



Scottish Law Commission
promoting law reform

| (DISCUSSION PAPER No 151)

Discussion Paper on Moveable Transactions

discussion
paper



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Discussion Paper on Moveable Transactions

June 2011

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The Commission would be grateful if comments on this Discussion Paper were submitted by 30 September 2011.

Please ensure that, prior to submitting your comments, you read notes 1 and 2 on the facing page. Comments may be made on all or any of the matters raised in the paper. All non-electronic correspondence should be addressed to:

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

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GLOSSARY, ABBREVIATIONS AND WEBSITES

Accessoriness principle. The principle that a security right has no independent existence, but is merely accessory to, or parasitical upon, another right, namely the obligation whose performance it secures. An Arizona court put it thus: "The note [= personal obligation] is the cow and the mortgage the tail. The cow can survive without the tail, but the tail cannot survive without the cow." (*Best Fertilizers of Arizona Inc v Burns*, 117 Ariz 178, 571 P 2d 675 (App 1977).) The secured obligation does not have to be an obligation owed by the grantor of the security: one person can grant a security for another's debt.

Account debtor or account party. If X owes money to Y, and Y assigns the claim to Z, X is the account debtor or account party. The term is used rather than simply "debtor" because in some cases Y is also a debtor (to Z). Also called the *debitor cessus*.

Accounts. Also called accounts receivable, or receivables, or book debts. See "receivables".

Accretion of title. If X purportedly transfers a right to Y, but in fact X does not have that right, Y does not acquire it: *nemo plus juris ad alium transferre potest quam ipse habet*. But if X thereafter acquires the right, then that right passes instantly and automatically to Y. This is called accretion of title.

After-acquired property/assets. In general, security rights can affect only assets held by the debtor at the time the security right is created. But some security rights can also affect after-acquired assets, ie assets acquired at a later date. Under current law, three types of security right have this power, the most important being the floating charge. (The others are the agricultural charge, and the landlord's hypothec.) After-acquired assets are also known as future assets.

Agricultural charge. A security under the Agricultural Credits (Scotland) Act 1929. It is a non-possessory security over the inventory (including after-acquired inventory) of certain co-operative agricultural associations.

Aircraft mortgage. A non-possessory security over an aeroplane, created by registration. See the Mortgaging of Aircraft Order 1972.

Alienation. To alienate is to transfer to another person.

Anti-assignment clause. A clause in a contract forbidding the assignment of rights arising under the contract. Also called a non-assignment clause or a *pactum de non cedendo*.

Anticipatory assignment. The assignment of a right that the cedent does not yet have, in the expectation that it will be acquired. Also called *cessio in anticipando*.

Arrestment. See "diligence."

Assignment or assignment. The transfer of incorporeal property from the assignor (also called the cedent), to the assignee (also, though rarely, called the cessionary). "Assignment" is the term generally used in Scotland, "assignment" in England and other common law systems. In many countries called "cession". Assignment may be (a) "outright" or "absolute" or (b) in security. Where there is an assignment in security the property is being used as collateral for a debt owed to the assignee. Absolute/outright assignment is sometimes identified with assignment by reason of sale, but this is not accurate, because it may happen for other reasons as well, such as exchange or even donation. Assignment (whether outright or in security) involves three stages, though the first two may be merged in practice. (i) Contract to transfer. (ii) Act of transfer. (iii) Intimation to the account party. The claim is transferred, ie passes from the grantor's patrimony to the grantee's, only at the third stage.

Assignatus utitur jure auctoris. (Literally, an assignee exercises the right of the author. "Author" here means grantor.) The assignee obtains no better right than the cedent had, so that the account party can plead against the assignee any defences that could have been pled against the cedent. Example: Seller sells goods to Buyer on credit, and then assigns the invoice to Financier. If the goods are defective, Buyer can plead that fact as against Financier's claim for payment, just as it could have been pled against Seller's claim for payment. This is so even if Financier was unaware of the problem. Thus assignment does not impair the account party's rights. Financier has no active liability for the Seller's obligations (for example to pay damages). Negotiable instruments are a partial exception to the *assignatus utitur* principle.

Attachment. This term has three different meanings. (i) In Scotland, a synonym for crystallisation. (ii) Also in Scotland, the freezing of an asset by an unpaid creditor, an aspect of the law of diligence. (See "diligence".) (iii) In the UCC/PPSAs a security interest is said to attach when it becomes effective as between debtor and creditor. An attached security that is not perfected is not normally effective against third parties, though this principle is subject to some exceptions.

Bill of exchange. A type of negotiable instrument. In the USA called a "draft".

Bill of lading. A document issued by a shipping company when goods are shipped. The goods are later released to the holder, at the time of presentation, of the bill of lading. A bill of lading thus constitutes indirect possession of the goods. See also "trust receipt financing".

Bill of sale. A concept of English law. It is not easy to pin down, but (notwithstanding the name) most bills of sale are non-possessory chattel mortgages. There is no equivalent in Scotland. Regulated by the Bills of Sale Act 1878, the Bills of Sale Act (1878) Amendment Act 1882, the Bills of Sale Act 1890 and the Bills of Sale Act 1891. In certain types of case, transactions other than securities over chattels are registrable. For example, Insolvency Act 1986 section 344 requires the registration of certain assignments. "The masters of the ... Queen's Bench Division ... shall be the registrar ..." (Bills of Sale Act 1878). The Bills of Sale (1878) Amendment Act 1882 section 11 provides for a local registration system, but such registrations do not oust the central registration in the Queen's Bench Division in London.

Book debts. Debts owed to a business for goods or services supplied on credit. Synonymous, or roughly so, with "receivables". It is a commercial term, but is also used in the company charges registration regime, for "charges" over "book debts" must be

registered. The term is not defined in the legislation, and since there is uncertainty as to its precise meaning the result is uncertainty as to precisely what has to be registered.

Business Finance Report. Business Finance and Security over Moveable Property (Scottish Executive Central Research Unit, 2002). A digital version can be found at <<http://www.scotland.gov.uk/cru/kd01/purple/bfas.pdf>>.

Catholic and secondary securities. If a debtor grants to X security over two assets, and later grants to Y a postponed security over one of them, X is the "catholic" secured creditor and Y is the "secondary" security holder. If the debtor defaults on the debt owed to X, X owes a duty to Y to resort in the first instance to the property over which Y has no security, and to resort to the latter only to the extent that the former is insufficient.

Cedent. A person who assigns. Also called assignor.

Cession. Another word for assignation.

Cessionary. Another word for assignee.

Charge. A term of English law. In a broad sense it means any security right. In a narrow sense it means an "equitable" security right. Nowadays the term is sometimes also used in Scotland, in the broad sense. In Scotland it is also used in the expression "floating charge."

Chargeback. A security granted by a bank customer to the bank over the credit balance on an account with that bank itself.

Chattel. A concept of English law. Chattels divide into personal chattels (= choses in possession) and real chattels (non-freehold non-equitable interests in land, eg leases). If used without an adjective, "chattel" means personal chattel. A chattel mortgage is a mortgage of a personal chattel. In England this is effected by "bill of sale".

Choses in action and choses in possession. Concepts of English law, corresponding fairly closely to incorporeal and corporeal moveable property respectively. See "personal property". In statutes, but seldom elsewhere, they are called "things in action" and "things in possession".

Claim. A personal right to the performance of an obligation, for example to payment of money. A claim is thus a debt, but viewed from the creditor's standpoint. A claim is typically based in contract. For example, the creditor's right arising out of a loan contract, or the seller's right arising out of a contract of sale. But a claim can arise for other reasons, for example a damages claim arising out of a delict. "Claim" is sometimes used to mean the assertion of a right that may be contested by others, such as an insurance claim or a damages claim, but in this discussion paper the word is used in the sense described, ie a personal right to the performance of an obligation.

Collateral. Property that stands as security for a debt. Thus if someone pledges a gold ring to a pawnbroker, the ring is collateral for the loan that the pawnbroker makes. Collateral may be corporeal property, as here, or incorporeal property.

Company charges registration regime. Part 25 of the Companies Act 2006 (and before it its predecessors, most recently Part XII of the Companies Act 1985) requires that certain security rights ("charges") in which the debtor is a company must be registered in the Companies Register within 21 days of their creation, on pain of invalidity against certain parties. Also applies to LLPs.

Companies Register. Each company registered under the Companies Acts has its own file. We refer to the totality of these files as the "Companies Register", though that term is not used in the Companies Acts. Most types of security rights granted by a company must be registered in this register: this is the "company charges registration regime". There are three such registers (England & Wales, Scotland, Northern Ireland), each with its own Registrar, though in practice they are closely connected, and share a website at <www.companieshouse.gov.uk>.

Completion of title. The final step whereby a right is acquired. For example in the acquisition of land, title is completed by registration. In an assignation of a claim, title is completed by intimation.

Conditional sale. The same as sale with retention of title. The term "conditional sale" tends to be used in consumer transactions.

Crowther Report. The Report of the Committee on Consumer Credit, 1971 (Cmnd 4596), chaired by Geoffrey Crowther. It was partially implemented by the Consumer Credit Act 1974. Part 5 of the report, recommending the adoption of legislation based on Article 9 of the UCC, was not implemented.

Crystallisation. The effect of a floating charge is suspended until such time, if any, as it crystallises. Crystallisation can happen in three ways: (i) liquidation, (ii) administration and (iii) receivership. (But whilst liquidation and receivership always imply crystallisation, administration does not necessarily imply it.) "Crystallisation" is the term used in England, and commonly used also in Scotland, though the legislation does not use this word, but rather "attachment".

DCFR. Christian von Bar and Eric Clive (eds), *Principles, Definitions and Model Rules of European Private Law: Draft Common Frame of Reference (DCFR)* (2010). The full version is in six volumes. A one-volume outline edition is also available in print and at <http://ec.europa.eu/justice/policies/civil/docs/dcf_r_outline_edition_en.pdf>. Book IX covers secured transactions over corporeal and incorporeal moveable property. Strongly influenced by the UCC/PPSAs.

Debt. The same as a claim, but viewed from the standpoint of the debtor. However, sometimes in practice the word "debt" is used in both senses. For example, one may read of "the sale of a debt", meaning not the sale of the debt by the debtor (which would not be possible) but the sale of the claim by the creditor.

Debtor. In this paper the word "debtor" is used on the assumption that the person who owes the debt and the person who grants the security are the same, as is usually the case. In fact it is competent for one person to grant security in relation to another's debt. For this reason, some legislative texts avoid the word "debtor" to mean the granter of the security, and use other terms, such as "security provider" (DCFR) or "chargor" (EBRD). The UCC and

some PPSAs use "debtor" but define it to include grantor of the security. (Eg UCC §9-102(28)(A).) For simplicity we follow the UCC/PPSA usage, but admittedly some such term as "security provider" would be more precise and should perhaps be used in any resulting legislation.

Delectus personae. Literally, selection of the person. There are two kinds. (i) *Delectus personae creditoris*. This, "selection of the person of the creditor", means that that person cannot assign to someone else, so that the other party's obligations are owed solely to the original right-holder. The doctrine thus bars the transfer of personal rights. (ii) *Delectus personae debitoris*. This, "selection of the person of the debtor", bars sub-contracting, ie the obligant must perform personally, and cannot perform by the hand of another. Whether there is *delectus personae* of either type depends on the facts and circumstances of the case.

Diamond Report. Aubrey L Diamond, *A Review of Security Interests in Property* (Department of Trade and Industry, 1989), recommending the adoption of legislation broadly based on Article 9 of the UCC. It was not implemented.

Diligence. The set of procedures whereby an unpaid unsecured creditor can enforce the claim against the assets, corporeal and incorporeal, of the debtor. For example, X owes money to Y and Y owes money to Z. Z obtains decree for payment against Y. The debt owed by X is an asset in Y's patrimony. To enforce this decree, Z can "arrest in the hands of" X, thereby attaching the claim. The subsequent step of "furthercoming" results in payment by X to Z, not to Y. Other forms of diligence also exist, according to the type of asset in question.

EBRD. European Bank for Reconstruction and Development. Its *Model Law on Secured Transactions* was devised as a model for legislation in the post-communist states of central and eastern Europe. It was strongly influenced by the UCC/PPSAs, but was adapted for use within a corpus of civilian private law. Available at <<http://www.ebrd.com/pages/research/publications/guides/model.shtml>>. The *Core Principles for a Secured Transactions Law* underlying the model law can be found at <<http://www.ebrd.com/pages/sector/legal/secured/core/coreprinciples.shtml>>. There is also the EBRD publication *Publicity of Security Rights: Guiding Principles for the Development of a Charges Registry*, available at <<http://www.ebrd.com/downloads/legal/secured/pubsec.pdf>>.

Equipment. See "inventory".

Equity/equitable. In English law, some rights have a double existence: they may exist "at law" or "in equity". (In the ordinary sense of the word "law" they are both part of English law.) Rights in security can be either legal or equitable. In general, equitable securities are created by simple agreement, without any external act. An equitable security is generally valid in the debtor's insolvency. But it is often defeasible, for example if the debtor sells the property to a *bona fide* purchaser. Thus it is often weaker than a legal security. The legal/equitable distinction does not exist in Scots law. "Equity" also means the market value of an asset, less the amount of debt secured over it. Thus if land is worth £1,000,000 and there is over it a standard security, securing a debt of £400,000, the "equity" of the property is £600,000.

Express security. Also called voluntary security, or security *ex voluntate*. A security deliberately granted by debtor to creditor. The contrast is with securities arising by operation of law.

External act (or overt act). Where X conveys to Y, or grants a subordinate right to Y, the law usually provides that the X/Y contract is not the sole requirement. For the transaction to affect third parties, there must be some additional, "external", act. It may be delivery, or registration, or (in assignation) intimation. Where an external act is not required, the transfer, security etc is said to take effect *solo consensu*, ie by consent alone. An external act is called for to satisfy the publicity principle. "All rights in security ... require for their constitution not only an agreement between the parties but some overt act." W M Gloag and J M Irvine, *The Law of Rights in Security, Heritable and Moveable, including Cautionary Obligations* (1897). The term "external" act is used in this discussion paper, but the meaning is the same as "overt".

Factoring. Two main transaction types fall under this name. In both cases what is dealt with is the invoice book of a business. (i) The business may use the factoring company simply as an agent, to administer its receivables etc. In this type of factoring the invoices are not sold. What is happening is simply an outsourcing of part of the work of the business's accounts department. (ii) The business sells to the factoring company the invoices as they arise. Thus the business first sells the goods (or renders the services) and then immediately sells the invoices for those goods. There is an assignation to the factoring company, with notification to the customers. It is for agreement as to whether the risk of the insolvency of a customer is to be borne by the business or by the factor. (If by the business, the arrangement becomes difficult to distinguish from a secured transaction.) The term "factoring" is sometimes applied to sale of receivables without notification, but this is more usually known as invoice discounting. The term is also occasionally used to refer to the use of invoices as loan collateral, but at present this practice does not seem to happen in Scotland.

Fiducia cum creditore. Or more fully *fiducia cum creditore contracta*. Also called fiduciary transfer of title. Transfer of title from debtor to creditor, for the purpose of security. It is an example of improper security.

Filing. The term used in the UCC to mean registration. (A distinction is occasionally drawn between filing and registration. See eg Crowther Report para 5.7.13. But this distinction is not generally accepted.) See "registration".

Finance lease. Or financial lease. A lease of moveable property in which the term represents most of the useful life of the property. The contrast is with an "operating" lease in which the lease term is small compared to the lifespan of the property. The hire of a car for a week or for a month would be an example of an operating lease.

Financial collateral. Financial assets used as collateral. The subject is regulated by the Financial Collateral Directive (Directive 2002/47/EC as amended by Directive 2009/44/EC). This is transposed for the UK by the Financial Collateral Arrangements (No 2) Regulations 2003 as amended by the Financial Markets and Insolvency (Settlement Finality and Financial Collateral Arrangements) (Amendment) Regulations 2010.

Financing statement. See "registration".

Fixed security. A security right other than a floating charge.

Floating charge. A security right developed at common law (more precisely, in equity) in England in the 19th century and adopted by statute in Scotland in 1961. It can cover all assets of the debtor, present and future. It can cover immoveable as well as moveable property. Only certain entities can grant a floating charge, most importantly companies and LLPs. Unless and until it crystallises its effect is suspended. When the debtor disposes of an asset, the charge automatically ceases to encumber the asset. If the debtor becomes insolvent, its priority is weaker than that of other securities. Lenders commonly expect to be granted a floating charge, often in combination with other security rights. Governed partly by the Companies Act 1985 and partly by the Insolvency Act 1986. The provisions of the former are prospectively repealed and replaced by Part 2 of the Bankruptcy and Diligence etc (Scotland) Act 2007.

Floating lien. In the UCC/PPSAs, a security that covers after-acquired property while allowing the debtor to dispose of (at least some types of) assets in the ordinary course of business. (The term itself is not used in the legislation, which does not have a specific term.) It is functionally comparable to the floating charge but it does not cover immoveable property. It does not make use of the concept of crystallisation.

Future assets. See "after-acquired" assets

Goods. (Almost always used in the plural.) The term can be used to refer to assets of any kind, but usually the term is limited to corporeal moveable property.

Halliday Report. *Report by the Working Party on Security over Moveable Property, 1986*, chaired by Professor John (Jack) Halliday. (Available on the SLC website.) It was not implemented.

Hire purchase (HP). X (eg a motor dealer) owns a corporeal moveable asset (eg a car). Y, a customer, lacks the resources to buy the car outright. X sells the asset to Z, a financier, and Z then hires it to Y, with an option for Y to acquire ownership by making full payment.

Hypothec. Non-possessory security over corporeal property. Whilst security over land is in principle a hypothec, in practice the term is used in Scotland only for moveable hypothecs ie non-possessory security over corporeal moveables. (By contrast in many countries the term is used mainly for land.) Scots law does not generally allow moveable hypothecs. Exceptions are ship mortgages, aircraft mortgages, floating charges, agricultural charges and the landlord's hypothec. The last of these arises by operation of law. It is a security over the tenant's goods in the tenanted property, in security of the rent. It has been abolished in relation to residential and agricultural tenancies.

Improper security. See "proper security".

Intellectual property (IP). Examples include patents, trade marks and copyright.

International private law (IPL). Also called private international law, or the conflict of laws. The branch of law that deals with (i) the question of which legal system governs a given matter (eg whether a contract is governed by Scots contract law or by Texas contract law) and (ii) which country's courts have jurisdiction to hear and determine a given matter (eg whether a dispute arising out of a contract is to be heard and determined by a Scottish court or by a Texas court). Each country has its own IPL. The different IPLs do not always

dovetail. IPL operates within non-unitary states. For example IPL issues arise as between England and Scotland.

Intimation. Notification of assignation to the account party. (Scots lawyers are used to this term. But others often find it puzzling, for in ordinary speech to "intimate" is to hint, or suggest, as in Wordsworth's *Intimations of Immortality*.)

