to recover property from the company or its liquidator

1 1981 S.C. 119.

for behoof of the security holder, there are no grounds for holding that he is precluded from recovering company property from 'another person' in his own name ... Whatever the purpose of s. 15(1)(f) it cannot, in my opinion, be construed as limiting the powers of the receiver in connection with the raising of legal proceedings."

3.42 The point was again argued before the court in the Typesetting case[1] where the decision reached was that the receiver did not have the power to sue in his own name for recovery of a book debt. The decision however turned upon a view of the effect of attachment on a book debt which must, we think, be taken to have been overruled by the later decision in the Forth and Clyde case.

3.43 Section 471(1) as drafted does not seem to preclude the receiver from suing either in his own name or in the name of the company, and certainly a receiver would wish the former power not only to pursue an action against a company director or a liquidator, but also where he is acting as a principal under a contract. For the avoidance of doubt however it might be advisable to incorporate a specific reference to this power in subsection (1) and consultees' views are invited on this proposal.

3.44 The Joint Working Party also recommended that the subsection should be expanded to empower a receiver to make compromises; to entitle him to make calls (on unpaid shares); to effect a hive down and carry out similar corporate re-organisation; to convene an extraordinary general meeting of the debtor company; and

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1 1982 S.L.T. (Reports) 172.

to acquire property. The first three powers referred to above have been incorporated by section 57 of the Insolvency Act 1985. The Joint Working Party illustrates the possible need for the last power mentioned by putting forward the example of a receiver who proposes to sell property belonging to the company and finds that in order to make it more marketable he requires to purchase adjacent property. Accordingly consultees' views are sought on the need to legislate for the power to convene an extraordinary general meeting of the debtor company and to acquire property. (Question 3.4).

3.45 It is uncertain whether the scope of section 471(1)(a) of the 1985 Act [formerly section 15(1)(a) of the 1972 Act] is sufficiently wide to empower a receiver to challenge a gratuitous alienation. If as we suggested above an all assets floating charge should secure acquirenda we would propose, for the avoidance of doubt, that the receiver is given specific powers to challenge a gratuitous alienation similar to those already available to a liquidator and creditors under the common law and statute. Consultees' views are sought on this proposal. (Question 3.5)

(ii) Power of the receiver and the company directors

3.46 Normally a floating charge is granted by a company over the whole of its property so that at the time of attachment all of the company's assets become subject to the administration of, and realisation by, the receiver on behalf of the floating charge holder. It has been the subject of the court's consideration whether in these circumstances the directors of the company concerned retain any residual powers during the receivership.

3.47 The issue arose in Scotland indirectly in the case of Macleod v. Alexander Sutherland Ltd.,[1] and directly in the case of Imperial Hotel (Aberdeen) Ltd. v. Vaux Breweries Ltd.[2] ("Imperial Hotel"). The same issue came before the English Court of Appeal in Newhart Developments Ltd. v. The Co-operative Commercial Bank Ltd.[3] ("Newhart"). In Imperial Hotel the debtor company had granted a floating charge for £350,000 and a standard security over the Imperial Hotel, Aberdeen in favour of Vaux Breweries Ltd., and had also granted a floating charge over their whole assets in favour of a bank. A receiver was appointed under the bank's floating charge. In the year following that appointment the creditors in the standard security, after failure by the debtor-company to comply with a calling-up notice, entered into missives for the sale of the hotel to Ushers Brewery Ltd. The debtor company raised an action for reduction of the missives on the ground that the creditors in the standard security had failed to take reasonable steps to obtain the best price as required by section 25 of the Conveyancing and Feudal Reform (Scotland) Act 1970. Lord Grieve dismissed the action. In the course of his opinion he said -

> "In my opinion it is quite apparent from the terms of the Act of 1972 and the nature of the duties which a receiver appointed under it is empowered to perform, that the receiver's primary duty is to the security holder, and that, in order to perform it properly, his discretion is not to be subject to interference by the directors of the company concerned."

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1 1977 S.L.T. 44 (Notes of Recent Decisions).

2 1978 S.C. 86.

3 [1978] Q.B. 814.

His lordship also said -

> "I am quite satisfied that the terms of the Act of 1972 do not empower the directors of a company, whose assets are the subject of a floating charge in connection with which a receiver has been appointed, to deal in any way with assets of theirs which are the subject of such a charge during the currency of the receivership. In particular it is not competent for the directors to raise actions in connection with such property."

3.48 In Newhart (the report of which was not available to Lord Grieve in Imperial Hotel) the question that arose was whether the plaintiff company could maintain an action of damages after the appointment of a receiver under a debenture granted by the company. An unusual feature of the case was that the action was directed against "the very people" who had appointed the receiver. The defendants claimed that the action could not proceed without the consent of the receiver. The Court of Appeal held that the action could be prosecuted by the plaintiff company. In the course of his opinion Shaw L.J., after referring to the receiver's power to take proceedings for recovery of the company's assets, said (at p.819) -

> "But the provisions in the debenture trust deed giving him that power is an enabling provision which invests him with the capacity to bring an action in the name of the company. It does not divest the directors of the company of their power, as the governing body of the company, of instituting proceedings in a situation where so doing does not in any way impinge prejudicially upon the position of the debenture holders by threatening or imperilling the assets which are subject to the charge."

Indeed, his lordship considered that -

> "The receiver is entitled to ignore the claims of anybody outside the debenture holders. Not so the company: not so therefore, the directors of the company. If there is an asset which appears to be of value, although the directors cannot deal with it in the sense of disposing of it, they are under a duty to exploit it so as to bring it to a realisation which may be fruitful for all concerned."

His lordship concluded -

> "But where there is a right of action which the board (though not the receiver) would wish to pursue, it does not seem to me that the rights or function of the receiver are affected if the company is indemnified against any liability for costs (as here). I see no principle of law or expediency which precludes the directors of a company, as a duly constituted board (and it is not suggested here that they were not a duly constituted board when they took the step of instituting this action) from seeking to enforce the claim, however ill-founded it may be, provided only, of course, that nothing in the course of the proceedings which they institute is going in any way to threaten the interests of the debenture holders."

3.49 The reaction in Scotland to the decisions reached in Imperial Hotel and Newhart suggests that the English decision is regarded more favourably. The Joint Working Party have expressed the view to us that directors should retain their powers after the company has gone into receivership, except in so far as those powers are inconsistent with the functions of the receiver. As Mr James Campbell points out in an Article on receivers' powers[1] "The fact that a company continues in existence

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1 Article by James R. Campbell - Receivers' Powers, English Style 1979 J.L.S.S. p.154. (See also Dr R.J. Reed's second of three Articles on Aspects of the Law of Receivership in Scotland 1983 S.L.T. (News) 237.)

during receivership and the hope that it will indeed continue beyond that period are more adequately reflected in the approach of the Court of Appeal in Newhart".