Inventory. Also called stock in trade. A business's corporeal moveable property intended for sale, or for processing and then sale. The contrast is with equipment, which is the remainder of a business's corporeal moveable property. Office equipment, vehicles etc are normally equipment. (But there are businesses that deal in office equipment, vehicles etc.)

Invoice discounting. The selling of invoices without notification of the account party, so that the invoice will be paid to the original creditor, who will then pass on the payment to the invoice buyer. It is for agreement as to whether the risk of the insolvency of a customer is to be borne by the business or by the factor. (If by the business, the arrangement becomes difficult to distinguish from a secured transaction.) Cf "factoring".

Landlord's hypothec. See "hypothec".

Law Com CP No 164. Law Commission of England and Wales (<www.lawcom.gov.uk>), Consultation Paper No 164, *Registration of Security Interests: Company Charges and Property other than Land* (2002).

Law Com CP No 176. Law Commission of England and Wales (<www.lawcom.gov.uk>), Consultation Paper No 176: *Company Security Interests: A Consultative Report* (2004).

Law Com Report No 296. Law Commission of England and Wales (<www.lawcom.gov.uk>), Report No 296: *Company Security Interests* (2005). This was not implemented.

Lien. (i) In its standard meaning in Scots law, a lien is a security over corporeal moveable property arising by operation of law. It presupposes possession by the creditor. An example would be the lien that a repairer has over the object repaired (eg a car) in respect of the repair bill. But, by way of exception, "maritime liens" are non-possessory. (ii) The word is sometimes used more broadly, especially in the USA, to mean any security right.

LLP. Limited liability partnership. (Limited Liability Partnerships Act 2000.) Not to be confused with limited partnerships. (Limited Partnership Act 1907.)

Logbook loan. A commercial (rather than a legal) term meaning a loan secured by a non-possessory security over a road vehicle. In England and Wales a logbook loan takes the form of a bill of sale. Under current law this is not possible in Scotland.

Mature. If X lends Y money on 1 February, payable on 1 November, the claim "matures" on the latter date. Until then it is "unmatured", unless before that date it is "accelerated." The loan contract may provide for early repayment, in defined circumstances, and this is known as acceleration.

Moveable property. Property other than immoveable (also called heritable) property. The latter means land and what is connected with land, such as buildings, and also rights connected with land, such as the lease of a building. As well as being divided into moveable and immoveable/heritable, property is also divided into corporeal and incorporeal. Examples of incorporeal moveable property include receivables and intellectual property.

Murray Report. *Security over Moveable Property in Scotland: a Consultation Paper* (Department of Trade and Industry, 1994). Produced for the DTI by an advisory group chaired by Professor John Murray. Strictly this was a consultation paper rather than a report, so that "Murray Report" is not an accurate title, but nevertheless the paper came to be known by that name, perhaps because it contained a draft bill. No final report was published. No legislation resulted, but some of the ideas were echoed in Part 2 of the Bankruptcy and Diligence etc (Scotland) Act 2007.

Negotiable instrument. A document that goes beyond evidencing a debt, and "embodies" it. The main types of negotiable instrument are the bill of exchange (also called the draft) and the promissory note. Negotiable instruments are more easily transferable than other claims. Notification to the account debtor is not required. The doctrine of *assignatus utitur jure auctoris* does not generally apply to them, so that a good faith transferee generally takes free of defences against payment. (The basic law of negotiable instruments is similar in all countries, as a result of their frequent use, over many centuries, in international trade. But the UK is not a party to the 1930 Bills of Exchange Convention. The Bills of Exchange Act 1882 continues in force.)

Nemo plus juris ad alium transferre potest quam ipse haberet. (Ulpian, Dig 50.17.54.) Nobody can grant a larger right than is held by the grantor. The same idea is sometimes expressed as *nemo dat quod non habet*. Thus if X borrows a bicycle from Y and then (fraudulently) sells it to Z, Z has no title. The principle applies even if the grantee is in good faith, but subject to certain exceptions, notably sections 24 and 25 of the Sale of Goods Act 1979. See also "accretion of title."

Non-notification security. Security over a claim without notification to the account party. This is competent under current law only in the case of the floating charge.

Non-possessory security. Security over corporeal property in which the debtor retains possession. That is always the case for security over corporeal immoveable (heritable) property. Scots law currently allows this for corporeal moveable property only in certain cases, namely the floating charge, the agricultural charge, the landlord's hypothec and certain maritime security rights.

Noting filing/registration. See "registration".

Operation of law. A security that arises "by operation of law" is one that comes into existence automatically in defined circumstances, without having to be granted to the creditor by the debtor. Also called a security *ex lege*, or a "tacit" security. An example is the repairer's lien. Thus a garage that repairs a motor vehicle has, in respect of the repair bill, a security over the vehicle, arising by operation of law. The contrast is with "express" security.

Outright assignment. See "assignment".

Pactum commissorium. Also called a *pactum legis commissoriae*. A clause in a secured loan contract whereby in the event of default, title to the collateral passes to the creditor. In most legal systems, including probably Scotland, such clauses are normally void.

Part 25 of the Companies Act 2006. See the "company charges registration regime".

Perfection. A term used in the UCC/PPSAs. In those systems, a security interest attaches when it is effective as between debtor and creditor, but at that stage it is not (subject to certain exceptions) effective against third parties. The next step is perfection, whereby the security interest becomes effective against third parties (subject to certain exceptions). Perfection usually requires either (i) registration or (ii) possession, but there are exceptions.

Person. In law a person is the subject of rights and obligations. So as well as (i) natural persons, such as David Hume or Rob Roy MacGregor, there are (ii) juristic persons (also called legal persons) such as companies.

Personal Property. Or "personalty". A term of English law, corresponding closely to the concept of moveable property. Personal property divides into "choses in possession" (also called tangible property) and "choses in action" (also called intangible property), corresponding approximately to the division between corporeal and incorporeal moveable property. The word "personal" in the phrase "personal property" is not the same as the concept of personal right.

Personal Property Security Acts (PPSA). Statutes based on UCC-9 are often called Personal Property Security Acts. (In Australia and New Zealand as the Personal Property *Securities* Acts.) In this context the word "personal" is used to mean "moveable". Whereas Article 9 is merely one part of a general commercial code, the PPSAs are free-standing enactments. The PPSAs differ to some extent from the UCC and also to some extent vary among themselves, but the similarities outweigh the differences. In Australia the PPSA has been adopted at Commonwealth (ie federal) level so that the law is the same in the different states. In Canada the law has been adopted at provincial level, so there is some variation within Canada. Quebec is the exception, but the legislation there has in fact been much influenced by the PPSAs. The links for the legislation in Australia, New Zealand, Ontario and Saskatchewan are as follows: <<http://www.comlaw.gov.au/comlaw/management.nsf/lookupindexpagesbyid/IP200944081?OpenDocument>>; <<http://www.legislation.govt.nz/act/public/1999/0126/latest/DLM45900.html>>; <http://www.e-laws.gov.on.ca/html/statutes/english/elaws_statutes_90p10_e.htm>, and <<http://www.qp.gov.sk.ca/documents/English/Statutes/Statutes/P6-2.pdf>>.

Personal right. A right against a person. Also called a claim. Contracts create personal rights, but such rights can also have other sources. A personal right is as good as the person against whom it is held. A personal right against the Bank of England to be paid £1 is better than a personal right for the same amount against a person who has become insolvent. A right may still be personal even if it relates to property. For example if X owns land and contracts to transfer it to Y, Y's right is personal. A real right is a right directly in a thing rather than against a person. Thus when Y's name replaces X's in the Land Register, Y has a real right, and the personal right against X is now spent. Real rights are as good as the thing in which they are held.

Pledge. Security over corporeal moveable property constituted by delivery to the creditor. For example if Jack goes to a pawnbroker, and borrows money on the security of an antique clock that he hands over the counter, the clock has been given in pledge as security for the loan. Pledge is sometimes thought of as a sale with right of redemption, but that is inaccurate. The debtor remains owner unless and until the lender, following default on the loan contract, sells the object. Occasionally the term is used in a broader sense to mean any kind of security.

Possession. To be distinguished from ownership. To quote Ulpian: "*Nihil commune habet proprietas cum possessione.*" (Dig 41,2,12. "Ownership and possession have nothing in common with each other.") Whilst ownership and possession commonly coincide, there are non-possessing owners and non-owning possessors.

Possessory security. Security over corporeal property in which the security is based on the possession of the creditor. Pledge and lien are the possessory securities in our law, the difference between them being that pledge is express (voluntary) and lien is tacit (implied by operation of law).

PMSI. See "purchase money security interest".

PPSA. See "Personal Property Security Acts (PPSA)".

Prior tempore potior jure. Earlier by time, stronger by right. For example, if there are two securities over an item of property, held by different creditors, the first to be created has a higher rank than (has priority over) the second. That is an example where the competing rights can both exist, and the only question is of ranking. Sometimes the competing rights cannot co-exist, so that the first excludes the second wholly. For example, X assigns a right to A and to B. The first to complete title by intimating to the account debtor excludes the other.

Proper security. A security right that is a subordinate right, leaving the title in the debtor. By contrast in an improper security title is vested in the creditor, and the debtor has a personal right against the creditor to acquire the title when the debt is paid.

Publicity principle. The principle that what affects third parties should be discoverable by third parties. It is not an absolute principle. Different legal systems apply the principle with varying degrees of enthusiasm.

Purchase money security interest (PMSI). A right in security that secures the financing of the purchase of the asset over which the financing is itself secured. In the UCC/PPSAs, a PMSI has priority over earlier security rights, held by other creditors, that cover after-acquired assets. Depending on whether the financing is provided by the seller or by a third party, a PMSI can be either (i) a seller-credit PMSI, where the goods are sold on credit or (ii) a lender-credit PMSI, where a lender such as a bank lends the buyer the money.

Quasi-security. This term is sometimes used to describe devices that have an effect similar to security, such as retention of title in sale, and hire-purchase.

Real right. See also "personal right". Real rights divide into (i) ownership and (ii) the subordinate real rights, or limited real rights, which are real rights held in something that is owned by someone else. For example if X owns land and borrows money from Y, granting to

Y a standard security, there are now two real rights in the property, X's real right of ownership and Y's subordinate real right of security. A subordinate real right is also called a *jus in re aliena*.

Receivables. Also called trade receivables, or accounts, or accounts receivable, or book debts. Money due in respect of goods sold, or services rendered, on credit. The term is a commercial rather than a legal one, and its precise scope is open to debate.

Recharacterisation. In the UCC/PPSAs, devices that function as security rights ("quasi-securities") are treated as security rights. Thus function prevails over form. So if X sells and delivers a bicycle to Y, retaining ownership until Y pays, that arrangement is "recharacterised" so that Y is treated as having become owner and X is treated as having a security interest. "Recharacterisation" is not a term used in these statutes themselves, but it is the standard label for this approach.

Registration. Also called filing. Sometimes registration is divided into "notice registration" and "transaction registration". The former, a feature of the UCC and the PPSAs, involves the registration of a skeletal "financing statement". This is different from the "security agreement" itself. The registered entry merely alerts third parties to the possibility that there may exist, or may exist in future, a security right. "Transaction registration" specifies the security right, and can involve registration of the security agreement itself. But the distinction between notice registration and transaction registration is not sharp. Registration can also vary in its nature in other respects. For example it can be a necessary condition for the creation of the security (the Scottish rule for security over land) or it can merely give notice of a security that has already been created off-register. The latter is the approach both of the UCC (and the PPSAs) and of Part 25 of the Companies Act 2006, though the consequences of non-registration are different in each case. One benefit of registration systems is that they can determine priority, and it is a common criticism of Part 25 of the Companies Act 2006 that (subject to certain qualifications) it fails to take advantage of this possibility.

Retention of title. Also called reservation of title, retention of ownership etc. If goods are sold and delivered on credit, the seller's position can be protected by retention of ownership (title). The sale contract says that ownership (title) is retained by the seller, notwithstanding delivery, until the price is paid. Also called conditional sale. The effect is in practical terms somewhat similar to an unconditional sale plus (i) a seller-to-buyer loan of the price, plus (ii) buyer-to-seller payment of the price (out of the notional loan), plus (iii) with a grant back to the seller, by the buyer, of a security right over the goods, to secure the loan.

Retrocession. If X assigns to Y, and later Y assigns back to X, that re-assignment is commonly called retrocession. The main case of retrocession in practice is where a right has been assigned in security of a loan, and the loan is later paid off.

Section 893 order. A security right granted by a company generally has to be registered in the Companies Register under Part 25 of the Companies Act 2006. If the security is registered in another register anyway (for example, a standard security registered in the Land Register), the result is a requirement for double registration. Section 893 of the 2006 Act is an innovation allowing the Secretary of State to make an order whereby registration in the "special" register (eg the Land Register) suffices, though in that case the information is passed on to the Companies Register. The benefit to the parties is that only one registration

is needed to protect the validity of the transaction. So far no section 893 order has been made.

Securitisation. The sale of financial assets from the original creditor ("originator") to a "special purpose vehicle" (SPV) which funds the purchase by issuing bonds. Sums due on mortgage (heritable security), credit cards, car loans etc are securitised. Securitisation may be effected by assignment, though in current practice this is uncommon. (That might change if the reforms proposed in this discussion paper were to be adopted.) But sale without actual transfer is more common. Securitisation is a business term rather than a legal term. In legal (but not business) terms, securitisation is similar to factoring.

Security agreement. The term used in the UCC/PPSA systems to mean the agreement that constitutes the security right. In those systems it is distinct from the "financing statement", the latter being the document that is registered.

Security. This term has two meanings, which have little connection. (i) A right in security, ie a right that secures some other right, such as a security over land that secures payment of a loan. "Security" in that sense is the subject of much of this paper. (ii) Company shares, bonds etc. This second sense is not a precise one. For example the Banking Act 2009 uses the term to include "any ... instrument creating or acknowledging a debt." (Section 14.)

Sequestration. Commonly known as bankruptcy. The insolvency process available for all types of debtor other than companies and LLPs, for which liquidation is the appropriate process. The person who administers a sequestration is called the trustee in sequestration.

Ship mortgage. A non-possessory security over a ship, created by registration. See the Merchant Shipping Act 1995 sch 1.

Situs. The place where an asset is situated for the purpose of determining which legal system is applicable to it. The *situs* of land is the country where the land is. The same is generally true of corporeal moveable property. Incorporeal property has no *situs* in a literal sense, but a *situs* has to be allocated to it for certain purposes. For example if Scottish company X lends money to Scottish company Y, the resulting monetary claim is an asset of X: it is incorporeal moveable property with a Scottish *situs*. The law of the *situs* is known as the *lex situs* or the *lex rei sitae*.

Solo consensu. By consent alone. A transfer, or a security, that works *solu consensu* is one that requires no external act.

Standard security. A right in security in land is called a "heritable security". (The English equivalent is a mortgage.) The only type of heritable security competent in modern law is the standard security. It gives the grantee a limited right in the property, leaving ownership with the grantor. (Conveyancing and Feudal Reform (Scotland) Act 1970.) Created by registration in the Land Register.

Tacit. See "operation of law".

Trust receipt financing. Imported goods are often paid for not by the importer but by a bank (under a letter of credit), with the importer later repaying the bank. Under such an arrangement the bill of lading is sent by the exporter not to the importer but to the bank. The bank will not normally release the bill of lading to the importer except in exchange for

payment. However, this letter of credit system can be extended by trust receipt financing, in which the importer receives the bill of lading from the bank without first paying. The importer gives the bank a document called a trust receipt (often abbreviated to TR), whereby it holds the bill of lading, and the goods it represents, on behalf of the bank until payment is eventually made. In the UCC/PPSAs a trust receipt is classified as a non-possessory security interest and therefore subject to the usual perfection requirements.

UCC. Uniform Commercial Code of the USA. Available at <<http://www.law.cornell.edu/ucc/ucc.table.html>>. The UCC is divided into parts called articles. Article 9 deals with security interests in moveable property and is in this paper cited as "UCC-9". The UCC is a model law, which has been enacted in virtually identical form by all fifty states. (Except Louisiana, which has not adopted the whole of the UCC. But it has adopted Article 9.) It is revised from time to time, and in practice the states adopt the revisions promptly. The most recent revision of Article 9 was in 1999, implemented by all the states in 2001.

UCC/PPSA. This term is used in this discussion paper to indicate the PPSA systems, and Article 9 of the UCC, from which the PPSAs took their inspiration. The PPSAs differ to some extent from the UCC, and also differ among themselves. Moreover, all of them are amended from time to time. Hence the expression "UCC/PPSA" does not signify some unique and unchanging system, but rather a broad approach.

UNCITRAL. The United Nations Commission on International Trade Law.

UNCITRAL Assignment Convention. The UNCITRAL Convention on the Assignment of Receivables in International Trade. Available at <http://www.uncitral.org/uncitral/en/uncitral_texts/payments/2001Convention_receivables.htm>.

UNCITRAL Legislative Guide on Secured Transactions. A set of recommendations by UNCITRAL as to what national laws about secured transactions should look like. Available at <http://www.uncitral.org/uncitral/en/uncitral_texts/payments/Guide_securedtrans.html>. The main Guide dates to 2007 and was supplemented in 2010 by a Supplement on Security Rights in Intellectual Property, available at <http://www.uncitral.org/pdf/english/texts/security-ig/e/10-57126_Ebook_Suppl_SR_IP.pdf>.

UNIDROIT Cape Town Convention. International Institute for the Unification of Private Law (UNIDROIT) Convention on International Interests in Mobile Equipment. "Mobile equipment" means "(a) airframes, aircraft engines and helicopters; (b) railway rolling stock; and (c) space assets." Available at <<http://www.unidroit.org/english/conventions/mobile-equipment/main.htm>>. The UK has signed but has not ratified or acceded. The Convention itself is a framework convention, which works in unity with its protocols. Two protocols so far exist, for aircraft (<<http://www.unidroit.org/english/conventions/mobile-equipment/aircraftprotocol.pdf>>) and railway rolling stock (<<http://www.unidroit.info/program.cfm?menu=instrument&file=instrument&pid=33&lang=en&do=fulltext>>). The third protocol is in preparation. There are separate international registries for each of the three categories of asset.

UNIDROIT Factoring Convention. International Institute for the Unification of Private Law (UNIDROIT) Convention on International Factoring. Available at <<http://www.unidroit.org/english/conventions/1988factoring/main.htm>>.

Warrandice. A warranty, or guarantee. If X assigns to Y money owed by Z, X is presumed to warrant to Y that the debt is indeed owed by Z. That is known as warrandice *debitum subesse* – warrandice that the debt subsists. Such warrandice is only that the debt is payable, not that it will in fact be paid. For instance, if Z becomes bankrupt, that would not constitute breach of the warrandice. (But an additional guarantee about Z's solvency could be added, if X and Y so agree.)

Chapter 1 Introduction

The project and its three strands

1.1 In our *Seventh Programme of Law Reform*, published in 2005, one of the new projects announced was the law relating to the assignation of, and security over, incorporeal moveable property.¹ As we noted at the time, however, the project would not make much progress until the completion of the Land Registration project, which did not happen until December 2009.² When consulting for the Eighth Programme, we found that there was interest in extending the project to include security over corporeal moveable property. We agreed, and the Eighth Programme accordingly extends the project so that it now has three strands.³ The three strands are:

- (i) Outright transfer (assignation) of incorporeal moveable property;
- (ii) Security over incorporeal moveable property;
- (iii) Security over corporeal moveable property.

Thus the project does not cover the outright transfer of corporeal moveable property. That remains subject to the Sale of Goods Act 1979 and, in the case of non-sale transfers, to other rules. (Transfer by way of donation and by way of exchange remain subject to the common law.) The omission of this fourth strand does not necessarily mean that we consider the law about the outright transfer of corporeal moveable property not to be in need of reform.

1.2 Whilst the three strands of the project are distinct, they are also linked. For example, (i) and (ii) are closely linked because under current law (ii) is effected by a transfer of title – assignation in security – so that in property law terms (i) and (ii) are actually carried out in the same manner. And (ii) and (iii) are closely linked, both involving security over moveable property.

1.3 The subject matter of this project belongs chiefly to the sphere of commercial law. In the typical case at least one party to the transaction will be a mercantile or financial enterprise. Often both parties will be. But the law must also make appropriate provision for non-commercial transactions, or semi-commercial transactions, which are also often small transactions. The expression "small town transactions" is not a happy one but it captures what we mean. As well as providing for multi-million pound securitisations, the law must also provide for the assignation of a modest legacy, for the assignation of a modest one-off debt, for the creation of a security over a van to secure a small loan, and so on.

¹ Scottish Law Commission, *Seventh Programme of Law Reform* (Scot Law Com No 198 (2005)).

² The final report was submitted to Ministers in December 2009 and was published in February 2010: Scottish Law Commission, *Report on Land Registration* (Scot Law Com No 222 (2010)).

³ Scottish Law Commission, *Eighth Programme of Law Reform* (Scot Law Com No 220 (2010)).

The need for review

1.4 The topics reviewed in this paper are of great practical and economic importance, but the law is badly out of date, and in some respects might even be described as archaic. The need for reform seems self-evident. In relation to moveable security, any legislation emerging from this project could be compared to the Conveyancing and Feudal Reform (Scotland) Act 1970, which overhauled the law of security over immoveable property.⁴

Scope of project: (a) outright assignation

1.5 "Assignation" means the transfer of incorporeal property. But this project does not cover every case of assignation. Some types of incorporeal property have their own special rules of transfer. In particular this is true of the various types of intellectual property,⁵ of negotiable instruments⁶ and of "securities" such as company shares and bonds.⁷ This project does not seek to deal with the transfer of these various special types of incorporeal property. These are distinct areas of law. Thus in respect of *transfer* this project is more limited in scope than it is for *security*, for this project does cover security over intellectual property, of negotiable instruments and of securities.⁸

1.6 Since the project is limited to moveable property, we do not discuss the assignation of incorporeal *heritable* property. To that there is one qualification. When a standard security is assigned, there is both an assignation of the money claim (moveable) and of the security for that claim (heritable). Accordingly this is a subject that must be touched on.

Scope of project: (b) security

1.7 The project does not cover tacit security rights ie those arising *ex lege*, by operation of law, such as the repairer's lien, the seller's lien in the sale of goods and the landlord's hypothec. Nor does it cover security rights created by diligence, such as the attachment of goods, or arrestment.

1.8 Rights of retention and rights of set off, though they have a security function, are not included in this project, since they belong to the law of obligations.⁹ In general, therefore, if X owes obligations to Y, and Y to X, the relationship of these two sets of obligations is not a matter for this project. But there is an exception. Sometimes parties wish that X should be able to grant to Y a security right over X's right against Y, this being intended to operate as a true security right and not just as a form of retention or set off. Such an arrangement is sometimes called a chargeback. Chargebacks are included in this project.

⁴ Even that now needs overhaul, and we have a separate project in that area. If the 1970 Act is outdated for security over immoveable property, the situation is much worse for security over moveable property, where almost all the law is older than 1970, much of it far older.

⁵ See Chapter 7.

⁶ Most types of negotiable instrument are subject to the Bills of Exchange Act 1882, which sets out transfer rules in detail. These rules are largely the same as the common law rules for the transfer of negotiable instruments. A few types of negotiable instrument fall outwith the 1882 Act. To them the common law rules apply.

⁷ See the Stock Transfer Act 1963, the Stock Transfer Act 1982 and the Uncertificated Securities Regulations (SI 2001/3755). The last of these is the legislative basis of the CREST system.

⁸ See Chapter 19.

⁹ We are conducting a separate general review of contract law. See Scottish Law Commission, *Eighth Programme of Law Reform* (Scot Law Com No 220 (2010)).

1.9 The project is limited to moveable property. Hence security over heritable (immoveable) property is not dealt with. We have a separate project on the law of heritable security.¹⁰

1.10 Whilst this project does not seek to deal with the *transfer* of the special types of incorporeal property mentioned above – intellectual property, negotiable instruments, and securities – the position about *security* over such property is rather different. It would be possible for such special types of property to be covered in relation to security rights while being excluded in relation to transfer. That is already the position for the legislation on floating charges,¹¹ for a floating charge can give security over property of any type, including special types of property, while at the same time it does not touch the general law of transfer. It is also the position for the "personal property security" legislation to be found in many parts of the world. For example, Article 9 of the UCC provides for the creation of security interests over securities, such as corporate stock, whilst leaving strictly alone the general law about the transfer of securities. The advisory group took the view that it would be desirable to consider in this project the law of security over these three special classes of incorporeal property, and accordingly we have decided to do so.¹²

Scope of project: (c) quasi-security

1.11 Some transactions operate in a manner that is similar to security. For example, if X sells and delivers a bicycle to Y, and retains ownership until payment, that is functionally rather like a transfer of ownership by X to Y with a security right being granted back by Y to X, the security right securing the unpaid price. Hire purchase is an even more obvious example, for whilst sale with retention of title is a fairly natural transaction,¹³ hire purchase is a highly artificial one. *In form*, the supplier sells to the financier who then instantly hires to the customer. But *in substance* what is happening is that the supplier is selling to the customer, with the financier providing the finance on a secured basis. Equipment leasing can also function as a security, the typical example being where the term of the lease represents most of the life expectancy of the equipment. (But some equipment leasing is clearly not security-like, for example the hire of a car for a week.)

1.12 Such arrangements are sometimes called quasi-securities. UCC-9 and the PPSAs take a radical approach. They say that since such arrangements function as security rights they should be treated as security rights. Substance should prevail over form. Accordingly if X sells and delivers a bicycle to Y, subject to retention of title until payment is made, X is to be regarded as having reserved a mere security interest, and Y is to be regarded as having acquired the right of ownership. This is called "recharacterisation" because X's and Y's rights, which are expressed in the contract as being one of a certain nature, are compulsorily "recharacterised."

1.13 The question of whether quasi-securities should be compulsorily recharacterised in this way is a major theme of law reform round the world. It is one of the most prominent features of UCC-9 and the PPSAs. The question is discussed in Chapter 21.

¹⁰ See Scottish Law Commission, *Eighth Programme of Law Reform* (Scot Law Com No 220 (2010)).

¹¹ Currently contained in the Companies Act 1985, and, prospectively, in Part 2 of the Bankruptcy and Diligence etc (Scotland) Act 2007.

¹² See Chapter 19.

¹³ Far from being a modern device, it can be found in use in Roman law: the *pactum reservati dominii*.

Scope of project: (d) the floating charge

1.14 The floating charge is a security right that can, and usually does, cover property of every type. As assets come into the debtor's patrimony they automatically fall under the charge, without the need for any fresh act of charge by the debtor. Conversely, as they are disposed of they are automatically freed from the ambit of the charge, without the need for any act of discharge by the creditor. Whereas other types of security right can be granted by any debtor, floating charges can be granted only by companies and certain other entities, such as LLPs. Natural persons cannot grant floating charges, even in respect of commercial debts, so that sole traders cannot make use of this device. Nor can partnerships (other than LLPs). There is, however, no matching restriction on the creditor side. Whilst in practice most floating charges are granted to banks, in principle anyone can be the grantee of a floating charge.

1.15 Whilst the law of floating charges could usefully be reviewed, we do not see the present project as the right occasion for doing so. In part it is a question of keeping the project to a manageable size. But it is also because, depending on what legislative decisions are made as a result of this project, in future the floating charge might disappear as a distinct entity, as has happened in Canada,¹⁴ in New Zealand and in Australia.¹⁵ In those jurisdictions it is possible to have a charge that functions much like a floating charge – it can cover after-acquired assets as well as present ones, and assets can be disposed of by the debtor – but does not share the floating charge's logic,¹⁶ such as the concept of crystallisation.¹⁷ Or the floating charge might survive but with its scope reduced. These issues are discussed later in this discussion paper.¹⁸ It therefore seems appropriate to put on one side, at least for the time being, the question of *specific* reforms to the law of floating charges, though we do raise certain questions.

Scope of project: (e) international private law

1.16 The law of security over immoveable property does not usually raise issues of international private law. It is otherwise with moveables. Corporeal moveables can cross boundaries. As for incorporeals, they often have an international dimension, and moreover the question of how their *situs* is to be determined for the purposes of the law of secured transactions is problematic in a number of respects. In principle it would be possible to address the international private law aspects of secured transactions within this project. The UCC and the PPSAs all have provisions on this topic.¹⁹ But we take the view that international private law issues should in general not be dealt with in this project, which should confine itself to the substantive (or internal) Scots law of moveable transactions, leaving it to existing international private law to determine when Scots law applies and when it does not. The reason for this approach is that the project needs to be kept within manageable bounds. For example, UK intellectual property legislation is unitary, but it leaves to the general law much of the law of security. Since English and Scots law differ about

¹⁴ Except Quebec.

¹⁵ The Personal Property Securities Act 2009 (Commonwealth) is not yet in force. But once it is in force, the effect will be as stated in the text.

¹⁶ Or lack of logic.

¹⁷ In this discussion paper we generally use this term. In the Scottish legislation on floating charges, a different term is used, "attachment". The practical meaning is the same.

¹⁸ See Chapters 9 and 22.

¹⁹ For example, UCC § 9-301 ff, Ontario PPSA s 5 ff, Saskatchewan PPSA s 5 ff, New Zealand PPSA s 26 ff, Australia PPSA ch 7.

security rights, it can be important to know whether an intellectual property right is to be regarded as English or Scottish for the purposes of security. No settled answers exist. But to enter into that difficult topic as part of the present exercise would not be easy, and it may be that the law would be best reviewed on a cross-border basis. A different example would be article 14 of the Rome I Regulation.²⁰ There are uncertainties as to what this article means, but evidently any review would have to be at the European level. There are, indeed, certain international private law issues that could not be considered without reference either to London or to Brussels, such as the effect that Scots law should accord to a foreign security interest over corporeal moveable property that enters Scotland – for example where a non-possessory security is validly granted under Ruritanian law in respect of an object located in Ruritania, and that object is then imported into Scotland without the secured debt being paid off. Nevertheless we think that it would be better to leave IPL issues on one side and to focus on the reform of internal Scots law. That approach does not, of course, mean that IPL issues could not be returned to in a future project. Indeed, that might be desirable.

Scope of project: (f) comprehensive or selective?

1.17 The law of assignation and the law of security over moveables, are extensive. A comprehensive review would be an immense and therefore slow undertaking. It seems to us preferable to identify the issues most in need of reform. This we attempt to do in this discussion paper, and of course we would welcome further suggestions from consultees. For example, we do not in this paper look at the law of "catholic and secondary" security, though that could be done if consultees so wished.

1.18 From what has been said it follows that for the present we are not thinking of the codification of these areas of law. In the longer term such codification might well be desirable. In the UCC and the PPSAs the law is, subject to certain qualifications, codified. But given the scale of the task we think that codification in these areas should not be pursued yet. The pressing need is for substantive reform.

Scope of project: (g) insolvency law

1.19 The law of rights in security is closely linked to insolvency law. Insolvency law has its own policies about the effect of security rights on the debtor's insolvency, for example about eve-of-insolvency securities²¹ and about ranking.²² This project is not about insolvency law and is thus intended to leave the policies of insolvency law substantially unaffected. If the way that insolvency law treats security rights is in need of review, that review would have to be a separate review. Our approach is thus the same as that of the Law Commission of England and Wales, which in its recent project said that the reforms that were being proposed would not make significant changes to insolvency law.²³

Extending the new register to diligence?

1.20 In this discussion paper we provisionally propose the setting up of a new register, the Register of Moveable Transactions, in which security rights over moveable property could be registered, and also assignations. The idea is based to some extent on comparable registers

²⁰ Regulation 593/2008 on the law applicable to contractual obligations.

²¹ Bankruptcy (Scotland) Act 1985 s 36; Insolvency Act 1986 ss 243 and 245.

²² Especially about floating charges. See eg Insolvency Act 1986 s 176A.

²³ See eg Law Com CP No 164 para 3.411.

set up in many other parts of the world. In some of the Canadian provinces, especially in Eastern Canada, the register has also found another use. Where a creditor obtains decree, and wishes to use what we in Scotland would call diligence against the debtor's moveable assets, the creditor can simply register the decree in the register. That then takes effect as a general security right over the debtor's moveable property, both corporeal and incorporeal.²⁴ The law of diligence is not part of the present project. Accordingly we say nothing more about it, except that it is a possibility that consultees might like to consider as a possible future benefit of the reforms here suggested.

Previous reviews of these areas of law

1.21 There have been a number of reviews, chiefly about secured transactions, though some touching on outright assignation, in recent decades. Apart from the introduction of the floating charge, which happened in 1961, following a report published in the previous year, these reviews have borne relatively little fruit. The history of these reviews is outlined in Chapter 10.

The UK and EU economic unions

1.22 The UK has a high degree of economic unity, and that fact gives rise to pressure for legal approximation or even unification – not in all areas, but in many. That is a fact that cannot be ignored. For example, one of the questions that we ask in this discussion paper is about "recharacterisation", ie the question of whether certain transactions that function like securities, such as hire purchase, should be treated as they are treated by the UCC/PPSAs, which is to say as mere security rights, and, moreover, rights that in many types of case must be registered. That question can be considered purely on its own merits, as if Scotland were an island. But there is also the background issue: how practical would such an idea be if the same course, or at least a similar course, were not being adopted elsewhere in the UK? The high degree of integration of the Scottish economy with the economy of the other parts of the UK, coupled with the fact that Scotland represents less than a tenth of the UK economy, is the sort of factor that, for example, was not relevant to New Zealand when it decided to opt for a UCC/PPSA-type system.²⁵ Arguably a nearer example is Ontario, which introduced such a system on its own; it was only later that the rest of Canada followed. But Ontario counts for more than three-tenths of the Canadian population and economy, and moreover is closely connected, both geographically and economically, with the USA, where the UCC was already in force. More recently, Australia's adoption of a UCC/PPSA-type system has been done at Commonwealth level, so that the legislation will come into force simultaneously in all states. To have left the matter to the individual states would have been in theory possible but in practice difficult. All this does not mean that it would be unwise for Scotland to reform its law on its own. What it does mean is that it would be unwise to do so without regard to the implications of the UK economic union.

²⁴ For example, in New Brunswick, the Creditors' Relief Act 1973 provides at section 2.2(1) that "a judgment creditor who has obtained a money judgment may register a notice of judgment in the [Personal Property] Registry in accordance with the regulations under the Personal Property Security Act." In Nova Scotia, the Creditors' Relief Act 1989 provides the same at section 2A(1).

²⁵ At that time, Australia had not adopted a PPSA, though it has since done so. However, it should be noted that there are strong economic links between New Zealand and Australia, supported by the Australia New Zealand Closer Economic Relations Trade Agreement of 1983, and moreover we understand that the banks in the two countries are closely connected.

1.23 On one view, the law of moveable security, and perhaps also the law of outright assignation, ought to be approached with the aim of achieving harmonisation or even unification on the two sides of the border, in much the same way as the law of sale of goods and the law of hire purchase.²⁶ There is clearly much to be said for such a view, and indeed it is a view that brought the floating charge to Scotland.²⁷ But few people would suggest that the English law of moveable security in its current state would be suitable for import to Scotland. (And it has been rejected in much of the Commonwealth.) As for reform of English law, that has been for forty years²⁸ an area of debate – one might almost say a battlefield²⁹ – and if the reform of Scots law is to be delayed until English law is reformed then the reform may have to be delayed for a very long time. Whatever the future may hold for the reform of the law in England, it seems sensible to move forward with reform here. Reform here would not prejudice the possibility of future convergence between England and Scotland if reasonable terms of convergence were to prove possible. Indeed, it might be that successful reform here could be of interest south of the border.

1.24 The EU is also an economic union. If the law on assignation and on secured transactions were the same across the EU, with the exception of England (plus Wales and Northern Ireland), then the picture would be different. But in fact the law varies considerably in the various member states, and nowhere has a system that is anything near the current Scots law.

One step at a time

1.25 It may be that the whole law should be codified. It may be that recharacterisation should be introduced. It may be that floating charges should be thoroughly overhauled or, indeed, abolished. And since the law of rights in security on the one hand, and the law of personal and corporate insolvency, on the other hand, are twin stars, in perpetual mutual orbit, a perfect system of security law would require changes to insolvency law. International private law relating to secured transactions may need reform. And so on.

1.26 But the project needs to be kept manageable. And for pragmatic reasons there is a need for a legislative package that would be within the legislative competence of the Scottish Parliament.³⁰ Some types of reform, such as recharacterisation, would be problematic while English law remains in its present form. For these various reasons, our approach is not to seek perfection in one step. The best can be the enemy of the good, and it seems better to us to develop a reform package that will be major but nevertheless limited, aware that further reform may be needed, but leaving such further reform until the initial package has been

²⁶ See C K Davidson, "The Scottish Law Commission 1965 – 1995" (1995) 1 *Scottish Law and Practice Quarterly* 18 for some discussion of the pressure from south of the border, in the 1965 to 1995 period, for Scotland to follow England in the area of security over moveable property.

²⁷ Companies (Floating Charges) (Scotland) Act 1961.

²⁸ The Crowther Report was published in 1971. See Chapter 10.

²⁹ For a recent survey of the battlefield see John de Lacy (ed), *The Reform of UK Personal Property Security Law: Comparative Perspectives* (2010).

³⁰ For legislative competence, see below. One of our proposals, about improving the position of debtors in pledge transactions governed by the Consumer Credit Act 1974, would not be within the legislative competence of the Scottish Parliament. But a bill giving effect to our other proposals could go through the Scottish Parliament and be put into operation regardless of whether the 1974 Act was amended. In other words, the proposal about the 1974 Act is a severable one. The same is true of our provisional proposals about aircraft mortgages.

implemented and had time to bed down, and also had time to show up snagging issues.³¹ (By which time, it may be added, English law may have moved on.)