3.50 It is important to note, however, that the circumstances arising in Newhart and Imperial Hotel can be distinguished, firstly by comparison of the powers of the receiver incorporated in the debenture granted by Newhart Developments Ltd. with those imported into the floating charge granted by the Imperial Hotel Ltd. by virtue of section 15 of the 1972 Act [now section 471 of the 1985 Act],[1] and secondly on the basis that in Newhart, unlike the position in Imperial Hotel, the company was not called upon to finance the action out of its own resources and was indemnified against liability for expenses.

3.51 It is conceivable therefore that if a Scottish court again considers the residual powers of company directors during receivership it may not follow the decision reached in Imperial Hotel.

3.52 Section 320 of the 1985 Act [formerly section 48 of the Companies Act 1980] appears to require a company to approve in general meeting any sale of assets by a receiver to the company's directors. The Joint Working

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1 In the debenture the receiver is empowered to carry on the business of the company or concur in carrying on the business. In the floating charge the receiver is given the power by section 471(1)(o) of the 1985 Act (as amended by section 57 of the Insolvency Act 1985) to carry on the business of the company or any part of it.

Party question whether it is appropriate for this section to apply (if indeed it does) where the directors have no control over the assets in question. It is for consideration whether this section should be clarified so as to ensure that company approval is not required to such a sale.

3.53 We shall be grateful for consultees' responses to the following questions.

(1) Is legislation desirable to clarify any residual powers to which company directors may be entitled notwithstanding the appointment of a receiver? or

(2) Should amending legislation provide that the directors of a company will retain their powers after the appointment of a receiver except in so far as the exercise of those powers interferes with the receiver in the exercise of his powers or prejudices the rights of the floating charge holder? or

(3) Should amending legislation provide that the directors' powers shall be suspended during receivership?

(4) If option (3) is recommended

(a) should the directors' present statutory obligations to hold an Annual General Meeting, file annual returns and prepare statutory accounts be suspended during receivership?

(b) should there be an express disapplication of section 320 of the 1985 Act [formerly section 48 of the 1980 Act] to the situation where the relevant disposal to a director is made by a receiver?

(Question 3.6).

(iii) Powers of the receiver during liquidation

3.54 This section concerns the effect of the winding up of a company on a receiver's powers during liquidation, and on his position as agent of the company.

(a) Powers of the receiver and the company's liquidator

3.55 A receiver is empowered by section 471(1)(a) of the 1985 Act [formerly section 15(1)(a) of the 1972 Act] to take possession of the company's assets from the company or a liquidator thereof or any other person.

3.56 This power of a receiver to recover assets from a liquidator inevitably poses the question, where a receivership and a winding up are concurrent, whether a liquidator, whose task it is to administer the affairs of a company and whose duty it is to account to preferential creditors who assert their claims by reference to the commencement of a winding up, who is faced with a demand from a receiver who has a similar task and duty, should cede to him any assets in the custody of the liquidator. In Manley Petitioners[1] a liquidator sought to challenge such a demand from a receiver and petitioned the court for a direction on whether he was obliged to comply with the demand. The liquidator had to argue for this purpose that under section 327 of the 1948 Act [now section 623 of the 1985 Act], the winding-up was declared to be equivalent to an arrestment in execution and decree of furthcoming, to an executed or completed poinding and to a decree of adjudication of the heritable estates of the company; that the liquidator was therefore in the position of having effectually executed diligence in all

1 1985 S.L.T. (Reports) p.42.

its forms; that the receiver's powers under section 15(1)(a) were "subject to the rights of any person who has effectually executed diligence on all or any part of the property of the company prior to the appointment of the receiver; and, accordingly, that section 15(1)(a) could not be operated against the liquidator". Lord Kincraig reached the conclusion that section 327 of the 1948 Act did not have the effect contended for by the liquidator; that the liquidator had not effectually executed diligence on the property of the company; and that accordingly the receiver could quite properly claim to have the assets ceded to him to be administered in the course of the receivership.

3.57 Lord Kincraig commented as follows -

> "The whole scheme of the 1972 Act is to give [the receiver] precedence over the liquidator in the administration of the whole property of the company, even if appointed after the commencement of the liquidation. ... whether the receiver is appointed before or after the commencement of the liquidation his rights take precedence over the rights of the liquidator and he is entitled to take control of the property of the company in order to satisfy the debt of the holder of the floating charge."

3.58 It will be seen therefore that the receiver's powers to ingather and administer the assets of a company continue to operate notwithstanding that a liquidator may operate concurrently with him. It follows that if a receiver's appointment is in respect of an all assets floating charge it will only be after such assets have been ingathered and realised, and used by the receiver to satisfy the claims of the prior creditors identified in section 476(1) of the 1985 Act [formerly section 20(1) of the 1972 Act] and the floating charge holder that any

surplus assets remaining will fall to be released to the liquidator. We think that this is the correct result, for a receiver ought to stand outside a liquidation and to ignore it, just as a secured creditor is able to stand outside a liquidation and ignore it, and subject to consultees' views to the contrary we do not propose to make any recommendation to alter this position. (Question 3.7).

(b) Termination of the receiver's agency on liquidation

3.59 Notwithstanding our view that a receiver should continue to exercise his powers during the debtor company's liquidation it is for consideration whether in so doing he should be entitled to act as the company's agent. It seems to us that there is a contradiction in the co-existence of the Scottish receiver's statutory agency with the appointment of a liquidator in a winding up - a contradiction, moreover, which is not found in the corresponding agency of an English receiver. If one looks at the position of an English receiver one finds that case law has long established the proposition that the notion of the receiver acting as the authorised agent of an insolvent company cannot co-exist with the appointment to that company of a liquidator charged with the conduct of the company's affairs on behalf of the creditors as a body.[1] The reason for the incompatability has been explained by Professor R.M. Goode in the following terms:-

> "Until winding up the company is master of its own fate, and, subject to the rights of any other secured creditors, the powers that it chooses to give a receiver over its assets and undertaking are a matter exclusively for the company itself, at any

1 Gosling v. Gaskell [1897] A.C. 575; Thomas v. Todd [1926] 2 K.B. 511.

rate to the extent that it acts intra vires. Unsecured creditors have no locus standi to complain if the company, in agreeing that the receiver shall be its agent, thereby exculpates the debenture holder from responsibility for the receiver's acts. The remedy of an unsecured creditor is to obtain and enforce a judgment, if necessary putting the company into liquidation."

"But once a winding up supervenes, it becomes an entirely different matter. Responsibility for management of the business now passes to the liquidator, as representative of the general body of creditors, and whilst the receiver remains entitled to hold and realise assets comprised in the security he ceases to have the right to carry on the company's business or to commit the company to new contractual liabilities."[1]

3.60 In Scotland, however, the agency of a receiver for the company derives entirely from section 473(1) of the 1985 Act [formerly section 17(1) of the 1972 Act] and since that section makes no special provision for the disapplication of that agency upon a winding up of a company a situation is allowed to arise in Scotland which could not arise in England, the jurisdiction from which the concept of a receiver as agent for the company was derived by the 1972 Act.