Economic significance

1.27 The economic significance of the subject matter of this paper – which includes such things as securitisation and factoring – is obvious. Nevertheless, much of the law would appear to be out of date. There has been no substantial reform of the law of assignation (whether outright or in security) since 1862.³² Except for the introduction of the floating charge in 1961,³³ the law of voluntary security over corporeal moveable property has not changed much since before the Union with England Act 1707, except for consumer protection legislation,³⁴ and the introduction of the questionable system of company charges registration.³⁵ The seemingly unsatisfactory state of the law has led to the development of workarounds, such as hire-purchase. Of course, old law is not necessarily out-of-date law. Old law is sometimes good law. It might be that the current law on assignation and on moveable security is perfect. But at the very least its age suggests that it needs a health check – especially in the light of its sheer economic importance.

1.28 More on the economic question will be found in Chapter 12 (considering whether secured debt is efficient in economic terms) and Appendix C, considering the economic impact of our proposals. In the final paragraph of Appendix C we ask consultees for their comments on the economic impact assessment in particular as to what consultees regard as the costs and benefits of our proposals.

Legislative competence

1.29 Under the Scotland Act 1998, the law of assignation is not reserved. Neither is the law of rights in security. In general terms therefore legislative competence in the subject matter of this project would lie with the Scottish Parliament. For example, the floating charge is capable of affecting assets of any description, and yet legislation of the Scottish Parliament has reformed the whole law of floating charges.³⁶ The following paragraphs consider to what extent there might be any qualifications or exceptions to this general picture.

1.30 "The subject matter of ... the Consumer Credit Act 1974" is reserved.³⁷ The amendment to that Act that we suggest, enhancing the rights of consumers dealing with pawnbrokers,³⁸ would thus not fall within the legislative competence of the Scottish Parliament. But it is not an integral part of the whole reform package, which could thus go ahead in the Scottish Parliament whether or not Westminster was inclined to amend the 1974 Act.

³¹ Of the project of the Law Commission for England and Wales, Michael Bridge has written: "Drawing upon the wisdom of hindsight, it is possible to say that a more modestly presented series of incremental reforms might have evoked less opposition..." (In Horst Eidenmüller and Eva-Maria Kieninger (eds), *The Future of Secured Credit in Europe* (2008) at p 184.)

³² Transmission of Moveable Property (Scotland) Act 1862.

³³ Companies (Floating Charges) (Scotland) Act 1961. For floating charges see Chapter 9.

³⁴ Now in the Consumer Credit Act 1974.

³⁵ Companies (Floating Charges) (Scotland) Act 1961, and now Part 25 of the Companies Act 2006. See Chapter 8.

³⁶ Part 2 of the Bankruptcy and Diligence etc (Scotland) Act 2007. (Not yet in force.)

³⁷ Scotland Act 1998 sch 5 part II head C7.

³⁸ See Chapter 15.

1.31 But the fact that some of our proposals would relate to non-business debtors as well as to business debtors would not affect the subject matter of the 1974 Act. For example, the 1974 Act has general rules that cover all types of security right, where the security right is granted by a consumer debtor. Those provisions would automatically apply to any new type of security interest that would become competent under our proposals, in so far as consumer debtors were involved.

1.32 We propose the creation of a new type of security right. Although any type of debtor, including consumer debtors, would be able to grant such a right, we suggest that it might be desirable to restrict the scope of the new security so that consumers would not be able to use it as freely as non-consumer debtors. This non-extension of the new security would not, in our view, be outwith the powers of the Scottish Parliament.

1.33 The law relating to "the creation, operation, regulation and dissolution of types of business association" is reserved.³⁹ Thus company law is in general terms outwith the legislative competence of the Scottish Parliament. Our provisional proposals would make it possible for a new type of security interest to affect moveable assets in general, and thus including company shares and company bonds. For example if Jack borrows from a bank and offers to the bank security over certain assets, including shares he holds in Royal Bank of Scotland plc, the security over the shares does not relate, except in an incidental manner, to "the creation, operation, regulation and dissolution of types of business association". Hence we see no difficulty in the possibility that any new type of security interest arising out of the present project should be capable of covering company shares or bonds.

1.34 Rather less clear is the subject matter of Part 25 of the Companies Act 2006. These provisions, with their predecessors, have been in force since 1961.⁴⁰ They require the registration in the Companies Register of certain types of "charge" over the property of a company. Whether these provisions should be regarded as being about the law of rights in security, and so not reserved, or as being (at least part) about company law, and so subject to reserved legislative competence, is open to argument. This Commission has previously examined the point, and concluded that the position is unclear, but that on balance these provisions are reserved.⁴¹

1.35 Intellectual property law is reserved.⁴² But similar points can be made here as about company law, which is to say that the law about rights in security relating to IP rights is not reserved.

1.36 The same is true of shipping law⁴³ and of aviation law.⁴⁴ Security rights over ships are excluded from this project. So for the most part are security rights over aircraft. But we do raise two issues about the latter,⁴⁵ both about purely Scottish aspects. Any legislation to give effect to these two provisional proposals would therefore have to be effected by Westminster

³⁹ Scotland Act 1998 sch 5 part II head C1.

⁴⁰ They were introduced (from English law) by the Companies (Floating Charges) Scotland Act 1961. Over the years there have been numerous changes, but only of detail.

⁴¹ Scottish Law Commission, *Report on Registration of Rights in Security by Companies* (Scot Law Com No 197 (2004)), Part 6. This relates to the immediate predecessor of Part 25 of the Companies Act 2006, namely Part XII of the Companies Act 1985, but this difference is immaterial.

⁴² Scotland Act 1998 sch 5 part II head C4.

⁴³ Scotland Act 1998 sch 5 part II head E3.

⁴⁴ Scotland Act 1998 sch 5 part II head E4.

⁴⁵ Chapter 17.

legislation. But these proposals are not an integral part of the whole package, and so if no Westminster legislation were to take place, the Scottish Parliament could still go ahead with the main package.

1.37 Sections 252 and 253 of the Banking Act 2009 exempts floating charges from registration in the Register of Floating Charges⁴⁶ if the creditor is a "central institution", ie the Bank of England or other central bank.⁴⁷ But no change was made to the Scotland Act 1998, so that the Scottish Parliament's legislative competence was not altered.

1.38 Section 255 of the Banking Act 2009 confers on the Treasury power to legislate, by statutory instrument, on the subject of "financial collateral arrangements". But no change was made to the Scotland Act 1998, so that the Scottish Parliament's legislative competence in relation to that area of law was not altered.⁴⁸

1.39 Section 104 of the Scotland Act 1998 says that "subordinate legislation may make such provision as the person making the legislation considers necessary or expedient in consequence of any provision made by or under any Act of the Scottish Parliament..." Section 104 orders are made from time to time, and it is not impossible that legislation emerging from the Scottish Parliament following this project might be supplemented by a section 104 order.

Human rights

1.40 We do not consider that any of our proposals raise a human rights issue and it is our opinion that they would be compatible with the European Convention on Human Rights.

EU law

1.41 Any reform would, of course, be subject to applicable EU legislation. Potentially relevant EU law is discussed in Chapter 2.

General question

1.42 The field of moveable transactions – the assignation of incorporeal moveable property, security over incorporeal moveable property, and security over corporeal moveable property – is a large one and this discussion paper is not exhaustive. We ask:

- 1. Are there issues in the field of moveable transactions that stand in need of reform that are not addressed in this discussion paper?**

⁴⁶ Established by Part 2 of the Bankruptcy and Diligence etc (Scotland) Act 2007.

⁴⁷ Section 252 exempts from registration under Part 25 of the Companies Act 2006. Section 253 exempts from registration under Part 2 of the Bankruptcy and Diligence etc (Scotland) Act 2007.

⁴⁸ There is EU legislation on financial collateral, and of course legislation of the Scottish Parliament cannot alter EU legislation. See Chapter 2.

Acknowledgements

1.43 At an early stage of the project, while our main efforts were concentrated on land registration, we conducted preliminary discussions with representatives from interested groups, including the financial sector, about the underlying financial and economic background, current practices, and deficiencies that were thought to exist in this area.⁴⁹ We are grateful to them all for the assistance they have given. Later in the project we received valuable assistance from experts on the US system and the systems it has inspired.⁵⁰

1.44 While in New Zealand on business the Chairman took the opportunity to speak to a number of people about the Personal Property Securities Act 1999, including members of the New Zealand Law Commission whose Report - A Personal Property Securities Act for New Zealand - led to the Act, officials from the Office of the Registrar of Personal Property Securities and from their sponsoring Government Department, and others including practitioners with experience of the system.⁵¹ He was also able to see the Personal Property Securities Register in operation. We are grateful to them for the advice and assistance that they provided.

⁴⁹ We had meetings with the following: CBI Scotland (Mr Iain McMillan, Director CBI Scotland, Mr John Alpine, National Australia Group Europe Limited, Mr Andrew Davison, Ernst & Young LLP, and Mr Bruce Wood, Morton Fraser LLP), the Royal Bank of Scotland Group plc (Mr R Beattie, Mr J Laing, and Mr J MacBean), Ms Caryn Penley, Ms Claire Massie and Mr Stephen Phillips of Dundas & Wilson LLP, Mr Neil Kelly of MacRoberts LLP, Mr Paul Hally and Mr Andrew Kinnes of Shepherd and Wedderburn LLP, Dr Hamish Patrick and Mr Graham Burnside of Tods Murray LLP, Ms Maureen Leslie of Active Corporate Recovery LLP, Mr Kenneth Pattullo of Begbies Traynor, and Mr David Wishart, Mr Alan Duncan, and Mr Douglas Thornton of HM Revenue and Customs.

⁵⁰ Mr Michel Deschamps (McCarthy Tétrault LLP, Montreal), Professor Michael Gedye (University of Auckland), Professor Aline Grenon (University of Ottawa), Professor Roderick Macdonald (McGill University, Montreal), Professor Harry C Sigman (Attorney, Los Angeles), and Professor Catherine Walsh (McGill University, Montreal).

⁵¹ Dr Warren Young, Deputy President, New Zealand Law Commission, and Professor John Burrows QC, Commissioner, New Zealand Law Commission; the Hon Justice Mark O'Regan, Court of Appeal of New Zealand (a member of the Advisory Committee who assisted the Commission in its work); Mr Michael Brosnahan, Companies Office, Ministry of Economic Development, Ms Sheree McDonald, Companies Office, Ministry of Economic Development and Ms Liz Thomson, Ministry of Economic Development; Professor Mike Gedye, University of Auckland; Mr David McPherson, Mr Murray King, and Mr Murray Tingey, of Bell Gully, Auckland; and Mr Antony Buick-Constable and Mr Mark Dowland, Bank of New Zealand, Wellington.

1.45 We acknowledge with thanks the advice and assistance of a small advisory group which read an earlier version of this paper and made a number of helpful suggestions.⁵²

1.46 Finally, we should note that the lead Commissioner on this project was Professor George Gretton, whose term of office as a Commissioner came to an end shortly before publication of this discussion paper. Apart from this paragraph, he is the principal author of the paper. We would like to express our gratitude to him for his immense contribution to the project, a contribution that is, we think, reflected in the quality of this paper.

⁵² Dr Ross Anderson (University of Glasgow), Mr David Gibson (Burness LLP), Mr Andrew Kinnes (Shepherd and Wedderburn LLP), Dr Hamish Patrick (Tods Murray LLP), Mr Bruce Wood (Morton Fraser LLP), and Mr Scott Wortley (University of Edinburgh). We also acknowledge with thanks the assistance that we received from Mr James McLean on intellectual property and international private law matters.

Chapter 2 The EU dimension (including the Financial Collateral Directive)

Introduction

2.1 In general the subject matter of this project is unaffected by EU law. In the 1970s there was a plan for a directive on security over moveable property, but eventually work was abandoned.¹

2.2 The DCFR covers both assignation and secured transactions, and the European Commission is preparing an official Common Frame of Reference based on the DCFR. It is not yet clear whether the official Common Frame of Reference will be adopted as an "optional instrument", a "toolbox", or indeed at all. But we understand that it will not cover the law of assignation, nor secured transactions. To what extent harmonisation or unification of property law within the EU is desirable is a matter of which opinions differ.²

2.3 Though in general the subject matter of this project is not affected by EU law, there are some exceptions and qualifications, noted below. The first four items can be dealt with fairly briefly. The fifth, the Financial Collateral Directive, calls for more extended discussion.

Unfair Terms in Consumer Contracts Directive (93/13)

2.4 The Unfair Terms in Consumer Contracts Directive³ strikes at terms "giving the seller or supplier the possibility of transferring his rights and obligations under the contract, where this may serve to reduce the guarantees for the consumer, without the latter's agreement." This was transposed, without change, by the Unfair Terms in Consumer Contracts Regulations 1999.⁴ The meaning is unclear to us.

Late Payment Directive (2000/35)

2.5 The Late Payment Directive⁵ requires member states to give effect to retention of title clauses in the sale of goods. Scots law does so. But were Scotland to adopt the UCC-9 approach, retention of title clauses would be "recharacterised". A seller who ostensibly retained title until payment of the price would be regarded not as retaining title, but as having a mere security interest, something that *prima facie* would be contrary to the Directive. This issue is considered in Chapter 21.

¹ See Eva-Maria Kieninger (ed), *Security Rights in Movable Property in European Private Law* (2004) pp 6 and 22.

² See for example Ulrich Drobnig, Henk Snijders and Erik-Jan Zippro (eds), *Divergences of Property Law, an Obstacle to the Internal Market?* (2006); Gerard McCormack, "Convergence, Path-dependency and Credit Securities: The Case against Europe-wide Harmonisation" (2010) *Global Jurist* art 2 (available at <<http://www.bepress.com/gj/vol10/iss2/art2/>>); Teemu Juutilainen, "Secured Transactions Laws: Centralized or Spontaneous Harmonization", 2010 *Edinburgh Student Law Review* 14. Horst Eidenmüller and Eva-Maria Kieninger (eds), *The Future of Secured Credit in Europe* (2008) is a valuable study of the possibilities of harmonisation or unification at the European level.

³ Council Directive 93/13/EEC of 5 April 1993 on unfair terms in consumer contracts.

⁴ Schedule 2.

⁵ Directive 2000/35/EC on combating late payment in commercial transactions. See Art 4.

Credit Agreements Directive (2008/48)

2.6 The Credit Agreements Directive,⁶ transposed for the UK by section 82A of the Consumer Credit Act 1974,⁷ provides that if the creditor of a consumer assigns, then "the consumer shall be informed of the assignment ... except where the original creditor, by agreement with the assignee, continues to service the credit vis-à-vis the consumer."⁸ This does not say when notice must be given, and indeed might possibly be construed as making notice an essential condition – in which case it would approximate to Scots law.⁹ In any event it would seem to make no difference for Scots law, where notification is essential anyway, whether or not the account party is a consumer. If, as a result of the present project, notification were to cease to be an essential condition of assignation,¹⁰ the provision will become more significant for Scots law. But the qualification is worth noting: if the cedent "continues to service the credit vis-à-vis the consumer" then the provision does not apply. Sales of consumer debt are often – though far from always – done on that basis.

2.7 The provision has no implications for assignments of non-consumer debt. Nor has it any implications for those cases where the proviso applies. In other words, it does not mean that if the cedent continues to "service the credit" then national laws cannot require notification. The provision is important but its target is fairly narrow.

Rome I Regulation (593/2008)

2.8 The Rome I Regulation¹¹ sets out common EU rules on the applicable law in contractual matters. Article 14 is about assignments of, and security over, claims.¹² The word "claim" is not defined but it means a personal right - usually, though not necessarily, a monetary obligation.¹³

"1. The relationship between assignor and assignee under a voluntary assignment or contractual subrogation of a claim against another person (the debtor) shall be governed by the law that applies to the contract between the assignor and assignee under this Regulation.

2. The law governing the assigned or subrogated claim shall determine its assignability, the relationship between the assignee and the debtor, the conditions under which the assignment or subrogation can be invoked against the debtor and whether the debtor's obligations have been discharged.

3. The concept of assignment in this Article includes outright transfers of claims, transfers of claims by way of security and pledges or other security rights over claims."

⁶ Directive 2008/48/EC on credit agreements for consumers.

⁷ Inserted by the Consumer Credit (EU Directive) Regulations 2010 (SI 2010/1010).

⁸ Article 17(2).

⁹ Section 82A of the Consumer Credit Act 1974 says that notice must be given "as soon as reasonably possible" after the assignation. This presupposes that the "assignment" has already taken place. This gives a particular interpretation to the Directive.

¹⁰ In this discussion paper we consider various options, including the option of registration as an alternative to intimation. See Chapter 14.

¹¹ Regulation 593/2008 on the law applicable to contractual obligations.

¹² Art 14 is currently under review: see Art 27(2).

¹³ Thus the French version speaks of "*créance*" and the German of "*Forderung*".

2.9 Since the Regulation is solely about international private law, it does not impose any constraints as to internal Scots law. The Regulation simply answers the question as to *when* internal Scots law (or Italian law, or Swedish law etc) is applicable. The question of *what* that internal law says is a matter for the appropriate national legislative bodies to determine. Put another way, Rome I takes away from the UK Parliament and the Scottish Parliament¹⁴ the power to legislate on the international private law in this area – but does not go further than that. As mentioned in Chapter 1, in this project we are not seeking to address issues of international private law, important as those issues undoubtedly are.

Financial Collateral Directive (2002/47)

2.10 By contrast, the Financial Collateral Directive¹⁵ does have effect on the internal laws of the member states. It dates from 2002. Major amendments were made in 2009.¹⁶ Its obscurity makes it impossible to summarise with any precision, but in broad terms its aims are to allow, as far as possible, transactions involving "financial collateral" to be free from legal formalities, and to ensure that such transactions can take effect according to the terms agreed by the parties.

2.11 Generally speaking, Scots law was already compliant with the Directive, and on the whole it is unlikely that any future reforms contemplated in this discussion paper would run foul of the Directive. Nevertheless, there are some issues to be considered, especially since the 2009 reforms expanded the Directive's scope.

2.12 A preliminary point is that the Directive's scope is limited to certain types of property and certain types of transaction. The Directive is a *lex specialis* and thus leaves to member states their *general* law concerning assignation and security rights. The present project deals with that general law.

2.13 One factor that determines whether the Directive applies to a transaction is the identity of the parties. The Directive has two categories of party.¹⁷ Category A includes public authorities, such as central banks, and commercial entities meeting certain requirements, such as authorised banks and clearing houses. Category B is any person other than a natural person. (Thus any entity in Category A would also qualify in Category B.) The Directive applies only if both of the parties fall into Category B and at least one of the parties falls into Category A. The UK Regulations¹⁸ go further, so that a financial collateral arrangement between two private companies would be caught. That does not seem to have a basis in the Directive.

¹⁴ The devolution settlement generally confers on the Scottish Parliament legislative competence in the field of international private law, but extensive legislative activity in recent years from Brussels now means that the scope for exercising that devolved competence has become limited – and the same is true of the UK Parliament.

¹⁵ Directive 2002/47/EC on financial collateral arrangements, transposed for the UK by the Financial Collateral Arrangements (No 2) Regulations 2003 (SI 2003/3226). For its interpretation in relation to Scotland see George L Gretton, "Financial Collateral and the Fundamentals of Secured Transactions" (2006) 10 EdinLR 209. The Regulations were amended by the Financial Markets and Insolvency (Settlement Finality and Financial Collateral Arrangements) (Amendment) Regulations 2010 (SI 2010/2993).

¹⁶ Directive 2009/44/EC amending Directive 98/26/EC on settlement finality in payment and securities settlement systems and Directive 2002/47/EC on financial collateral arrangements as regards linked systems and credit claims. (For the European Commission Report leading to the amending directive see <http://ec.europa.eu/internal_market/financial-markets/docs/collateral/fcd_report_en.pdf>.)

¹⁷ Art 1(2).

¹⁸ Financial Collateral Arrangements (No 2) Regulations 2003 (SI 2003/3226).

2.14 "Financial collateral" means "cash, financial instruments or credit claims".¹⁹ "Cash" means not cash but "money credited to an account in any currency, or similar claims for the repayment of money, such as money market deposits."²⁰ The term "financial instruments" means:

"Shares in companies and other securities equivalent to shares in companies and bonds and other forms of debt instruments if these are negotiable on the capital market, and any other securities which are normally dealt in and which give the right to acquire any such shares, bonds or other securities by subscription, purchase or exchange or which give rise to a cash settlement (excluding instruments of payment), including units in collective investment undertakings, money market instruments and claims relating to or rights in or in respect of any of the foregoing."²¹

2.15 "Credit claims" are defined as "pecuniary claims arising out of an agreement whereby a credit institution, as defined in Article 4(1) of Directive 2006/48/EC, including the institutions listed in Article 2 of that Directive, grants credit in the form of a loan."²² Thus if a bank lends Jack £10,000, the bank has a "credit claim". But if TradeCo is owed £10,000 by one of its customers in respect of goods sold, TradeCo does not have a "credit claim." Nor is there a credit claim if Jack borrows the money not from the bank but from his brother Tom.

2.16 Hence the Directive does not cover land, or intellectual property, or corporeal moveable property. Its scope is limited to certain types of incorporeal moveable property.

2.17 The Directive provides:²³

"Member States shall not require that the creation, validity, perfection,²⁴ enforceability or admissibility in evidence of a financial collateral arrangement or the provision of financial collateral under a financial collateral arrangement be dependent on the performance of any formal act.

...When credit claims are provided as financial collateral, Member States shall not require that the creation, validity, perfection, priority, enforceability or admissibility in evidence²⁵ of such financial collateral be dependent on the performance of any formal act such as the registration or the notification of the debtor of the credit claim provided as collateral. *However, Member States may require the performance of a formal act, such as registration or notification, for purposes of perfection, priority, enforceability or admissibility in evidence against the debtor or third parties.*"²⁶

2.18 The first of these paragraphs is a general provision against any requirement, on the part of national law, for any "formal act", whilst the second is a special and more detailed provision in the case where the financial collateral consist of "credit claims".

¹⁹ Art 1(4).

²⁰ Art 2(1)(d).

²¹ Art 2(1)(e).

²² Art 2(1)(o).

²³ Art 3(1).

²⁴ The meaning of this term, which is also used in the next paragraph, is uncertain. Possibly it has the UCC meaning. But the French and German terms ("*conclusion*" and "*Abschluss*") do not fit such a meaning. When Recital 9 speaks of perfection, the French term is "*opposabilité*", and yet that latter term matches, in Art 3, not "perfection" but "enforceability".

²⁵ This list is different from the list in the previous paragraph and both are different from the list in the last sentence of the second paragraph. The significance of these differences is unclear.

²⁶ Emphasis added.

2.19 The second sentence of the second paragraph would seem to take away most of the force of the first sentence. More generally, the force of both paragraphs is circumscribed by Article 1(5), which provides that "this Directive applies to financial collateral *once it has been provided*." This slightly cryptic provision is explained by Article 2(2), which says:

"References in this Directive to financial collateral being 'provided', or to the 'provision' of financial collateral, are to the financial collateral being *delivered, transferred, held, registered* or otherwise designated so as to be in the possession or under the control of the collateral taker or of a person acting on the collateral taker's behalf."²⁷

2.20 Recitals 9 and 10 are also relevant. Recital 9 says: "...the only perfection requirement regarding parties which national law may impose in respect of financial collateral should be that the financial collateral is *under the control of the collateral taker* or of a person acting on the collateral taker's behalf..."²⁸ Recital 10 says that "this Directive cover[s] only those financial collateral arrangements which provide for some form of *dispossession, ie the provision* of the financial collateral..."

2.21 The Financial Collateral Directive is in this and other respects difficult to interpret and unfortunately has brought uncertainty to an area that should have as little uncertainty as is reasonably possible. But the provisions just quoted show that its scope is limited. In a nutshell, the Directive says that if the grantee has "control" of the collateral (which is something that happens according to the provisions of national law), no *further* requirements may be imposed. And if the grantee does not have "control" then the Directive is simply inapplicable.

2.22 The concept of control is not elaborated by the Directive. What it means is a matter for interpretation within the context of the various systems of private and commercial law in force in each Member State. In Scots law it would seem to mean, for example, that if X bank lends money to Y and then grants to Z an assignation in security, and the assignation is intimated to Y, the law could not impose an additional requirement that the assignation be registered, because the intimation has given "control" to Z.

2.23 It seems that current law does not infringe the Directive. Part 25 of the Companies Act 2006 provides that an assignation in security must be registered, but only where what is being assigned is a book debt. Book debts are outwith the scope of the Directive. So, in our view, are floating charges.²⁹ Of course, in many cases the assets of a company that grants a floating charge do not include "financial collateral." But even where the contrary is the case, the requirement that floating charges be registered, whether the current requirement in the Companies legislation³⁰ or the new provisions, not yet commenced, about the Register of

²⁷ Emphasis added.

²⁸ Emphasis added.

²⁹ This view is consistent with *Gray v G-T-P Group Ltd* [2010] EWHC 1772 (Ch). H M Treasury appears to have a different view. The Financial Markets and Insolvency (Settlement Finality and Financial Collateral Arrangements) (Amendment) Regulations (SI 2010/2993) by regulation 5 provides that a floating charge does not have to be registered in so far as it is a financial collateral arrangement. (These regulations were made not under the Banking Act 2009 but under the European Communities Act 1972.)

³⁰ Companies Act 2006, Part 25 (formerly Companies Act 1985, Part XII).

Floating Charges,³¹ is compatible with the Directive, because an unregistered floating charge confers on the creditor no "control" over the assets in question.³²

2.24 The Directive requires member states to recognise transfer of financial collateral for the purpose of security. That is not a problem for Scots law, where this is in fact the only way (apart from the floating charge) of giving security over financial assets. But the point nevertheless needs to be borne in mind, for if (as we propose) a new form of "proper" security over incorporeal moveable property is introduced to Scots law, the question inevitably arises as to whether assignation in security should continue to be allowed, as a parallel to the new security, or whether it should cease to be competent. The effect of the Directive is that this policy option is not open in respect of financial collateral. In other words, were the decision to be taken that assignation in security should cease to be competent, financial collateral would have to be excepted.³³

2.25 For the reasons given above, the requirement that floating charges be registered is unaffected by the Financial Collateral Directive.³⁴ The same would apply to the new security right that we provisionally propose in this paper. That is to say, the requirement for registration would be compatible with the Financial Collateral Directive. Accordingly, we propose no exemption from registration.

³¹ Bankruptcy and Diligence etc (Scotland) Act 2007, Part 2.

³² Cf *Gray v G-T-P Group Ltd* [2010] EWHC 1772 (Ch).

³³ Thus if Scotland were to go down the road of the UCC/PPSAs, an exception would have to be made for financial collateral. Dutch law does not allow assignation in security (see Appendix B) but has had to introduce an exception for financial collateral.

³⁴ And accordingly we think that the Treasury regulations mentioned above are misconceived.

Chapter 3 A possible scheme in outline

Introduction

3.1 It may be helpful to set out, in outline, a possible new scheme. The reason is that the issues discussed in this paper are complex and the policy options are manifold. As a result it is difficult to see the wood for the trees. In offering this outline we would stress that it is for illustrative purposes only and does not represent concluded thinking. We would also stress the word "outline". The following does not attempt to address all the numerous points of detail discussed elsewhere in this discussion paper.

Register of Moveable Transactions

3.2 There would be a new Register of Moveable Transactions, which would be comparable, in broad terms, with the registers used in the UCC/PPSAs. It would be public and available online, and so searchable online, and registration could be made online. It would be used (i) for the creation of security rights in moveable property (corporeal and incorporeal) and (ii) for the completion of assignments of personal rights, as an alternative to intimation.¹

3.3 Where a right was acquired by registration, registration would be a necessary condition of acquisition, rather than merely giving publicity to a right that had already been acquired.

3.4 Priority would thus normally be as from the date of registration. But where registration was in relation to an after-acquired right, priority would be from the acquisition date, which would be later than the date of registration. For example, X, a motor dealer, grants to Y a security over its vehicle stock, present and future, and there is registration on 1 June. On 1 July X acquires ten new motor vehicles. The security would come into being, in respect of those vehicles, on 1 July.

3.5 The register would be added to the stable of registers administered by the Keeper of the Registers of Scotland in the Department of the Registers² and on the same financial basis as most other registers, such as the Companies Register and the Land Register, ie on a self-financing basis. That is to say, the costs of the register would be covered by fees for registration, for searches etc. Thus there should be no cost to the taxpayer.

3.6 Registrations would expire after a certain period, unless renewed, to prevent the register from becoming cluttered. This could be done either by a fixed period such as five years, or by allowing the applicant to state the period, with the registration fee correlating to the period chosen.

¹ On intimation, see below.

² Such as the Land Register, the Register of Sasines, the Register of Inhibitions, the Books of Council and Session, etc. As an aside, not all registers are within the Department of the Registers. For example the Companies Register, the Register of Insolvencies and the Registers of Births Marriages and Deaths are all outwith the Department of the Registers.

3.7 Registration would be by the name of the debtor, with possible exceptions, for example for road vehicles where registration could perhaps be both by name and by identifying number. The rules would be fairly demanding as to the identity of the debtor. For companies, not only name and address would be required, but also registration number, because whereas names and addresses can change, the registration number cannot change. For natural persons name and address would be required, but also date of birth.

3.8 Registration would have third-party effect. But there would be defined exceptions where a third party would be unaffected. The precise scope of these exceptions would need detailed consideration, but here are some probable examples. (i) X owes money to Y and Y assigns the claim to Z. Z completes title by registration. X, unaware of the assignation, pays Y. X would be discharged. (ii) A company that runs a shop grants a security over all its present and future stock. It sells goods to customers. Such sales in the ordinary course of business would give the customers a title free from the security. (iii) Someone buys goods unaware of a registered security, because the existence of the security was not discoverable by reasonable searches in the register. The buyer would obtain an unencumbered title.

Assignment: completion of title

3.9 Assignment would be completed *either* by intimation *or* by registration in the Register of Moveable Transactions. Here are some examples. (i) W owes money to X. X can assign this to Y, Y's title being completed by registration, without notification to W. Y can later assign to Z, this assignation being completed by notification. Thus in a chain of assignments, different methods of completion could be used. (ii) W owes money to X. X fraudulently assigns to Y and also to Z. Y completes title by intimation and Z by registration. Whichever completes title first would prevail.

Protecting the account party

3.10 As mentioned above, in an assignation, an account party who acted in reasonable ignorance of an assignation (eg by paying the previous creditor) would be protected. The account party would not be regarded as having constructive knowledge of the contents of the new register. For example, X owes money to Y. Y assigns to Z, the assignation being registered but not intimated. X in good faith pays Y. X is thereby discharged, and so Z cannot now require X to pay.

3.11 The assignee would be subject to information duties, so as to ensure that the account party was not put in a difficult position. (One possible model for these information duties would be the rules in the DCFR.)

Assignment in security

3.12 Assignment in security would continue to be competent, ie the transfer of a right to the assignee, the latter to hold for the purpose of security. Such assignments would, like other assignments, be completed by intimation or by registration.

Anti-assignment clauses

3.13 The law would remain as it is, which is to say that such a clause would invalidate a purported assignation.

Assignment of after-acquired rights

3.14 A registered assignment of after-acquired rights would be effective, as from the time when the right was acquired by the cedent. But consumer granters might be excepted from this rule.

Codification of the law of assignment

3.15 No attempt would be made to codify the law of assignment. But the possibility of codification in the future would exist.

Some other issues about assignment

3.16 The rule that an assignee may sue in the cedent's name would be abolished.

3.17 The rule that a mandate can constitute an assignment would be abolished.

3.18 An assignment of a standard security registered in the Land Register would transfer the claim as well as the security.

3.19 The assignment of a secured claim would carry the security too except in so as otherwise provided in the assignment.

3.20 An assignment of a future right would not take effect before the date when the right is eventually acquired.

Proper security, without notification, over incorporeal moveable property

3.21 It should be competent to grant a proper security over incorporeal moveable property (including IP rights), by means of registration in the new register. (The "new moveable security".) Being a proper security, the grantee would acquire a subordinate right of security, with the debtor retaining the title. The result would be what might be called a "standard security over moveable property". Various consequences would follow. (i) Where the collateral was an income stream, the stream would continue to be payable (unless and until default) to the debtor. (ii) The debtor could grant more than one security over the same asset, the securities relating to each other according to the general law of ranking. (iii) The debtor could transfer the right to another party, subject always to the security.

3.22 In the case of a security over a claim, notification to the account party would not be required to constitute the security.

3.23 The security could include after-acquired property, the security coming into existence when the debtor acquired the property in question.

Non-possessory registered security over corporeal moveable property

3.24 It would also be competent to grant the new moveable security over corporeal moveable property by means of registration in the new register. It would be non-possessory. It could include after-acquired property.

3.25 As mentioned above, in certain cases buyers would take free of the security. For example, in many legal systems where a seller sells goods in the ordinary course of

business any non-possessory security over those goods is automatically discharged, and some such rule might be adopted here. More than one rule, or combination of rules, would be possible.

Asset types

3.26 Ships and aircraft would be excluded from the scope of the new moveable security. But apart from that all moveable property, corporeal and incorporeal, could be used as collateral in relation to the new security. (Subject to issues of *situs*, and subject to the general proviso that the asset is one capable of being used as collateral. For example non-transferable rights could not be used as collateral.)

The attachment/perfection distinction

3.27 The attachment/perfection distinction to be found in the UCC/PPSAs would not be adopted. A registered security would not be capable of coming into existence before registration.

3.28 The new moveable security would be a species of the genus "security" and thus would be subject to the general law of security, both statutory and common law, except in so far as the legislation otherwise provided.

Ranking

3.29 The general principles of ranking would apply to the new security. A security over a future asset would not take effect before the asset is eventually acquired.

Ability to grant the new moveable security

3.30 The new moveable security could be granted by anyone, not only companies.

Enforcement

3.31 Enforcement would be extrajudicial, in the interests of speed and keeping costs down. (But of course in some cases where there was a dispute about fact or law, litigation might be unavoidable.) Enforcement would result in sale, but in the case where the collateral was a money debt it could result in the simple realisation of the debt.

Consumer protection

3.32 Only those acting in the course of a business could grant security over after-acquired assets.

3.33 The possibility of security being granted over consumer goods would be restricted. For example, the rule might be that property exempt from diligence would be exempt from the new security.

Codification of the law of security

3.34 No attempt would be made to codify the law of security over moveable property. But the possibility of codification in the future would exist. In relation to the new types of

registered security, the legislation would have to give some detail, but it could also rely on common law in some respects, for example the *prior tempore potior jure* principle.

Treatment in insolvency

3.35 Because the new security right would be a new species of the genus "security" it would be subject to the general rules about security to be found in the insolvency legislation.

3.36 The new moveable security right, to the extent that it functioned in a way similar to the floating charge, would be treated, in the event of insolvency, in substantially the way that floating charges are treated. For example, the new security would rank behind preferential claims. Any change to this approach would need to be considered as part of a future review of insolvency law.

Floating charges

3.37 It would remain competent to grant floating charges, at least for the time being. If experience proved the new security to be a success, then the question of whether the floating charge should continue would be suitable for review.

3.38 The ranking rules for floating charges might be modified so that they would be postponed to subsequent security rights other than floating charges.

3.39 The decision in *Lord Advocate v Royal Bank of Scotland*³ would be reversed by legislation, so that the rules about the interaction between a floating charge and diligence by other creditors would be restored to what was the original intention of Parliament.

3.40 It is for consideration whether future floating charges should apply to land.

Pledge

3.41 The law of pledge would in general remain as it is, though the possibility of future reform (and codification) would not be excluded. But there would be certain reforms. (i) The rules about forfeited pledges contained in the Consumer Credit Act 1974 would be reformed to make them fairer to debtors. (ii) Scots law would depart from the rule in *Hamilton v Western Bank*⁴ and instead adopt the English rule in *Sewell v Burdick*,⁵ whereby a pledge of goods on bill of lading is regarded as a true pledge.⁶ (iii) Trust receipt financing would require registration, so that the rule in *North Western Bank, Limited v John Poynter, Son, & Macdonalds*⁷ according to which non-possessory security over goods held on bill of lading is competent would be abrogated.

Recharacterisation

3.42 "Recharacterisation" (the compulsory conversion of quasi-securities into actual securities) should not be adopted. This is not because we necessarily reject the idea. We

³ 1977 SC 155.

⁴ (1865) 19 D 152.

⁵ (1884) LR 10 App Cas 74.

⁶ On one view, Scots law has already implicitly abandoned the *Hamilton* rule in favour of the *Sewell* rule. But this is by no means certain.

⁷ (1894) 22 R (HL) 1; [1895] AC 56.

think that there are reasonable arguments for and against. But we think that even if there is a good case for recharacterisation, there are pragmatic reasons against attempting its introduction at the present time. The possibility of introducing it could be reviewed in the future.

International private law

3.43 No changes would be made to international private law. It would thus continue to be for existing international private law to determine when substantive Scots law would or would not apply. It may be that some reform to international private law would be desirable but that would not fall within the scope of the project. This too would be a difference from the approach of the UCC/PPSAs, which generally include in the statute provisions regulating the international private law of moveable security.

How near to the UCC/PPSAs?