3.61 It is necessary at this stage to explain what is entailed in the cessation of the receiver's agency on the winding up of an English company, if only because the notion of cessation of agency is a concept which Scottish practitioners have never had to consider. The essential point to emphasise, it seems to us, is that the cessation of the agency in no sense involves a cessation or diminution of the powers of the receiver over the charged

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1 "Some Aspects of Receivership Law", Centre Point Publications 1981 J.B.L. 313.

assets. As it was put by Goulding J. in Sowman & Others v. David Samuel Trust Limited (In Liquidation) & Another:-

> "Winding up deprives the receiver, under a debenture as that now in suit, of power to bind the company personally by acting as its agent. It does not in the least affect his powers to hold and dispose of the company's property comprised in the debenture, including his power to use the company's name for that purpose ...".[1]

3.62 What it does entail however is that the receiver no longer has the power, except with the authority of the liquidator, to procure the company to enter into new contracts, and if he purports to do so without that authority he cannot claim any indemnity out of the assets of the company as regards his own liability thereunder. (It is the loss of the indemnity which ought to be stressed here, and not the personal liability as such, because it is clear following the amendment to section 473(2) of the 1985 Act [formerly section 17(2) of the 1972 Act] made by the Insolvency Act 1985[2] that a receiver who procures a company to enter into a contract cannot escape personal liability therefor.) In the case of employment contracts the result of a compulsory winding up, it should be noted, may be that a receiver has to accept personal liability because a compulsory winding up will operate to determine the contract which has subsisted up to that date between the company and an employee.

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1 [1978] 1 All E.R. 616.

2 Section 58(2)(a) of the Insolvency Act 1985.

3.63 It is also important to emphasise that the termination of the agency of a receiver on the commencement of a winding up does not, as such, result in the receiver becoming the agent of the floating charge holder. In England, as we understand it, the receiver does not become the agent of his appointer once winding up has commenced. He becomes a principal. It is true that recent case law in England (which would we think be followed in Scotland) shows that a receiver can come to be regarded as the agent of his appointor if that appointor intervenes beyond a certain extent in the conduct of the receivership.[1] This situation, however, can arise whether or not liquidation has intervened and it does not affect the point made above.[2]

3.64 We doubt whether it was appreciated at the time that the drafting of section 17(1) of the 1972 Act [now section 473(1) of the 1985 Act] would result in a discrepancy as between England and Scotland in relation to the extent of a receiver's agency. It seems to us, moreover, that there are positive reasons for providing that a receiver's agency should cease, as it does in England, on a winding up. The well recognised paradoxes in the position of a receiver as agent for a debtor

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1 American Express International Banking Corp. v. Hurley and Hurley v. American Express International Banking Corp. and Another [1985] 3 All E.R. 564. Mr J.R.Lingard in his recent book Corporate Receivers and Insolvencies published in 1986 draws attention to the fact that the circumstances in the case were hardly such as to justify the view that the Bank appointor had "interest" in the receivership process.

2 Standard Chartered case [1982] 3 All E.R. 938.

company may be acceptable, in the interests of convenience, while the company is in receivership only. But those paradoxes may cease to be acceptable once a winding up intervenes, for the continuing agency of a receiver for the company is manifestly at odds with the role of the liquidator in a winding up.

3.65 We are not aware that the superseding of the receiver's agency in an English winding up creates any unacceptable practical problems for English receivers even taking into account the point made above in relation to employment contracts in a compulsory winding up. That encourages us to suggest that the discrepancy between the agency position in England and the agency position in Scotland (which as we note above was probably not intended when the 1972 Act was designed) should be removed.

3.66 (1) Is it agreed that provision be made for the statutory agency of a receiver to terminate on the winding up of a Scottish company on the basis suggested above namely that (1) the powers of the receiver in respect of the charged assets would continue but (2) the receiver would not have power to undertake contracts except with the consent of the liquidator.

(2) If it is agreed that as a matter of principle the receiver's statutory agency should cease on winding up are there any consequential effects of such a cessation which are not identified above but which ought to be taken into account in the relevant legislation?

(Question 3.8).

4. Miscellaneous proposals

(a) Applications to the court during receivership

3.67 Chapter II of Part XVIII of the 1985 Act provides a wide range of powers that can be used to resolve legal difficulties arising in the course of a receivership.

3.68 Section 479(1)(b) of the 1985 Act (as substituted by section 61 of the Insolvency Act 1985) [formerly section 15(1)(e) of the 1972 Act] enables a receiver to apply to the court for directions in connection with the performance of his functions. Under section 477 [formerly section 21 of the 1972 Act] he may seek the court's consent to sell property belonging to the company where a creditor, having an interest in such property, has refused to agree to the sale. A floating charge holder may apply to the court under section 479(1)(a) of the 1985 Act (as substituted by section 61 of the Insolvency Act 1985) [formerly section 23(1) of the 1972 Act] for direction in any matter arising in connection with the performance by the receiver of his functions. A receiver, in the course of taking possession of the company's property, or in carrying on the business of the company, may wish to institute court proceedings using either the power contained in section 471(1)(a) of the 1985 Act [formerly section 15(1)(a) of the 1972 Act] or that contained in section 471(1)(f) of the 1985 Act [formerly section 15(1)(f) of the 1972 Act]. He can in addition agree to a summary trial on a special case.

3.69 The Joint Working Party considered that notwithstanding the wide range of powers available for access to the courts during a receivership the usefulness

of such powers was considerably reduced by the court delays arising in the resolution of any dispute of substance.

3.70 On the basis that a receiver may wish to bring the receivership to a close within a period of 6 months to a year, this time scale makes litigation undesirable where delays are anticipated. The Joint Working Party's view was that a more rapid form of court procedure was required - one which would provide immediate relief on an interim basis and an early hearing on any contentious matter. As they pointed out many of the issues that arise in the course of receivership require immediate resolution, and if a quick decision on an interim basis can be made, the issue may be withdrawn from the court.

3.71 The Joint Working Party also expressed the view to us that it should be made clear in the Rules of Court that the court may ad interim order a defender to take some positive action. The present law on this subject is in some doubt, and it is understood that this has discouraged litigants in a number of cases. They pointed out that in English law clear provision is made for the power to make such an order.

3.72 We have considerable sympathy for the Joint Working Party's view that the usefulness of some of the receiver's powers is reduced by the delays arising in obtaining the resolution in court of any disputes of substance and we think it possible that such factors could affect the decisions by commercial concerns as to whether to use an English registered company in preference to a Scottish registered company. We agree

that the present problems arising from such delays could be resolved by the adoption of some form of expedited court procedure. It is however necessary to remember that the need to consider expedited court procedures in commercial matters is not limited to procedures concerning rceiverships and it would go beyond the scope of our present exercise to make a specific recommendation in an area which may require a more general review of court procedures as they impinge upon commercial issues.