3.44 The scheme outlined in this chapter would take much from the UCC/PPSA approach. But there would also be large differences. Here are some features of the outline scheme that would be different from the UCC/PPSA approach: the absence of recharacterisation, the absence of a specific "proceeds" rule, the survival of the floating charge, the absence of a set of rules about international private law, the possibility of intimation to complete assignments, the absence of a codification, or semi-codification, of moveable security law in general, and the rule that a registrable security interest could not come into existence before registration. Those differences look extensive, and are extensive, but there would also be a great deal in common with the UCC/PPSA approach.

General question

3.45 Detailed questions are asked later in this discussion paper. Some consultees may wish to deal only with the latter. But some consultees, perhaps because of pressure of time, may wish to respond only to the outline given in this chapter. We therefore ask a general question at this point.⁸

2. **Would a new scheme on the general lines sketched in this chapter be appropriate?**

⁸ Consultees who offer responses to the detailed questions and proposals later in this discussion paper are also free, if they wish, to respond to this question.

Chapter 4 The current law in outline: outright assignments

Introduction

4.1 This chapter outlines the current law in relation to outright assignment of incorporeal moveable property.¹ It is not a full account of the law, but focuses on issues that are of particular relevance to this project. "Outright" or "absolute" assignment means assignment not for the purpose of security. Assignment in security is considered in Chapter 7. The scope of the present chapter is narrower than the scope of that chapter, because the present chapter deals only with the transfer of ordinary personal rights.

4.2 This chapter does not deal with the outright transfer of corporate shares and bonds, with the transfer of negotiable instruments or with the transfer of intellectual property rights. By contrast, Chapter 7 considers security rights over all kinds of incorporeal moveable property. That is because the project has a broader scope in relation to secured transactions than it does in relation to transfer. In summary, this chapter is limited to the transfer, by assignment, of ordinary personal rights.

4.3 Reasons for assigning incorporeal moveable property vary just as reasons for other transfers vary. The commonest reason is sale, though incorporeal moveable property can pass for other reasons, such as inheritance or donation. Sometimes a business wishes to shift assets from one entity in a corporate group to another, and in the case of incorporeal moveable property this is done by assignment. Using business language, factoring and securitisation may involve assignment.

4.4 The transferability of property of all kinds is a vital feature of market economies and mixed economies. It is true that securitisations were involved in the financial crisis that emerged in 2007. But the issues raised by the financial crisis have been mainly issues of regulatory law rather than of private law.

4.5 Where the reason for assignment is a sale, the price may not be the par value of the claim that is sold. For example, if a company falls into financial difficulties, a creditor, instead of pressing for payment and perhaps raising an action for payment, may decide to sell the claim, and in that case the price is likely to be substantially below par. For example a claim for £1,000,000 might be sold for £600,000. The buyer takes a risk. The debtor company might go into insolvent liquidation, with creditors being paid only 10%, in which case the buyer will be paid only £100,000, and thus make a loss on the deal of £500,000. Or the company might recover from its problems, and pay all creditors in full, in which case the buyer will have made a profit of £400,000. There are those who think that a buyer of a claim should not be entitled to receive from the debtor company more than the buyer has paid for the claim, in this example £600,000. This view is not coherent, and is not adopted by any

¹ For the law of assignment, see, among other sources, William W McBryde, *The Law of Contract in Scotland* (3rd edn, 2007) and Ross G Anderson, *Assignment* (2008).

legal system. There is no reason why the sale of the claim should suddenly reduce the company's debt from £1,000,000 to £600,000. Indeed, if the claim were to be assigned only to the extent of £600,000, that would suggest that £400,000 of the claim would remain in the hands of the original creditor.

4.6 There has been some political controversy about financial institutions that buy claims against certain poorer countries that are in financial difficulties and then seek to enforce. Critics label these institutions "vulture funds". We express no view, but would only note that if there is a problem, it does not lie in the fact that claims are assignable.

General

4.7 Assignment is the transfer of incorporeal property from one person to another. It is not limited to the sphere of moveable property, for assignment is also the mode whereby incorporeal heritable property is transferred. For example, a standard security is transferred by assignment. Nor is assignment confined to personal rights. Thus, to take the example of a standard security again, the assignment is of both the secured debt (a personal right) and the security for that debt (a real right). The test for what is transferable by assignment is, therefore, neither a personal/real test nor a moveable/immoveable test, but a corporeal/incorporeal test. It remains to add that this discussion paper is concerned only with moveable property.²

4.8 The commonest case of assignment is the transfer of a monetary claim.³ The monetary claim may have arisen in a variety of different ways. Charles may lend money to Deirdre and later assign the right to be repaid to Alan. Or Cilla may sell goods on credit to Donald and later assign to Anne the right to be paid the price. Both of those are cases where the claim assigned is a contractual claim. Non-contractual claims are also normally assignable. For example, if Dugald causes personal injury to Chris, the latter could assign the delictual damages claim to Alex. Subject to certain exceptions, any monetary claim is assignable.⁴ More broadly, all personal rights are presumptively assignable. As already indicated, this chapter deals with the assignment of personal rights.

Some terminology

4.9 The transferor is known as the assignor, or cedent. The transferee is known as the assignee, or cessionary. If Cosmo assigns to Abigail and she later assigns back to Cosmo, that is commonly called retrocession. The debtor is sometimes known as the account debtor, or account party,⁵ rather than simply as debtor. That is because the cedent is also often a debtor to the assignee, so that it is convenient to have a term that distinguishes the debtor in the assigned right. (The term "assignment" is not normally used for the transfer of company shares,⁶ company bonds, public sector bonds and negotiable instruments, even though in

² Except to the extent that in the discussion of the law of assignment we consider what the position is, and should be, if the assigned claim is secured by standard security.

³ The word "claim" has a range of meanings. In this paper it is used to mean a personal right.

⁴ Including, for example, a claim for damages for personal injury (including any claim for solatium): *Cole-Hamilton v Boyd* 1963 SC (HL) 1.

⁵ Or, to use an academic term, the *debitor cessus*.

⁶ The question may not be merely terminological. For the question of the juridical nature of the transfer of company shares see Paul Davies (ed), *Gower and Davies' Principles of Modern Company Law* (8th edn 2008) para 27-4, note 14 and authorities there cited.

substance the transfer of such property is an assignation. But such transfers in any case lie outwith the scope of this project.)

Account debtor's consent not required

4.10 The account debtor's consent is not required, unless the contract between the account debtor and the original creditor otherwise provides.

Bars on assignation and *delectus personae*⁷

4.11 If a contract has an anti-assignation clause, also called a non-assignment clause,⁸ and one party thereafter purports to assign, the assignation is ineffective.⁹ In other words, such a clause has effect not only as between the contracting parties themselves but also as against any purported assignee.¹⁰ So if Cosmo contracts to do construction work for Duncan, and the Cosmo/Duncan contract says that Cosmo is not to assign, and he nevertheless purports to assign the contract price to Abigail, she thereby acquires no right against Duncan. It may be asked why such clauses are used. Duncan must pay for the work done for him, and it presumably makes little difference to him whom he pays. One reason is convenience. It is administratively simpler for Duncan to know that he is to pay Cosmo, and not have to deal with the possibility that the claim has become payable to someone else. Another reason is that in some types of contract assignation may give rise to potential difficulties. For example, a contract may contain an arbitration clause, and if there were to be an assignation that might give rise to questions as to the position of the assignee in relation to the arbitration clause. Barring assignation means that such questions should not arise. Lord Browne-Wilkinson has said:¹¹

"The reason for including the contractual prohibition viewed from the contractor's point of view must be that the contractor wishes to ensure that he deals, and deals only, with the particular employer with whom he has chosen to enter into a contract. Building contracts are pregnant with disputes: some employers are much more reasonable than others in dealing with such disputes."

4.12 It is sometimes said that contracts cannot be assigned if there is *delectus personae*.¹² But contracts cannot normally be assigned, whether there is *delectus personae* or not.¹³ What is assigned is a right (which may be a contractual right), not a contract.¹⁴ *Delectus personae* bars the assignation of rights. There are two types of *delectus personae*. The first

⁷ For discussion and references see ch 11 of Ross G Anderson, *Assignation* (2008). See also W M Gloag and J M Irvine, *The Law of Rights in Security, Heritable and Moveable, including Cautionary Obligations* (1897) ch XIII.

⁸ To use academic language, a *pactum de non cedendo*.

⁹ See *James Scott Ltd v Apollo Engineering Ltd* 2000 SC 228. (English law is the same: *Linden Gardens Trust Ltd v Lenesta Sludge Disposal Ltd* [1994] 1 AC 85.) The alternative possibility, not adopted by Scots law, is that the assignation is valid, albeit that the cedent, in assigning, acts in breach of contract. For discussion of anti-assignation clauses see, for example, Roy M Goode, "Inalienable Rights" (1979) 42 *Modern Law Review* 553, Bob Allcock, "Restrictions on the Assignment of Contractual Rights" (1983) 42 *Cambridge Law Journal* 328, Ross G Anderson, *Assignation* (2008) ch 11, and for a comparative study see Ute Goergen, *Das Pactum de non cedendo: eine Untersuchung zum vertraglichen Abtretungsverbot im englischen, französischen und deutschen Recht unter Einbeziehung internationaler Harmonisierungsiniciativen* (2000).

¹⁰ *James Scott Ltd v Apollo Engineering Ltd* 2000 SC 228.

¹¹ *Linden Gardens Trust Ltd v Lenesta Sludge Disposal Ltd* [1994] 1 AC 85 at 105.

¹² Latin, meaning "selection of the person".

¹³ See para 4.16.

¹⁴ The main case where the assignation of a whole contract is (sometimes) possible is a lease of land. Here *delectus personae* will bar assignation of the contract.

is *delectus personae creditoris*,¹⁵ ie an anti-assignment agreement, express or implied. This bars assignment of rights under the contract. The second is *delectus personae debitoris*.¹⁶ This bars sub-contracting. If X agrees to paint a portrait of Y, there is *delectus personae debitoris*: the painter cannot subcontract the work.

4.13 Whether a contract implicitly forbids assignment of contractual rights will depend on the facts and circumstances of the case. In some loan contracts the interest is unilaterally variable by the creditor.¹⁷ This is an example of a case where the identity of the creditor is not a matter of indifference to the debtor. It may be that there is an implied prohibition of assignment by the creditor, or it may be that assignment is possible but the assignee cannot exercise the power of variation. Similar issues can arise for other contract terms conferring power on the creditor.

4.14 In certain cases, assignment is forbidden by statute, for example rights to social security payments.¹⁸

Rights assignable, not obligations

4.15 What is assigned is a right, not an obligation. Obligations cannot normally be transferred except with the creditor's consent: if Ishbel owes money to Nestor, he can transfer his claim without her consent, but she cannot transfer her obligation without his consent. Even if an obligation is transferred, that is not an assignment, but a delegation. (Indeed, in delegation the obligation is not actually transferred: rather the existing obligation is extinguished and replaced by a new one.)

Assignment of contracts

4.16 It follows that whilst contractual rights are normally assignable, whole contracts are normally non-assignable, because a contract consists of both rights and obligations. The rights can be assigned, but not the obligations. Thus if Cosmo contracts with Duncan to repair his roof, he can assign the contract price, but he cannot assign the contract. Scots law in this respect is in broad terms the same as English law.¹⁹ An entire contract can be transferred, provided that there is mutual agreement, express or implied, which consent may be given in advance. A lease of land is, from the point of view of assignability, subject to special rules. In some cases the tenant can assign the whole contract, thereby substituting the assignee in both the rights and the obligations of the contract of lease. (And where the landlord disposes, there is normally a transfer of the whole contract, including both rights and obligations,²⁰ to the transferee.)

¹⁵ Selection of the person of the creditor.

¹⁶ Selection of the person of the debtor.

¹⁷ This is common in home loans.

¹⁸ Social Security Administration Act 1992, s 187. For more examples see Ross G Anderson, *Assignment* (2008) para 10-30.

¹⁹ Cf Lord Browne-Wilkinson in *Linden Gardens Trust Ltd v Lenesta Sludge Disposal Ltd* [1994] 1 AC 85 at 103: "Although it is true that the phrase 'assign this contract' is not strictly accurate, lawyers frequently use those words inaccurately to describe the assignment of the benefit of a contract since every lawyer knows that the burden of a contract cannot be assigned." In *Scottish Homes v Inverclyde District Council* 1997 SLT 829 doubt was expressed as to whether this is Scots law. With respect we think that the doubt was misplaced.

²⁰ In so far as these are *inter naturalia* of the lease.

Assignment, tripartite novation, sub-participation and personal subrogation

4.17 Assignment is different from *tripartite novation*. If Darius owes £1000 to Cassandra, there may thereafter be a tripartite agreement between them and Edmund, whereby Cassandra discharges Darius and the latter binds himself to pay the money to Edmund. The net result is similar to an assignment by Cassandra to Edmund, but the result is achieved without the use of assignment.

4.18 In *sub-participation* Cassandra sells her claim to Edmund but the latter does not complete title. (Though the contract is in practice likely to contain words of assignment so that Edmund always does have the option to complete title by intimation.) Thus the claim against Darius is not transferred. He still owes the debt to Cassandra, and if he defaults it is she who will sue. Between Darius and Edmund there is no legal relationship. The right to payment has not passed from Cassandra's patrimony to Edmund's.

4.19 *Personal subrogation* can happen when one person pays the debt of another. If Dugald owes money to Cornelia and Susie pays this debt, then the latter is subrogated to Cornelia's rights against Dugald.²¹ This is a general doctrine. In addition there is the special doctrine in insurance law whereby if A causes delictual loss to B, and B is insured with C, and C pays B in terms of the insurance policy, C can claim against A.²²

Assignatus utitur jure auctoris

4.20 "All exceptions²³ competent against the cedent before the assignment or intimation are relevant against the assignee, as payment, compensation etc."²⁴ This principle bears the Latin tag *assignatus utitur jure auctoris*. For example, Cosmo sells oats to Duncan for £10,000. The sale is on credit, and Cosmo assigns the invoice to Alison. The oats as delivered are of a quality that is, says Duncan, disconform to contract. If Duncan had the right to refuse to pay anything to Cosmo, he also has that right against Alison. If he had the right against Cosmo to pay a reduced sum, he also has that right against Alison. The fact that the assignee will, in the typical case at least, have taken the assignment in good faith is irrelevant.²⁵ Thus the rights of an account debtor are unimpaired by an assignment.

Waiver-of-defence clauses

4.21 What if the Cosmo/Duncan contract has a "waiver of defence" clause? (This is the name generally given to a clause in the Cosmo/Duncan contract whereby Duncan renounces his right to plead against an assignee substantive defences that he could have pled against Cosmo.) The effect of this is to make the resulting invoices more marketable. Some legal systems recognise the validity of such a clause.²⁶ Though such clauses are quite

²¹ See Laura Macgregor and Niall Whitty, "Payment of Another's Debt, Unjustified Enrichment and *Ad Hoc Agency*" (2011) 15 EdinLR 57.

²² See the opinion of Lord President Rodger in *Caledonia North Sea Ltd v London Bridge Engineering Ltd* 2000 SLT 1123.

²³ Pleas by way of defence.

²⁴ Stair 2,1,20.

²⁵ Cases on the *assignatus utitur jure auctoris* doctrine are numerous. See eg *Johnstone-Beattie v Dalziel* (1868) 6 M 333; *Scottish Widows Fund v Buist* (1877) 4 R 1076; *Train v Clapperton* 1907 SC 517 aff'd 1908 SC (HL) 26.

²⁶ For example UCC § 9-403; Saskatchewan PPSA s 41(2); Ontario PPSA s 14; New Zealand PPSA s 102(2); Australian PPSA s 80(2).

often used in Scotland, their effect seems to be untested in the courts. But as far as the common law is concerned, there would seem to be no reason why they should not be valid.²⁷

Registration for execution

4.22 A somewhat similar issue can arise with a contract which contains a consent to the registration of the contract for preservation and execution in the Books of Council and Session. The debtor thereby consents to an adverse decree. In such a case, objections can be pled, probably, only by way of suspension and interdict.²⁸ Suppose then the creditor assigns. The assignee can do diligence on the registered document.²⁹ There is a possible argument that this procedure is ineffective against consumer debtors.³⁰

Negotiable instruments

4.23 The same effect arises automatically if a negotiable instrument is used to document the Cosmo/Duncan debt. All that is needed is for Duncan to sign a bill of exchange or a promissory note.³¹ If Cosmo then transfers the bill of exchange or note to Alison, the latter, if in good faith, can enforce against Duncan for the full amount. (Of course, if Duncan has to pay in full for goods that are disconform to contract, he can in turn recover from Cosmo. But that is in practice a less attractive prospect for him than to be able to refuse to pay Alison.)

4.24 Indeed, it may be that there is a lack of knowledge of the law of negotiable instruments, and that there are those who seek to use ordinary assignation in a way that the law already allows, by a different route, negotiability. Indeed, some of the pressures to reform the law of assignation may, in some measure at least, arise from an inadequate appreciation that the law already allows what is asked for. For example, (i) negotiable debt can be transferred without intimation and (ii) negotiable debt can be transferred free of latent defences.

Warrandice *debitum subesse*

4.25 In every assignation there is, by implication of law, warrandice *debitum subesse*,³² which is to say that the cedent guarantees to the assignee the existence of the right.³³ So if the assignee finds the claim barred, wholly or partially, by a plea of *assignatus utitur jure auctoris*, the cedent is in breach of warrandice and must compensate the assignee. Thus Alison could claim compensation from Cosmo. The implied-in-law guarantee is only that the debt is payable,³⁴ not that it will in fact be paid. For example if the reason that the assignee cannot collect is that the account party has become bankrupt, that is not a breach of warrandice. The parties are free to add a guarantee that the claim will actually be paid, but such a guarantee is not implied by law.

²⁷ But they may be struck at by the Unfair Contract Terms Act 1977: *Coca-Cola Financial Corporation v Finsat International Ltd* [1998] QB 43; *Axa Sun Life Services Plc v Campbell Martin Ltd* [2011] EWCA Civ 133 at para [75].

²⁸ J Imrie *et al*, "Public Registers and Records" *Stair Memorial Encyclopaedia* (Reissue) (2006) para 41.

²⁹ Debtors (Scotland) Act 1987, s 88(1) and (2) and RCS r 16.12.3.

³⁰ Unfair Contract Terms Act 1977 s 17; Unfair Terms in Consumer Contracts Regulations 1999 (SI 1999/2083), sch 2, paras 1(o) and (q).

³¹ But the use of negotiable instruments in consumer transactions is restricted: Consumer Credit Act 1974 s 123.

³² Warrandice means warranty, or guarantee. "*Debitum subesse*" means literally "the debt to subsist".

³³ Being an implied-in-law term it could be excluded. But that would be unusual.

³⁴ Not necessarily immediately, or unconditionally. Thus if a debt payable in 12 months is assigned today, the fact that the assignee cannot collect for another twelve months is no breach of the warrandice.

4.26 The position is different where the debt is constituted by negotiable instrument. When a negotiable instrument is transferred by endorsement, there is an implied-in-law guarantee not only that the debt is payable but also that it will be paid.³⁵ If the latter guarantee is to be excluded, it must be excluded expressly.

The *assignatus* principle a shield, not a sword

4.27 Because of confusion³⁶ about "assigning contracts" a fear is sometimes expressed that an assignee might become liable on the contract, as if what was being assigned was the contract itself. This fear is sometimes linked to the principle *assignatus utitur jure auctoris*. But that principle is a shield, not a sword. The account debtor can invoke it against the assignee, but it does not engage the assignee in liability. Thus in one case the buyer of 12,000 bottles of orange squash for a price of £725 paid £375 to account. The seller then assigned the balance of the price, ie £350. The buyer refused to pay the assignee on the ground that it had validly rejected the whole consignment as being disconform to contract. The assignee raised an action for £350. The defender (i) argued that it was not obliged to pay, because it had validly rejected the goods and (ii) counterclaimed £375 from the assignee. It was held that (i) was relevant, but not (ii).³⁷

Redfearn v Somervail

4.28 In *Redfearn v Somervail*³⁸ W took shares in company X, in trust for another company, Y. W then, acting in breach of trust, transferred the shares to Z. The question for decision was whether Z had a good title to the shares as against Y. The Court of Session held in favour of Y. The reason was that as the law then stood an assignee took subject to the rights not only of the account debtor (here company X) but also of other parties. The House of Lords reversed, limiting the *assignatus utitur* principle so as to subject the assignee to the rights of the account debtor but not to the rights of other parties.³⁹ Although the case concerned shares, it established a general principle about the law of assignment.

Writing?

4.29 Before the Requirements of Writing (Scotland) Act 1995, the law was that writing was not required for step (1),⁴⁰ ie contracts to assign, but was required for stage (2), ie assignments.⁴¹ The document had to be signed by the granter, but not by the grantee. The 1995 Act provided that assignments (ie step (2)) need not be in writing.⁴² This implemented a 1988 report of this Commission.⁴³ With the benefit of hindsight, we now think that our report may not have fully considered the issues. For example, the law of intimation presupposes

³⁵ Bills of Exchange Act 1882 s 55(2).

³⁶ For a relatively recent example see *Scottish Homes v Inverclyde District Council* 1997 SLT 829.

³⁷ *J E Binstock Miller & Co Ltd v E Coia & Co Ltd* 1957 SLT (Sh Ct) 47. See also *Alex Lawrie Factors Ltd v Mitchell Engineering Ltd* 2001 SLT (Sh Ct) 93. The law is the same elsewhere in Europe, including England, for which see the decision of the House of Lords in *Pan Ocean Shipping Ltd v Creditcorp Ltd (the Trident Beauty)* [1994] 1 WLR 161.

³⁸ (1813) 1 Dow 50.

³⁹ It is sometimes said that the case established that an assignee takes free of "latent equities" but this is a concept of English law, not of Scots law.

⁴⁰ For the three steps involved in assignment, see para 4.34 below.

⁴¹ See William W McBryde, *The Law of Contract in Scotland* (3rd edn 2007) para 12.52 and references therein.

⁴² Section 11(3).

⁴³ Scottish Law Commission, *Report on Requirements of Writing*, (Scot Law Com No 112 (1988)) paras 2.51 and 2.52.

that there is a written document of assignation that can be exhibited to the account debtor.⁴⁴ It may be that we did not sufficiently distinguish step (1) from step (2).

4.30 A possible argument might be that the 1995 Act by implication abolished the need for intimation, for if intimation involves the delivery of a copy of the deed of assignation, and the law no longer requires a deed of assignation, the law no longer insists on intimation. A less radical argument would be that the law still requires intimation, but that there is no longer any requirement to deliver a copy of the deed of assignation. A third possibility would be that a copy of the deed of assignation must be delivered, but if there is no such deed, intimation, though still required, can be done without delivering a copy of what does not exist.

4.31 The law strikes us as unclear, but we do not think that the 1995 Act means that the requirement for intimation was wholly abolished. The third possibility mentioned in the previous paragraph is perhaps the best bet, but the law cannot be stated with any confidence.

Wording?

4.32 No special form of words is required,⁴⁵ though the phrase "do hereby assign" is unambiguous and hence is the favourite of careful drafters. Sometimes no assignation takes place because the wording used does not go beyond a contract to assign. For example in one case the nearest the agreement got to words of transfer was that "you ...shall ... transfer the title of the debt to us by delivering to us such form of assignation as we may specify."⁴⁶ This was held not to be an assignation. As the sheriff commented: "If the agreement was the assignation, as the solicitor for the pursuers submitted, why bother with another assignation? It seems to me that the agreement is no more than a contract of sale."⁴⁷ In other words, only step 1 (contract) had been reached, not step 2.

4.33 Although the law does not require any particular form of words, but only an expressed intention to transfer, there have been cases where it has been held that wording that not only fails to express an intention to transfer, but which expresses an intention to create an entirely different legal state of affairs, should be interpreted as an assignation. This is the subject of mandates, discussed below.⁴⁸

The three steps to completed title

4.34 Assignation is the transfer of a right from the transferor's patrimony to the transferee's. It involves three steps, leading to the final result of the assigned right being vested in the assignee in place of the cedent. (1) The contract to assign.⁴⁹ (2) The act of assignation, which is typically a formal deed. These first two steps are often in practice combined into a single act. (3) The intimation to the account party. The claim is transferred only at the third stage. Thus the day when the right passes out of the cedent's patrimony and

⁴⁴ Thus the Transmission of Moveable Property (Scotland) Act 1862 requires the delivery to the account party of a certified copy of the deed of assignation. The 1995 Act did not remove this requirement.

⁴⁵ See eg, *Laurie v Ogilvy*, 6 Feb 1810 Fac Coll; *Carter v McIntosh* (1862) 24 D 925; *Brownlee v Robb* 1907 SC 1302.

⁴⁶ *Bank of Scotland Cashflow Finance v Heritage International Transport Ltd* 2003 SLT (Sh Ct) 107.

⁴⁷ At 110.

⁴⁸ Paras 4.46 ff.

⁴⁹ Strictly this is not necessary, just as with the transfer of land missives are strictly not necessary.

enters that of the assignee is the day of intimation.⁵⁰ From this fact follow various consequences, such as that until intimation, the claim remains arrestable by the cedent's creditors. Again, if there are two competing assignments, the first to be intimated has priority. The word "assignment" is sometimes used to mean the *consequence* of these steps, ie the transfer itself. Sometimes it is used to mean step (2). Quite often, and misleadingly, it is used to mean step (1). The first step is typically a contract of sale, for it is not only corporeal property that can be bought and sold. But the contract of sale is not in itself a transfer.

4.35 Sometimes no assignment takes place because the wording used does not go beyond a contract to assign, ie the first stage has not been followed by the second.⁵¹

Completing title: intimation

4.36 Just as the sale of land involves (1) contract (2) delivered deed (3) registration, and the right of ownership does not pass to the grantee (disponnee) until the final step has taken place, so in assignment the right does not pass to the grantee (assignee) until the third step – intimation – has taken place. It is by intimation that the grantee "completes title".⁵² For example, suppose that Wendy owes money to Xerxes. A creditor of the latter, Yvonne, arrests in Wendy's hands on 15 April. Suppose that on 10 April Xerxes assigns to Zachary. If Zachary intimates before 15 April, he prevails over Yvonne. But if he intimates after 15 April, Yvonne prevails over Zachary. It is on the date of intimation that the right to payment passes from Xerxes' patrimony to Zachary's. Identifying this time precisely often does not matter, but sometimes it does, as this example shows.

4.37 In many legal systems, the claim passes before intimation, simply as a result of the transaction between cedent and assignee. An account party who, unaware of the assignment, pays the old creditor, ie pays the wrong person, is discharged. Intimation is a precaution, to ensure that the account party does not inadvertently pay the old creditor. In Scots law intimation goes further than that: it is the moment when the claim passes. In Scots law an account debtor who, not having received intimation, pays the old creditor, pays the correct creditor.

4.38 One consequence of our rule is that debtors know who their creditors are. In legal systems that do not require notification, debtors cannot know who their creditors are: any debt may have been assigned the day after it was incurred, and, indeed, may have been passed through many hands. Such legal systems then have to have special rules protecting debtors who act in good faith, such as paying the original (but not current) creditor. In the case of consumer debtors there has been EU legislation to try to ensure that debtors do

⁵⁰ These three stages also exist, in principle, in other types of transfer, such as land: (i) missives, (ii) disposition, (iii) registration.

⁵¹ For example *Bank of Scotland Cashflow Finance v Heritage International Transport Ltd* 2003 SLT (Sh Ct) 107.

⁵² "The assignment itself is not a complete valid right, till it be orderly intimated to the debtor, which, though at first (it is like) hath been only used to put the debtor *in male fide* to pay the cedent, or any other assignee, yet now it is a solemnity requisite to assignments..." (Stair, 3,1,6.). "The assignment is not completed by executing and delivering it to the assignee, but it must likewise be intimated to the debtor, till which is done, the cedent is not understood in our law to be denuded ... Any onerous deed, executed by the cedent before intimation, will prejudice the assignee, and a second assignment, for a valuable consideration, first intimated, will be preferable." (Bankton, 3.1.6.).

know who their creditors are.⁵³ This legislation is not needed in jurisdictions such as Scotland where notification is an essential condition of transfer.

4.39 At common law, intimation had to be done notarially,⁵⁴ subject to certain exceptions. The Transmission of Moveable Property (Scotland) Act 1862 introduced a second, and less cumbersome, form of notarial intimation. It also introduced a non-notarial method:⁵⁵

"An assignation shall be validly intimated ... by the holder of such assignation, or any person authorized by him, transmitting a copy thereof certified as correct by post to such person."

4.40 Today the common law notarial method seems to be unknown in practice, though it remains competent. The notarial method introduced by the 1862 Act is rare but is, we understand, occasionally used, in cases where evidence of intimation is wanted but it is thought that the account party is unlikely to give a written acknowledgement.

4.41 The postal method introduced by the 1862 Act is widely used, but not universally. What often happens is that notice is sent by post, but without a copy of the assignation.⁵⁶ In that event none of the three methods just mentioned is used.

4.42 Is this valid? As Professor McBryde comments, in a chapter in which the authorities are carefully studied, "one of the long, slow burning questions ... is whether a debtor's mere knowledge of an assignation is sufficient intimation to him."⁵⁷ In *Christie Owen & Davies plc v Campbell*⁵⁸ the view was taken that to intimate is simply to inform, and so none of the three methods just mentioned is necessary. But much of what was said was *obiter*, and since there was no competing claimant the effectiveness of the intimation was not tested.⁵⁹ The authorities cannot be reconciled. It is unsatisfactory that the law should be uncertain, whatever view is taken as to what the law should be.

4.43 One problem is that a notice may not be done in such a way as to bring it home to the account party. In *Christie Owen & Davies plc* the sheriff commented that "I am not prepared to hold that a solicitor is under an obligation to read every document sent to him or that a solicitor is deemed to have read all such documents."⁶⁰

⁵³ Directive 2008/48/EC. See Chapter 2.

⁵⁴ On notarial intimation see Ross G Anderson, *Assignation* (2008) ch 6.

⁵⁵ Section 2.

⁵⁶ Often the notice is in small print, and often the account party is not asked to make any arrangements to pay the transferee, because the cedent and assignee arrange for the latter to take control of the account into which the account party is paying.

⁵⁷ William W McBryde, *The Law of Contract in Scotland* (3rd edn, 2007) para 12-93. See also Ross G Anderson, *Assignation* (2008). These texts analyse the authorities.

⁵⁸ [2009] CSIH 26, 2009 SC 436. *Libertas-Kommerz GmbH v Johnson* 1977 SC 191 is often cited as supporting a low threshold for intimation. But much proceeded on concessions by counsel. See footnotes 30, 38 and 39 in ch 7 of Ross G Anderson, *Assignation* (2008).

⁵⁹ Ross G Anderson, "A Strange Notice" (2009) 13 EdinLR 194. Among the oddities of the case is one it shares with *Libertas-Kommerz GmbH v Johnson* 1977 SC 191. In both the assignee sued the account debtor, and the question was whether there had been intimation. But the raising of an action is itself intimation. So in both cases, whether or not there had previously been an effective intimation, by the time the case came to procedure roll for debate the fact of intimation was beyond question. Hence in both cases it is difficult to see what the debate was about.

⁶⁰ This stage of the case is unreported. See Reid/Gretton *Conveyancing 2007* (2008) p 145 ff and Ross G Anderson "Intimation 1868-2008" (2008) 12 EdinLR 275. The sheriff's decision was upheld on appeal to the Sheriff Principal, but the Inner House reversed.

4.44 The methods of intimation outlined above presuppose that the person who intimates is the assignee. That is what generally happens in practice. Provided that the 1862 Act is followed, the account party will have a certified copy of the assignation and so be able to form a judgment as to the validity of the assignation. There is some authority that intimation can also be made by the cedent.⁶¹ This is sometimes done in practice. If the objective is to ensure that the account party can be confident that the assignation is indeed intended by the cedent, this operates as an alternative to the standard method whereby the assignee intimates but gives the account party a copy of the deed of assignation.

Effect of assignation on accessory rights

4.45 What if a claim is assigned, and the claim is secured? What happens to the security right. This question is considered in Chapter 5.

Mandates

4.46 In Roman law, assignation as such did not exist. But a functional equivalent gradually developed. If Gaius owed Julia money, she could "assign" to Claudia by granting her a mandate to collect from Gaius.⁶² By late Roman law this had reached the point at which it was fairly close to a true assignation, though it seems never to have got all the way.

4.47 Scots law seems to have developed the assignation in the later mediaeval period.⁶³ It appears that it did not borrow it from Roman law, and thus did not (contrary to what is often said) develop assignation out of mandate. Scots law thus did not need to borrow from the less-developed Roman law on this topic. But the influence of Roman law was so strong that the Roman quasi-assignation came to influence the Scots law. Two results of this "assignation as mandate" idea are:

- An assignee can sue in the name of the cedent.⁶⁴
- A mandate to collect, if granted for onerous consideration, takes effect as an assignation. "Mandate and assignation are two distinct and very different legal concepts, though ...what professes to be in form a mandate can in given circumstances be construed as an assignation."⁶⁵

4.48 The second doctrine has been extended. Suppose Constantia owes money to Prospero and the latter owes money to Olwen. If Prospero grants to Olwen a mandate to collect from Constantia, that is an assignation. But what if, instead, Prospero grants to Constantia an authorisation to discharge her debt (ie the Constantia/Prospero debt) by paying Olwen. That is not a mandate to collect, but a mandate to pay. Yet it too is treated as an assignation. In the well-known case of *Carter v McIntosh*,⁶⁶ the deed in question, granted

⁶¹ Discussed in Ross G Anderson, *Assignation* (2008) para 6.30. Dr Anderson identifies two cases where intimation by the cedent has been said to be good: *A v B* (1540) Mor 843 and *Libertas Kommerz GmbH v Johnson* 1977 SC 191. Under § 410(1) of the German Civil Code (BGB), the account party may withhold payment against delivery of the assignation deed signed by the cedent. But this right to withhold payment does not apply where the cedent has notified the account party of the assignment: § 410(2) BGB.

⁶² For the history see Reinhard Zimmermann, *Law of Obligations: Roman Foundations of the Civilian Tradition*, (1990) ch 13; Ross G Anderson, *Assignation* (2008) ch 4.

⁶³ It seems likely that there was a strong French influence.

⁶⁴ Ross G Anderson, *Assignation* (2008) para 2.25 ff.

⁶⁵ Lord Cameron in *National Commercial Bank of Scotland Ltd v Millar's Tr* 1964 SLT (Notes) 57 at 59.

⁶⁶ (1862) 24 D 925.

by certain beneficiaries of a trust, provided that "the said parties on the first part ... *authorise and direct the said Charles Fyfe's trustees* to pay over the said principal sum" to two persons. Lord Justice Clerk Inglis said: "If anything is settled in the law of Scotland, it is that no words directly importing conveyance are necessary to constitute an assignation, but that any words giving authority or directions, which if fairly carried out will operate a transference, are sufficient to make an assignation."⁶⁷ Even if the idea that a mandate to pay can be an assignation is sound, the quoted statement stands in need of a qualification. It seems to be generally accepted that a mandate cannot operate as an assignation unless it is given for onerous consideration.⁶⁸ By contrast, a document that is overtly an assignation does not need consideration.

4.49 If Clement is owed money by Deirdre and writes to her *authorising* her to pay the money to Aeneas, the natural meaning is that she has an option: she can discharge her debt by paying Aeneas, or she can still discharge the debt by paying Clement. But the doctrine referred to above is that this is not the case, if Aeneas is Clement's creditor. Of course, whether Aeneas is Clement's creditor is something Deirdre will be ignorant of, so the doctrine means that she cannot know whether the document she has received is or is not an assignation. A further oddity about the doctrine is that if all Clement wishes to do is to *permit* Deirdre to pay Aeneas, then (if Aeneas is his creditor) he is unable to do so, because the law will refuse to give effect to his intention.

4.50 In *Carter v McIntosh* itself the words in the deed were "authorise *and direct*". This latter term might reasonably be interpreted as going beyond mere authorisation, and being tantamount to assignation. On that basis, the words of the Lord Justice Clerk quoted above, saying that "any words giving authority" can amount to an assignation would seem to have gone beyond what was necessary for the decision. Nevertheless, this *obiter dictum* came to establish a doctrine.⁶⁹

The assignation of future and contingent rights⁷⁰

4.51 There is no difficulty in assigning today a money claim that is not payable until tomorrow. For example, if Donna borrows £1 from Claudia on 1 February, repayable on 1 August, Claudia can assign her right to Alan on 1 May. As from the date of intimation, Alan is Donna's new creditor. Of course, he cannot demand payment until 1 August. But that does not alter the fact that the claim was assignable and has been assigned.

4.52 Nor is there is a problem about assigning a claim that is subject to a contingency. Suppose that the Claudia/Donna loan contract has this clause: "But Donna's obligation to repay shall be extinguished if, before 1 August, Donna dies." The debt is still assignable, though if Donna dies before 1 August, Alan will be owed nothing from Donna's estate: *assignatus utitur jure auctoris*.

⁶⁷ (1862) 24 D 925 at 933.

⁶⁸ The leading case on this point is *National Commercial Bank v Millar's Tr* 1964 SLT (Notes) 57. More precisely, the doctrine may be that irrevocable mandates are assignations and that a mandate is irrevocable if granted for onerous consideration.

⁶⁹ For discussion of the issues raised in this and the preceding paragraphs see G L Gretton, "Mandates and Assignations" 1994 JLSS 175. And see further Ross G Anderson, *Assignation* (2008) ch 5.