3.73 However, we invite consultees views on the following.

(1) Have consultees experienced delays in securing court judgments on applications submitted to the court during receivership?

(2) If answer (1) is in the affirmative have consultees any proposals to put forward for minimising delays in securing a court judgment?

(3) Should it be made clear in the Rules of Court that the court may ad interim order a defender to take some positive action?

(Question 3.9).

(b) Appointment of a receiver under a floating charge granted by a society registered in Scotland under the Industrial and Provident Societies Acts 1965 and 1967 ("a registered society")

3.74 Under Chapter I of Part XVIII of the 1985 Act [formerly Part I of the 1972 Act] an incorporated company[1] and under section 3 of the Industrial and Provident Societies Act 1967 (as substituted by section 26 of the Companies Consolidation (Consequential

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1 Section 462 of the 1985 Act [formerly section 1 of the 1972 Act].

Provisions) Act 1985) a registered society may create a floating charge over the whole or part of its assets. Chapter II of Part XVIII of the 1985 Act [formerly Part II of the 1972 Act] provides that it is competent for the holder of a floating charge created by a company which the Court of Session has jurisdiction to wind up, or for the court on the application of the holder of such a floating charge, "to appoint a receiver of such part of the property of the company as is subject to the charge". There is however no provision under the Industrial and Provident Societies Acts for the appointment of a receiver by or on the application of the creditor in a floating charge granted by a registered society. Accordingly such a creditor can only realise his security on the winding up of the society. We understand that the inability of a registered society's creditor to appoint a receiver under his floating charge has been to the disadvantage of a registered society seeking credit facilities. It has also been brought to our attention that it is competent under English law to appoint a receiver and manager of the assets of a society registered in England under the Industrial and Provident Societies Acts 1965 and 1967.[1]

3.75 As in the case of the appointment of a receiver of the property of a company any provision for the appointment of a receiver of the property of a registered society should enable the appointment to be made either by a creditor in a floating charge created by the registered society or by the court on the application of

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1 Section 43 of the Industrial and Provident Societies Act 1965.

such a creditor. The court which has jurisdiction to wind up a society is the sheriff court and accordingly it would be for consideration whether a court appointment should be made by the sheriff court instead of by the Court of Session.

3.76 Consultees' views are invited on the following.

(1) Should the facility of receivership be extended to a floating charge granted by a registered society?

(2) Keeping in mind that jurisdiction is conferred upon the sheriff court to wind up a registered society, in the event of question (1) being answered in the affirmative should the court appointment of a receiver be made by the sheriff court or by the Court of Session?

(Question 3.10).

(c) Section 467(6) of the 1985 Act [formerly section 11(5) of the 1972 Act] (Power to appoint a receiver) - Joint Receivers

3.77 A floating charge holder is entitled to appoint more than one receiver of the property attached by the charge, such receivers being collectively referred to as "joint receivers" in section 467(6) of the 1985 Act [formerly section 11(5) of the 1972 Act].

3.78 It has been suggested by the Joint Working Party that where more than one receiver is appointed by the same floating charge holder the act of any one of them should bind all of them unless the instrument of appointment expressly provides that they shall act otherwise. Consultees views are invited on this proposal. (Question 3.11).

(d) **Method of execution of an Instrument of Appointment of a receiver**

3.79 Section 469(3) of the 1985 Act [formerly section 13(3) of the 1972 Act] provides for the methods of execution of an instrument of appointment. The instrument will be regarded as validly executed by a company if it is executed in accordance with section 36 of the 1985 Act [formerly section 32 of the 1948 Act] as if it were a contract.

3.80 Difficulties in execution can arise where the floating charge holder is a company, formed outside the United Kingdom, and which does not possess a common seal. A similar problem has already been discussed above in relation to the execution of an instrument of alteration. As we indicated in that earlier section this problem will be considered in the context of our Consultative Memorandum No. 66 "Constitution and Proof of Voluntary Obligations and the Authentication of Writings".

(e) **Section 476 of the 1985 Act [formerly section 20 of the 1972 Act] (Distribution by the receiver of monies received on realisation of the company's assets) (as amended by Schedule 6 paragraph 21 of the Insolvency Act 1985)**

3.81 Section 476 has been amended by the Insolvency Act 1985 so as to overcome the earlier doubts expressed on whether the list of the categories of prior creditors is a mere tabulation or a statement of the categories in order of priority. Now that these doubts have been resolved by legislation it is important to ensure that each category is clearly defined and no overlap arises between categories. Doubts arise in this respect with regard to subsections (1)(c) and (1)(d). In many instances a receiver will be personally liable under

contracts operating during his period of office subject to a right of indemnification from the company's assets. It has been suggested to us that the distinction between the claims, charges and expenses of creditors incurred by or on behalf of the receiver under subsection (1)(c) and the liabilities and expenses of the receiver and his right of indemnification out of the company's assets under subsection (1)(d)[1] requires to be clarified, in that the creditor's claims under subsection (1)(c) would appear to be the receiver's liabilities and possibly his right to indemnity under subsection (1)(d). Consultees' views are sought on this need for clarification. (Question 3.12).

(f) Section 477 of the 1985 Act (as amended by section 59 of the Insolvency Act 1985) [formerly section 21 of the 1972 Act] (Application by the receiver to the court for consent to dispose of property where consent of prior creditors etc. cannot be obtained)

3.82 The Joint Working Party has identified for us several issues arising out of section 477 of the Act, in so far as it is concerned with applications to the court to release charged assets from pari passu or postponed security interests or encumbrances. We consider first the general question of whether the existing procedures should be superseded by a new scheme for the automatic discharging of pari passu or postponed securities and encumbrances without the need for application to the court. We then consider particular difficulties which arise under the section 477 procedure as it exists.

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1 Subsection (1)(d) was amended by paragraph 21(3) of Schedule 6 to the Insolvency Act 1985.

3.83 Under section 477 of the 1985 Act [formerly section 21 of the 1972 Act] where a receiver appointed under a floating charge granted by a Scottish registered company wishes to sell property covered by the floating charge under which he was appointed but that property is subject to any security interest, burden or encumbrance in favour of, a creditor the ranking of which is prior to, pari passu with, or postponed to, the floating charge, or is attached by effectual diligence executed by any person, and the consent of such a creditor or such person cannot be obtained to the transaction, the receiver must apply to the court for authority to sell.

3.84 It will be seen that a need may arise to seek the consent of the court to a realisation even when the relevant encumbrance or security ranks postponed to or pari passu with the floating charge. The position of a floating charge holder in this respect falls to be contrasted with that of a standard security holder. In the case of a standard security section 26 of the Conveyancing and Feudal Reform (Scotland) Act 1970 enables a pari passu or postponed security or encumbrance to be discharged automatically by virtue of the realisation of the security subjects.

3.85 The present position may put a floating charge creditor at a very real practical disadvantage as compared with a standard security creditor. An encumbrance such as a diligence may (as we have seen) be postponed in priority to a floating charge. But that will not prevent it, by its very existence, from adversely affecting a receiver's ability to dispose of the relevant asset. The point can be illustrated by

considering the effect of an inhibition. As Mr. J.A.D. Hope Q.C. has pointed out in a published Article,[1] it is clear that an inhibition will in most cases be postponed to a floating charge because it will not have the characteristics of being effectually executed on the property of a company for the purpose of the 1985 Act. Nevertheless, its very existence will operate to "cloud the title" which the receiver can offer to a purchaser of the relevant property and the receiver may be required by a prospective purchaser to have the inhibition removed.[2] In that event the receiver will have to go through the time consuming procedures of petitioning the court under section 477 of the Act before the inhibition can be recalled. As Lord Cameron pointed out in the Royal Bank case the drafting of section 477 which refers to a diligence which has "attached" and not (as in section 471(2)(a) of the 1985 Act [formerly section 15(2)(a) of the 1972 Act]) to a diligence which has been "effectually executed on the property", makes it clear that the section 477 procedure is intended to extend to diligences which would not, in terms of section 471(2)(a) necessarily be regarded as being effectually executed in a competition with a floating charge creditor.

3.86 The first question we have had to consider is whether it is appropriate that a floating charge creditor should have to apply to the court before he can procure the disburdening of the charged property from a par passu or postponed security or diligence. The Joint

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1 "Inhibitions and Company Insolvencies: A Contrary View" 1983 S.L.T. (News) p.177.

2 Dryburgh v. Gorden 1896/97 24 R. p.1.

Working Party thought that there should be a provision in relation to floating charges analogous to section 26 of the Conveyancing and Feudal Reform (Scotland) Act 1970 so that realisation by a receiver could automatically disburden the property. We agree with the Joint Working Party that such a provision would be appropriate and desirable.

3.87 Is it agreed that provision should be made to the effect that the disposal of a charged asset by a receiver will disburden automatically the assets of any pari passi or postponed security or encumbrance? (Question 3.13).

3.88 We have noted above that a receiver may require to petition the court under section 477 of the Act to release a diligence, such as an inhibition, in order to facilitate a disposal of charged assets. In that event the court has a discretion to release the inhibition on such terms and conditions as it thinks fit.

3.89 In Armour & Mycroft Petitioners[1] joint receivers found themselves obliged to petition the court under section 477 to release an inhibition (which the inhibitor's own Counsel did not seek to maintain was effectually executed in competition with the floating charge under section 471(2)(a)) so as to enable the property to be sold by them.

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1 1983 S.L.T. (Reports) 453.

3.90 The question of devising satisfactory terms and conditions did not give rise to any difficulty in the case. Lord Kincraig was told that there was no liquidation pending and no security interest other than the floating charge. On that basis he felt able to order that the inhibition should be released and the inhibiting creditor left free to rank for his claim on any proceeds of sale of the property surplus to the requirements of the receiver before the receiver remitted any balance to the debtor company under section 20 of the 1972 Act [now section 476 of the 1985 Act].

3.91 It has, however, been questioned whether it would be appropriate to proceed on that basis in a case where other creditors' interests could be affected by such an order. It has been argued by Mr. G.L. Gretton[1] that, since an inhibitor ought to vindicate his claim by adjudging to secure the reversion or arresting the proceeds of sale, it could be said to be a fraud on creditors to allow an inhibitor to recoup his claim from the free proceeds without such further procedure.

3.92 We think that the point could helpfully be met, as Mr. Hope himself has suggested,[2] by amending the Rules of Court so as to require an advertisement of a section 477 petition. That would enable any creditors with a relevant interest to intervene in the proceedings so as to ensure that they were not prejudiced by the terms of any order.

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1 "Inhibitions and Company Insolvencies" 1983 S.L.T. 145.

2 "Inhibitions and Company Insolvencies: A Contrary View" 1983 S.L.T. (News) p.177.

3.93 Is it agreed that the Rules of Court should be amended as suggested above? (Question 3.14).

3.94 A receiver who is appointed under a floating charge granted by an English registered company, and seeks to sell property belonging to that company in Scotland, may experience difficulty in carrying out that transaction where any of the creditors or other persons identified in section 477 are unwilling to consent to the sale in that section 477 does not entitle an English receiver to apply to the Court of Session in such circumstances for authority to sell the Scottish assets. With a view to overcoming this difficulty we put forward for consultees consideration the proposal that a provision should be made (a) to ensure that the disposal of a charged asset situated in Scotland by an English receiver will disburden automatically that asset of any pari passu or postponed security or encumbrance and (b) to entitle an English receiver to apply to the Court of Session for consent to sell Scottish assets encumbered by a prior security or diligence "effectually executed on the property" of the debtor company. (Question 3.15).

(g) Section 522 of the 1985 Act [formerly section 227 of the 1948 Act] (avoidance of dispositions of property etc. after commencement of winding up)

3.95 Section 522 of the 1985 Act provides that any disposition of a company's property made after the commencement of a winding up by the court shall be void unless the court otherwise orders. Although it appears to have been decided in England that the section can have no application to a disposition which is made by the

receiver of a company,[1] we understand that the question of its application is still raised from time to time in Scottish receiverships. It is we think clear that the section should have no application to a disposition by a receiver and we propose therefore that this be expressly enacted for the avoidance of doubt. (Question 3.16).

3.96 We have considered whether there is any need to make a similar provision in relation to another aspect of section 522, namely whether the attachment of a floating charge to property of a company can be said to constitute a disposition of that property for the purpose of the section.[2] We do not think however that any doubt can arise in this area. As we point out above in discussing Ross v. Taylor it is the floating charge instrument itself which operates by its own effect to attach the assets comprised within its scope and no disposition in the sense of section 522 arises upon an attachment. We suggest therefore, but subject to consultees' views, that it is not necessary to make any avoidance of doubt provision as regards the application of section 522 to the attachment of a floating charge. (Question 3.17).

(h) Section 724 of the 1985 Act - Extra-territorial enforcement of a floating charge by an English company

3.97 Much of the impetus for the introduction first of floating charges and then of receivers into the law of Scotland came from the desire to create equality of

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1 Sowman & Others v. David Samuel Trust Limited (In liquidation) & Another 1978 1 All E.R. 616. Picarda, op.cit., p.158.

2 R.M. Goode, "Legal Problems of Credit and Security", p.8.

opportunity as between Scottish and English companies. It was appropriate therefore that the 1972 Act should have contained a provision facilitating the enforcement of a floating charge created by an English company over its Scottish situated assets. The statutory provision in question, section 15(4) of the 1972 Act, was concerned only with cross-border enforcement as between England and Scotland, and was in the following terms:-

> "A receiver or manager of the property and undertaking of a company incorporated in England which has or acquires property in Scotland shall have, in relation to such part of that property as is attached by the floating charge by virtue of which he was appointed, the same powers as he has in relation to that part of the property attached by the floating charge which is situated in England so far as those powers are not inconsistent with the law of Scotland."

3.98 The scope of section 15(4) of the 1972 Act was extended in 1977 to encompass cross-border enforcement within the United Kingdom as a whole. Section 15(4) was then replaced by section 7 of the Administration of Justice Act 1977 and the latter section was expressed in a rather more direct way than section 15(4) of the 1972 Act had been, with the removal of the express references in the latter to attachment which had been impliedly criticised in a Scottish case to which we refer below. Section 7 of the Administration of Justice Act 1977 has in turn been re-enacted on Consolidation as section 724 of the 1985 Act. Section 724 provides as follows:-

> "A receiver appointed under the law of either part of Great Britain in respect of the whole or any part of the property or undertaking of a company and in consequence of the company having created a charge which, as created, was a floating charge may exercise his powers in the other part of Great Britain so far as their exercise is not inconsistent with the law applicable there."

3.99 We consider below whether the present wording could pose any difficulties for the Scottish practitioner who is asked, as he may well be, to advise on the enforceability of an English floating charge in Scotland.

3.100 The statutory provision in its original form, as contained in the 1972 Act and as set out above, was considered in Gordon Anderson (Plant) Limited v. Campsie Construction Limited and Anglo Scottish Plant Limited ("the Midland Bank case").[1]

3.101 We think it is helpful to recall the precise basis on which that case was decided before considering whether the present statutory wording as contained in section 724 of the 1985 Act should be further clarified or simplified in any way.

3.102 In the Midland Bank case the issue before the court was whether a receiver, appointed by the Midland Bank to an English company, under a floating charge granted by that English company, had the right to collect an asset of that company, namely a debt due to it by one of its Scottish debtors, which had, subsequent to the receiver's appointment, been arrested in Scotland. The majority in the court had no difficulty in deciding that the statutory provision enabled, and was intended to enable, a receiver of an English company to obtain the benefit of a charged asset such as a book debt due by a Scottish debtor. The process, however, by which the court reached its conclusion was, as Professor W.A. Wilson

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1 1977 S.L.T. 7.

pointed out at the time, a rather curious one.[1] Lord President Emslie began by recognising that the statutory provision "clearly intended that a receiver appointed under a floating charge created by a company incorporated in England shall be able to exercise powers over that company's property in Scotland". But he went on to consider the effect to be given to the appointment of the English receiver on the basis that "it must be the law of Scotland, the lex situs, which determines the effect of such an appointment upon assets in Scotland".

3.103 As Professor Wilson commented "it is odd that a section which provides that an English receiver in Scotland is to have the powers which an English receiver has in England should be construed to mean that an English receiver in Scotland should have the powers of a Scottish receiver in Scotland".[1] It is possible that the slightly reformulated statutory provision which now appears as section 724 of the 1985 Act would encourage a court in future to proceed on the more direct basis that an English receiver should be treated as having in Scotland the powers which he has under the law of England. Even so, Professor Wilson's criticism ought in our view to prompt a further reconsideration of the drafting of the statutory provisions on extra-territorial enforcement and in particular, an examination of the proviso to the present section. That proviso, which states that extra-territorial enforcement powers are to be permitted "so far as those powers are not inconsistent

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1 [1977] J.B.L. 160.

with the law of Scotland" can we think be criticised on two counts. First, it is obscure. What kind, or degree, of inconsistency is to be taken into account? Is the wording to be read as some kind of safeguard for public policy considerations? If so, would it not be more appropriate to refer expressly to such considerations? The second ground of criticism is that the proviso may indirectly encourage a court to approach extra-territorial enforcement on the basis which Professor Wilson criticised in his note on the Midland Bank case by concentrating on the local law where it ought to be giving direct effect to the law under which the receiver has been appointed.

3.104 We would be grateful for consultees' views as to whether the proviso to section 724 or any other aspect of the section or the reasoning in the Midland Bank case creates difficulties for those who have to advise on the extra-territorial enforcement of floating charges by an English company. (Question 3.18).

SUMMARY OF QUESTIONS

Note. Attention is drawn to the notice at the front of the memorandum concerning confidentiality of comments. If no request for confidentiality is made, we shall assume that comments submitted in response to this memorandum may be referred to or attributed in our subsequent report.

Part II

Acquirenda

2.1 Is it agreed that a floating charge expressed so as to comprise assets both present and future should as a matter of general principle be capable of attaching assets within its scope whether those assets subsist as assets of the company at the date of attachment or do not come into existence as such until after the date of attachment? (Para. 2.19).

2.2 Should there be any distinction between the scope of an attachment under section 463(1) of the 1985 Act as compared with the scope of an attachment under section 469(7) of the 1985 Act? (Para. 2.25).

The reduced fraudulent preference

2.3 (1) Do consultees consider that, if the value or amount of assets within the scope of a floating charge is increased by virtue of the operation of the rules for reduction of fraudulent preferences, the relevant increase should operate to benefit the floating charge holder or should he be excluded from such benefit so that it can enure for the exclusive benefit of the general creditors?

(2) If consultees consider that a floating charge holder should not be excluded from benefiting from a reduction of a fraudulent preference should a receiver be given express statutory powers to reduce a fraudulent preference?

(3) If it is considered that a floating charge holder should be excluded from the benefit arising from the reduction of a fraudulent preference and that such reduction should operate exclusively for the benefit of the general creditors is it agreed that in order to achieve that end it is necessary to provide that the claims of preferential creditors must be met by a receiver so far as possible in the first instance from assets other than the assets which result from or represent the benefit of the reduced preference?

(Para. 2.40).

The reduced diligence

2.4 (1) Do consultees consider that the reduction, in a winding up, of a diligence by operation of section 623 of the 1985 Act should be capable of operating so as to increase for the benefit of a floating charge holder, the value of the assets attached by his floating charge?

(2) If it is considered that a floating charge holder should be excluded from such a benefit and that the general creditors alone should benefit from the operation of section 623 is it agreed that it would be necessary to provide that the claims of the preferential creditors must be met, so far as possible, in the first instance, from assets other than the assets disencumbered by virtue of the reduction of the diligence?

(Para. 2.47).

Diligence

2.5 (1) Do consultees agree that, as a matter of policy, legislation should continue, for the reasons suggested above, to give the holder of an attached floating charge a priority over a diligence which has been begun prior to attachment but which remains "inchoate" in the sense that a bare arrestment or a poinding or an inhibition is an "inchoate" diligence?

(2) If consultees do not agree that the general policy objective should be as suggested above what in their view should the overall policy objective be as regards the effectiveness of a

diligence against a receiver taking into account the potential ineffectiveness of any such diligence in a subsequent winding up?

(3) If consultees agree that the policy objective of the legislation should be as suggested above do they consider that the technique presently used in the legislation (namely the limitation of the priority to those stages in diligence where the diligence can be said to have been "executed upon the property" of the company) is appropriate to distinguish between the special categories of diligence which ought to have priority and the general category of "inchoate" diligences which ought not to have priority?

(4) In particular are consultees of the view that legislation should specifically itemise those stages in diligence which are to have priority on the ground that they are equivalent in effect to a real right of security or does the present expression "executed upon the property" enable the characteristics of such diligences to be identified with sufficient clarity?

(5) If consultees are of the view that there should be an express itemisation of the diligences which are to have priority as being equivalent to real rights are there any diligences other than those identified for the purpose in the Royal Bank case, namely a furthcoming proceeding upon the arrestment of corporeal moveables and a warrant of sale proceeding upon a poinding, which should be itemised as being equivalent in effect to a real right in security?

(Para. 2.66).

Compensation/set off

2.6 (1) Are consultees of the view that the decision reached in the Forth and Clyde case (1) explains and resolves the inconsistencies within the earlier case law and (2) provides a satisfactory general basis for resolving priorities in situations when the rules on set off or retention of debts have to be reconciled with the attachment of the benefit of a debt by a floating charge?

(2) Do consultees agree that it would nevertheless be helpful if an express statement were included in the legislation as to the basis upon which priorities should be regulated as between a receiver and a party claiming a right of set off or retention?

(3) If consultees think that such an express statement would be helpful do they agree that the Joint Working Party formulation referred to in paragraph 2.76 above as expanded in paragraph 2.79 would be an appropriate basis upon which to proceed?

(4) Are consultees aware of any difficulty which arises under the present law, or of any difficulty which could arise under the kind of statutory formulation suggested above, as regards the application of the expanded rules of set off ("balancing of accounts in bankruptcy") where there is a receivership of an insolvent company?

(5) Can consultees identify any situations not dealt with above where the availability or non availability of rights of set off or retention in relation to a receiver could give rise to anomalies?

(Para. 2.83).

Debts due to preferential creditors as identified in section 614 of the 1985 Act

2.7 Is it agreed that it should be expressly provided that a floating charge which has attached on the prior appointment of a receiver should not be regarded as within the scope of the expression "floating charge" for the purpose of section 89 of the Insolvency Act 1985, thereby ensuring that, where a receivership and winding-up overlap, preferential claims cannot be asserted against a receiver of a Scottish company by reference to the priority point arising on the commencement of the winding-up? (Para. 2.90).

Is the debt secured by the floating charge heritable or moveable?

2.8 (1) Is there a need to provide by legislation whether the rights under a debt secured by a floating charge should be classified as heritable or moveable?

(2) If consultees answer to (1) is in the affirmative do they agree that such rights should be classified as moveable rights, and that no distinction should be drawn for this

purpose between floating charges which comprise heritable property or are limited to heritable property on the one hand and floating charges limited to moveable property on the other hand? (Para. 2.92).

Restriction on disposal of assets secured by a floating charge

2.9 Should legislation specifically provide that a company which has granted a floating charge can only dispose of any property subject thereto in the ordinary course of business? (Para. 2.95).

Difficulties arising from section 464 of the 1985 Act

2.10 Should it be made clear in section 464 of the 1985 Act that the ranking of a floating charge can only be regulated under that section in a manner which is consistent with the protection conferred upon prior charge holders by section 466? (Para. 2.98).

2.11 (1) Have consultees experienced difficulties or inconvenience in situations similar to those described in paragraphs 2.100-2.101 above?

(2) If the answer to question (1) is in the affirmative should legislation specifically provide that the ranking of fixed and floating charges can be regulated by a ranking clause incorporated in the fixed security?

(Para. 2.102).

2.12 Is it desirable to provide that the statutory order of priorities prescribed by section 464(4) can be effectively disapplied by a section 464(1)(a) prohibition no less than by a section 464(1)(b) regulation of priorities? (Para. 2.103).

2.13 In general consultees views are sought on the problems outlined in paragraphs 2.104-2.110 above. In particular where a charge is registered which purports to rank prior to or pari passu with an existing registered floating charge in breach of a section 464(1)(a) prohibition, which of the following remedies should be available to the holder of the existing registered floating charge?

(a) Reduction of the purported prior or pari passu ranking of the offending second charge?

(b) Reduction of the offending second charge as such?

(Para. 2.110).

2.14 (1) Has the ambiguity arising in section 464(5), as to whether a first floating charge holder's preference on receipt of intimation of a second registered floating charge is restricted absolutely (i.e. in a question with any other interested party, including a liquidator of the debtor company) or restricted only in a question with the second floating charge holder, caused real difficulty in practice?

(2) If the answer to question (1) is in the affirmative on what basis would consultees consider that the ambiguity should be resolved?

(Para. 2.115).

2.15 Is legislation necessary to provide that a floating charge securing a contingent obligation such as a guarantee should continue to be available, following intimation of a subsequent floating charge, as security for the maximum contingent amount secured at the date of such intimation? (Para. 2.117).

2.16 For the reasons outlined in paras. 2.119 to 2.121 above are consultees agreed that section 464(4) should be left unaltered, disapplication of its provisions being left, as at present to the initiative of creditors? (Para. 2.122).

2.17 Should legislation make it clear that (1) section 464(5) is to operate subject to any different regulation of priorities imposed under section 464(1) upon the ranking of a postponed floating charge and (2) a prohibition under section 464(1)(a) may extend to include a prohibition on the creation of a subsequent postponed security as well as a prior or pari passu security? (Para. 2.130).

Execution of an instrument of alteration (involving ranking provisions)

2.18 (a) Does the requirement of a debtor company to execute an instrument of alteration which involves ranking arrangements cause difficulties in practice? (b) Should such an instrument of alteration be executed by the debtor company? (Para. 2.131).

Society registered in England or Wales under the Industrial and Provident Societies Act 1967

2.19 Should it be made competent under Scots law for a society registered in England or Wales under the Industrial and Provident Society Acts to grant a floating charge over its assets? (Para. 2.136).

Date of creation of a floating charge or instrument of alteration granted by a Scottish registered company

2.20 Should the date of creation of a floating charge or instrument of alteration granted by a Scottish registered company be the date of its registration in the company's register of charges? (Para. 2.139).

Part III

The receiver

3.1 (1) Is it agreed that legislation should appropriately impose upon a receiver a duty to advertise the sale of heritable property comprised in the charged assets prior to realising any such property?

(2) Is it agreed that legislation should appropriately impose upon a receiver the same equitable constraints as are imposed on a secured creditor by the common law rules regulating the relation between a catholic creditor and a secondary creditor?

(3) Do consultees think that there are any other duties of a procedural nature which could appropriately be imposed upon a receiver as regards the manner of realisation of assets attached by a floating charge?

(Para. 3.23).

3.2 Is it agreed that the potential liability in delict of a receiver should continue to be regulated solely by the general law of delict and should not be the subject of any statutory formulation? (Para. 3.32).

3.3 Is it agreed that it would be appropriate for legislation to protect a receiver against any liability to preferential creditors under section 475 of the 1985 Act in, but only in, the specific circumstances illustrated in paragraph 3.38 above? (Para. 3.39).

Powers of the receiver

3.4 Should subsection (1) of section 471 of the 1985 Act be expanded to confer upon the receiver the power (a) to sue in his own name, or in the name of the company, (b) to convene an extraordinary general meeting of the debtor company and (c) to acquire property? (Paras. 3.43 and 3.44).

3.5 As an avoidance of doubt provision should the receiver be given specific powers to challenge a gratuitous alienation similar to those already available to a liquidator and creditors under the common law and statute? (Para. 3.45).

Power of the receiver and the company directors

3.6 (1) Is legislation desirable to clarify any residual powers to which company directors may be entitled notwithstanding the appointment of a receiver?

(2) Should amending legislation provide that the directors of a company will retain their powers after the appointment of a receiver except in so far as the exercise of those powers interferes with the receiver in the exercise of his powers or prejudices the rights of the floating charge holder?

(3) Should amending legislation provide that the directors' powers shall be suspended during receivership?

(4) If option (3) is answered in the affirmative

(a) should the directors' present statutory obligations to hold an Annual General Meeting, file annual returns and prepare statutory accounts be suspended during receivership?

(b) Should there be an express disapplication of section 320 of the 1985 Act [formerly section 48 of the 1980 Act] to the situation where the relevant disposal to a director is made by a receiver?

(Para. 3.53).

Powers of the receiver during liquidation

3.7 Where a company goes into liquidation should a receiver appointed before or after that of the liquidator retain his present powers to take possession of the company's assets attached by the charge under section 471(1)(a) of the 1985 Act from the company or the liquidator or any other person and to satisfy therefrom the claim of the prior creditors and the floating charge holder releasing any surplus assets remaining thereafter to the liquidator? (Para. 3.58).

The receiver's statutory agency

3.8 (1) Is it agreed that provision be made for the statutory agency of a receiver to terminate on the winding up of a Scottish company on the basis suggested in paragraphs 3.59 to 3.65 above, namely that (1) the powers of the receiver in respect of the charged assets would continue but (2) the receiver would not have power to undertake contracts except with the consent of the liquidator?

(2) If it is agreed that as a matter of principle the receiver's statutory agency should cease on a winding up are there any consequential effects of such a cessation which are not identified above but which ought to be taken into account in the relevant legislation?

(Para. 3.66).

Applications to the court during receivership

3.9 (1) Have consultees experienced delays in securing court judgments on applications submitted to the court during receivership?

(2) If answer (1) is in the affirmative have consultees any proposals to put forward for minimising delays in securing a court judgment?

(3) Should it be made clear in the Rules of Court that the court may ad interim order a defender to take some positive action?

(Para. 3.73).

A society registered in Scotland under the Industrial and Provident Societies Acts ("a registered society")

3.10 (1) Should the facility of receivership be extended to a floating charge granted by a registered society?

(2) Keeping in mind that jurisdiction is conferred upon the sheriff court to wind up a registered society, in the event of question (1) being answered in the affirmative should the court appointment of a receiver be made by the sheriff court or by the Court of Session?

(Para. 3.76).

Joint receivers

3.11 Where more than one receiver is appointed by the same floating charge holder should the act of any one of them bind all of them unless the instrument of appointment expressly provides that the joint receivers shall act otherwise? (Para. 3.78).

Section 476 of the 1985 Act

3.12 Is there a need to clarify the distinction between claims, charges and expenses of creditors incurred by or on behalf of the receiver under subsection (1)(c) and his right of indemnification out of the company's assets and the liabilities and expenses of the receiver under subsection (1)(d)? (Para. 3.81).

Section 477 of the 1985 Act

3.13 Is it agreed that provision should be made to the effect that the disposal of a charged asset by a receiver will disburden automatically the assets of any pari passu or postponed security or encumbrance? (Para. 3.87).

3.14 Is it agreed that the Rules of Court should be amended so as to require an advertisement of a section 477 petition? (Para. 3.93).

3.15 Do consultees agree that provision should be made (a) to ensure that the disposal of a charged asset situated in Scotland by an English receiver will disburden automatically that asset of any pari passu or postponed security or encumbrance and (b) to entitle an English receiver to apply to the Court of Session for consent to sell Scottish assets encumbered by a prior security or diligence "effectually executed on the property" of the debtor company? (Para. 3.94).

Section 522 of the 1985 Act (avoidance of property etc. after commencement of winding up)

3.16 Do consultees agree that it should be expressly enacted for the avoidance of doubt that section 522 of the 1985 Act shall have no application to a disposition which is made by the receiver of a company? (Para. 3.95).

3.17 Do consultees agree that it is not neccessary to make any avoidance of doubt provision as regards the application of section 522 of the 1985 Act to the attachment of a floating charge? (Para. 3.96).

Section 724 of the 1985 Act

3.18 Does the proviso to section 724 of the 1985 Act or any other aspect of the section or the reasoning in the Midland Bank case create difficulties for those who have to advise on the extra-territorial enforcement of floating charges by an English company? (Para. 3.104).

APPENDIX A

List of consultees who responded to the Scottish Law Commission's Memorandum No. 33 on the registration of charges created by companies

1. Mr D.M. Allan, then University of Aberdeen.
2. The Committee of Scottish Clearing Bankers.
3. The Faculty of Advocates.
4. The Law Society of Scotland.
5. Mr W.A. Leitch C.B., then Law Reform Consultant, Office of Legislative Draftsmen, Belfast.
6. Mr H.B.W. MacAllan, Solicitor, Glasgow.
7. Dr. W.W. McBryde, University of Aberdeen.
8. Oswalds of Edinburgh Ltd.
9. Mr H.C. Rumbelow, Solicitor, London.
10. The Working Party consisting of members of the Faculty of Law, University of Aberdeen.[1]

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1 Membership of the Working Party - Mr D.M. Allan, Mr G A Buchan, Miss J.J.H. Gray (now Mrs J.J.H.Pearson), Professor P.N. Love C.B.E., Dr W.W. McBryde.

APPENDIX B

Membership of Joint Working Party on Receivership

Representatives of the Law Society of Scotland

Professor R.B. Jack, Solicitor, Glasgow - Chairman

Mr D.J. McNeil, W.S., Edinburgh (now President of the Law Society of Scotland)

Mr O.H. Speirs, Solicitor, Glasgow

Representatives of the Faculty of Advocates

Mr D.A.O. Edward, Q.C.

Mr R.N.M. Anderson, C.A.

Mr J E Drummond Young

Representatives of the Institute of Chartered Accountants of Scotland

Mr S.M. Fraser, C.A., Glasgow

Mr P.C. Taylor, C.A., Edinburgh

Scottish Law Commission Observer

Mr A.J. Sim, Solicitor, Scottish Law Commission

Secretary

Mr N.H. Rose, Solicitor, Secretary (Law Reform), Law Society of Scotland

Assistant Secretary

Mr R.M. Richardson, C.A., Director, Parliamentary and Law, Institute of Chartered Accountants of Scotland