⁷⁰ A controversial area. For some discussion see G L Gretton, "Assignation of Contingent Rights" 1993 Juridical Review 23. The cases there cited will not be mentioned here, *brevitatis causa*. For a different perspective see R Bruce Wood in Noel Ruddy *et al*, *Salinger on Factoring* (4th edn 2006) para 7-34.

4.53 Nor is there any problem about *selling* claims that do not exist – that is to say, entering into a contract of sale of such claims. Charles can sell today to Aline any debt that may be owed to him in future by Dugald, with whom he has no contractual or other relations and whom he has never even met. The Charles/Aline contract of sale is valid, just as a contract to sell an object that does not yet exist can be valid. The problems about future rights arise not in the law of contract, but in the law of property.

4.54 There is a spectrum of possibilities, from the assignation of a claim that exists but is still unmaturing, where assignability is clearly competent, to the assignation of a claim that does not exist, where assignation (in the sense of a transfer, as opposed to a contract to transfer) is clearly incompetent, in the sense that what does not exist cannot be transferred.

4.55 A middle case is where a right emerges out of an existing contract, such as future credit card advances. Can that right, whose future existence is uncertain, be assigned today? It may be argued that such rights are like the future apples of an existing tree, and as such have sufficient potential existence to be presently assignable. We express no views.

4.56 There are two reasons why the assignation of a non-existent claim, though it may be valid as a *contract* between the parties, cannot be an actual *transfer*, that is to say a performance of the seller's contractual obligation. The first is that there is (at present) nothing to transfer. In a transfer of nothing, nothing is transferred.⁷¹ The second is that there is no one to whom intimation can be made. Intimation must be made to the account debtor, but Dugald is not an account debtor.⁷² (This latter problem is even clearer in the case of a general assignation of future receivables, in which the future customers are simply unknown.) The second difficulty applies only to legal systems, such as Scots law, that make intimation a requirement of transfer.⁷³ The first difficulty exists in any legal system.

4.57 In countries where intimation is not a requirement, such as Germany and legal systems influenced by German law, assignation of such claims is in principle competent, taking effect as from the day when the right comes into existence. For example, suppose that on 1 March Caspar assigns to Anton any debt due to him by Dieter, and on 1 October Caspar sells goods on credit to Dieter. The claim comes into existence on 1 October, and is immediately and automatically transferred to Anton.⁷⁴

4.58 It has often been said that the same is true in Scots law. For example, Glog and Irvine wrote:

"A future right, which is neither vested nor exigible at the date of assignation, is none the less capable of being legally alienated, to the effect of giving a good title to the assignee when the right comes to be vested. An expectant, who grants a conveyance of a right which he hopes to acquire,⁷⁵ actually conveys at the time no more than a mere chance – his chance of becoming proprietor of the subject in question. 'The conveyance becomes effectual by accretion alone. Till then it is

⁷¹ *Bank of Scotland Cashflow Finance v Heritage International Transport Ltd* 2003 SLT (Sh Ct) 107.

⁷² *Bank of Scotland Cashflow Finance v Heritage International Transport Ltd* 2003 SLT (Sh Ct) 107.

⁷³ In many legal systems the right is transferred by agreement alone. Intimation is needed simply to ensure that the account party does not pay the old creditor.

⁷⁴ *Vorausabtretung*.

⁷⁵ This is a rather compressed statement. An example of what Glog and Irvine were thinking of would be where a company (the "expectant") assigns future receivables ("a right which he hopes to acquire").

nothing but a mere agreement to convey the subject of the expectancy when it shall vest."⁷⁶

4.59 Accretion of title is a doctrine whereby if X ostensibly conveys to Y a right that X does not have, but X later acquires that right, the right will, at that stage, pass immediately, automatically and without the need for any further act of transfer, from X to Y.⁷⁷ In considering whether it can apply to assignation, different types of case must be distinguished.

4.60 The first type of case is where a claim exists against Z and it is assigned by X to Y, who intimates to Z. But X was not in fact the holder of the claim. The holder was A. The assignation is therefore a nullity. But if A later assigns to X, then Y's title will be validated by accretion.⁷⁸ Of course, cases of this sort are unusual.

4.61 Whereas in the previous case the claim existed, but was assigned by the wrong party, in the second type of case the claim does not exist at all at the time of the ostensible assignation. J assigns to K a claim that does not exist. (For example a future receivable.) This possibility itself subdivides into two sub-cases.

4.62 The first sub-case is where the identity of the account party is unknown and so no intimation is made. Here accretion cannot operate. An essential requirement of accretion is that the original transfer is fully valid in all respects *except* that the granter has no title. But if there is no intimation, there is not even a *purported* transfer.⁷⁹

4.63 The second sub-case is where a good guess can be made as to the identity of the account party. For example, a company, J, often sells goods to a buyer, L. J assigns to K its (ie J's) future claims against L. Intimation is made to L, in respect of claims that it does not yet owe but may hereafter owe. If, later, a debt does arise, owed by L to J, does accretion operate so as to validate the assignation? Whereas the law is clear in the first sub-case (above), it is not so clear in this second sub-case. So far as we know, this issue, despite being an important one in practical terms, has never been fully litigated. The nearest case we are aware of is *Bank of Scotland Cashflow Finance v Heritage International Transport Ltd*.⁸⁰ In that case Camac European Ltd granted a deed to Bank of Scotland Cashflow Finance⁸¹ which was, at least according to the grantee, an assignation of Camac's future receivables. A copy was sent to Heritage International Transport Ltd. The question for the court was whether *later* (ie post-intimation) invoices issued by Camac to Heritage Transport were effectually assigned to Bank of Scotland Cashflow Finance. It was held that the deed in

⁷⁶ W M Gloag and J M Irvine, *The Law of Rights in Security, Heritable and Moveable, including Cautionary Obligations* (1897) p 441. The quotation is from Lord Rutherford-Clark in *Reid v Morison* (1893) 20 R 510 at 514. For discussion of Lord Rutherford-Clark's statement see Ross G Anderson, *Assignation* (2008) para 11-53. For a recent assertion of the accretion idea see Lord Hoffmann in *Buchanan v Alba Diagnostics Ltd* 2004 SC (HL) 9. For criticisms of Lord Hoffmann's assertions see Ross G Anderson, "*Buchanan v Alba Diagnostics: Accretion of Title and Assignation of Future Patents*" (2005) 9 EdinLR 457.

⁷⁷ On accretion generally see Kenneth G C Reid, *The Law of Property in Scotland* (1996), para 677 ff. For the applicability of the doctrine to assignations see Ross G Anderson, *Assignation* (2008) ch 11.

⁷⁸ Y's title would also be validated if A were to convey to Y.

⁷⁹ *Buchanan v Alba Diagnostics Ltd* 2004 SC (HL) 9 has *dicta* about accretion in relation to assignations of intellectual property rights. These *dicta* seem to overlook the fact that accretion cannot operate unless there has been a purported transfer. See Ross G Anderson, "*Buchanan v Alba Diagnostics: Accretion of Title and Assignation of Future Patents*" 2005 EdinLR 457.

⁸⁰ 2003 SLT (Sh Ct) 107.

⁸¹ This is the entity identified as the pursuer in the case. According to the Companies House website no company of that name exists.

question could not, in any case, be interpreted as being an assignation. It was merely an agreement to assign. But it was also held, separately, that intimation cannot be validly made to a party who is not, at the time of intimation, an account party. So intimation can never be made in respect of an assignation of future claims. The doctrine of accretion as such was not, it seems, discussed.

4.64 A practical reason against applying the doctrine of accretion of title in such cases is that it may place the future account party in a difficult position. The future account party (L) receives notice that debts that it does not owe are being transferred from a person (J) that is not its creditor to someone it has not heard of (K). What if it throws the letter into the bin as little better than junk mail? The doctrine, however convenient to banks, would perhaps not be so convenient to traders.

4.65 In summary: (i) Claims that are vested, but that are not exigible until a future date, or are subject to a contingency, are assignable. (ii) Claims that do not exist (such as future receivables) can be sold, in the sense of a valid contract of sale. In that limited sense the "assignation of future rights" is competent. (iii) The doctrine of accretion of title cannot apply where there is no intimation. (iv) If a future right is purportedly assigned, with intimation to a person who later, when the right comes into existence, proves to be the account debtor,⁸² it is uncertain whether the assignation is validated by accretion, but we incline towards a negative answer. The reason is that the doctrine of accretion of title presupposes that the act of transfer is fully valid, and that the only reason for its failure is lack of title in the transferor, but in the case described the act of transfer does not seem to be valid in itself, because the person to whom intimation is made is not the account party. Thus in *Bedwells and Yates v Tod*⁸³ a legacy in the will of a still-living testator was assigned by the legatee, and intimation made to the future executor. The assignation was held invalid.

4.66 To what extent it is possible to assign future rights is thus not free from difficulty. The topic is commercially important, and ideally the law would be clearer. If, as provisionally proposed later in this discussion paper, it becomes possible to complete an assignation by registration in the proposed new Register of Moveable Transactions, the law would be clearer.

Policies of Assurance Act 1867

4.67 The Policies of Assurance Act 1867 provides for the assignation of insurance policies. Does it apply in Scotland? It doesn't say that it doesn't, so presumptively it does.⁸⁴ And the Act is sometimes cited in Scottish texts as if it were in force here.⁸⁵ But the Act was passed to make it possible in England for life assurance policies to be assigned at law (and not merely equitably assigned, as formerly). In Scotland they had always been assignable. The reform was purely about English law. The drafting of the Act confirms the point. For example the Act begins:

⁸² Example: J assigns future receivables to K. Intimation is made to L. Later L becomes debtor to J.

⁸³ 2 December 1819 FC.

⁸⁴ See eg Daniel Greenberg (ed), *Craies on Legislation* (8th edn, 2009) para 11.1.2.

⁸⁵ For example W M Gloag and J M Irvine, *The Law of Rights in Security, Heritable and Moveable, including Cautionary Obligations* (1897) p 530.

"Any person or corporation now being or hereafter becoming entitled, by assignment or other derivative title, to a policy of life assurance, and possessing at the time of action brought the *right in equity* to receive and the right to give an effectual discharge to the assurance company liable under such policy for monies thereby assured or secured, shall be at liberty *to sue at law* in the name of such person or corporation to recover such monies."

Thus internal evidence, as well as external evidence, indicates that the intention was that the Act was not intended to apply in Scotland.⁸⁶ We would add that as far as we can ascertain the Act has never been applied in any Scottish case.

Partial assignation

4.68 It is competent to assign part only of a debt. So if Alan owes Beth £100,000, she could assign £60,000 to Charles and the balance she could retain, or could assign it to Dora.⁸⁷

⁸⁶ Cf Francis A R Bennion, *Bennion on Statutory Interpretation* (5th edn 2008) p 337.

⁸⁷ Ross G Anderson, *Assignment* (2008) para 2.22 ff. In English law, partial assignment is not competent, except in equity: *In Re Steel Wing Co Ltd* [1921] 1 Ch 349.

Chapter 5 The nature of security rights

Introduction

5.1 This chapter examines certain general issues about the nature of rights in security. It does not seek to be exhaustive, but focuses on issues of particular relevance to this discussion paper.

"Security"

5.2 First, a terminological point. The terms "security" or "security right" or "right in security" mean a security for an obligation, such as a security over land backing up a loan. The term "securities" is also used to mean corporate equity and tradable debt documents such as corporate bonds. This second meaning is quite separate from the first. "Securities" in the second sense may in fact be unsecured.

The purpose of security

5.3 The classic definition of security is by Gloag and Irvine. It is "any right which a creditor may hold for ensuring the payment or satisfaction of his debt, distinct from, and in addition to, his right of action and execution against the debtor under the latter's personal obligation."¹ The aim of security is not to subject the debtor's assets to the claims of the creditor, for those assets are subject to those claims in any event.² If a debt is not paid, all the debtor's assets³ are potentially liable to be compulsorily realised so that the debt is paid. That is done either through diligence, or through an insolvency process. Diligence is at the behest of particular creditors, whereas insolvency processes are collective procedures for the benefit of all creditors, and are conducted by someone who takes over the whole affairs of the debtor. The principal insolvency processes are liquidation (for companies and LLPs) and sequestration (for other debtors).

5.4 But this power of compulsory realisation is not always sufficient. The assets may be inadequate, and even if adequate in themselves to meet the creditor's claims, may not be adequate given the existence of other unpaid creditors. Hence creditors often seek to take security for a debt.⁴

Effect against third parties

5.5 A security right that is effective only against the debtor, and not at all against third parties, is not an effective security right, for such a right gives no more than is given by the

¹ W M Gloag and J M Irvine, *The Law of Rights in Security, Heritable and Moveable, including Cautionary Obligations* (1897) p 2. See also G L Gretton, "The Concept of Security", in D J Cusine (ed): *Scots Conveyancing Miscellany: Essays in Honour of Professor J M Halliday* (1987).

² There are certain exceptions, ie certain assets exempt from creditors.

³ There are certain exceptions.

⁴ Advertisements for home loans say: "YOUR HOME IS AT RISK IF YOU DO NOT KEEP UP REPAYMENTS ON A MORTGAGE OR OTHER LOANS SECURED ON IT." This is misleading, for it suggests that the home is not at risk in relation to unsecured loans. The home is at risk regardless of whether the loan is secured or unsecured.

general right to use diligence or to open up a collective insolvency proceeding. For example, if Cleopatra borrows money from a bank and grants security over her house, but the security is effective only against her, and not against third parties, it would mean that she could sell the property free of the security (for the security would not be effective against the buyer). It would mean that another creditor using diligence could attach the house, free of the security. Such a security would be without effect and Scots law would not regard it as a security at all.

5.6 Having said that, some legal systems do say that a security right can be created, with effect only between the parties, gaining its effect against third parties only by a later step such as registration.⁵ In such systems the creditor may gain something thereby, namely a quicker enforcement power than would be available to an unsecured creditor. Moreover, a legal system could say that assets of a certain type are exempt from diligence but can be made subject to a security right, and in such a case a security right that was effective only as between the parties would still confer a valuable protection to the creditor.⁶

5.7 Assuming that a security right has been fully constituted, there are several types of third party against whom it might have effect. The strongest type of security will have effect against all third parties, but security rights can exist which are effective against some third parties but not others. Thus a floating charge is in general effective against other creditors of the debtor, but it is in general not effective against buyers from the debtor. Thus if X grants a floating charge to Y over all its assets and next day sells to Z certain goods, the charge is ineffective against Z. But the charge is still effective against X's other creditors. It is also possible, in principle, to have a security right that is effective against some buyers but not others, for instance not against buyers who are legitimately unaware of the existence of the security. That is the essence of the equitable security of English law.

5.8 It is often said, and rightly said, that insolvency is the test of security. A right that does not give some element of priority in the debtor's insolvency is not a security.

External (overt) act needed to constitute security

5.9 The purpose of security is to take effect *against third parties*, and accordingly the existence of the security should, as a matter of principle, be discoverable *by third parties*. Hence some "external" or "overt" act is normally needed, such as delivery to the creditor, or registration.⁷ This issue is discussed further in Chapter 11.

Types of security

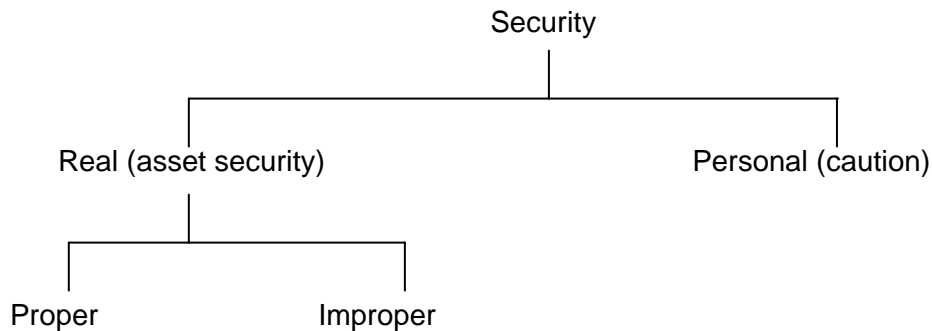
5.10 Rights in security divide into (a) personal (cautionary security) and (b) real (asset security).⁸ Personal security is a guarantee by a third party, so that the creditor's security consists in having another party bound, as well as the principal debtor. This project is not concerned with personal security.

⁵ The UCC-9 and the PPSAs are usually described in this way. In them a security right "attaches" when it becomes effective between the parties and is "perfected" when it becomes effective against third parties. In fact close analysis of UCC-9 and the PPSAs reveals that even at the stage of attachment a certain degree of third party effect is attained.

⁶ Precisely this is the position in relation to the debtor's home in a number of jurisdictions, which give the home some degree of protection against diligence and bankruptcy but allow security to be granted over it.

⁷ *Bank of Scotland v Hutchison Main & Co* 1914 SC (HL) 1.

⁸ We do not wish to discuss the theoretical issue as to whether all types of asset security in fact result in "real" rights.



Proper and improper security

5.11 Asset security itself divides into two types. In the first place, the asset may remain vested in the debtor, with the creditor having a limited right in the property. There are thus two proprietary rights in the same property. An example of this is the standard security. The debtor remains the owner of the property in question, notwithstanding the grant of the standard security. The security, on being registered, confers on the lender a real right in the land, but it is a limited or subordinate right, a right in something of which the right of ownership is vested in another person. The same happens if goods are pledged with a pawnbroker. The pledger (debtor) continues to hold the real right of ownership, and the pledgee (pawnbroker) acquires a limited real right in the pledged property. Security created in this way – where the creditor acquires a subordinate right, the title remaining with the debtor – is sometimes called a proper security.

5.12 In a proper security, when the debt is paid off no conveyance is needed from the ex-creditor to the ex-debtor. The debtor does not need to acquire the title because the debtor already has the title. The creditor's right is a mere encumbrance on the debtor's title. If the debt was a specific sum, which has been paid off, the security is automatically extinguished. Even in the case of land, no deed of discharge is needed, though it is convenient for evidential purposes, to provide evidence of an extinction that has already happened, when the debt was paid off.⁹ A deed of discharge is only necessary (other than for evidential purposes) where the security is for something like an overdraft. When the account ceases to be overdrawn, the security is not automatically extinguished, because it is intended to secure future lending as well, but nevertheless the account holder could insist on the grant of a discharge at that time. (In which case a future overdraft would no doubt be harder to obtain.)

5.13 As an alternative to proper security, title may be vested in the creditor for the purpose of security. Since the creditor has the title, the debtor does not. The debtor has a personal right to acquire title to the asset as and when the secured debt is paid off. Hence when the debt is paid off, title passes from ex-creditor to ex-debtor. Such an arrangement is sometimes called improper security, or *fiducia cum creditore*. This is the only way in which security can be granted over incorporeal moveable property.¹⁰ As Gloag and Irvine say, "a right in security in an incorporeal moveable is constituted by the owner, ie the creditor, transferring the right to enforce payment of the debt or performance of the obligation to the

⁹ In the case of heritable security, a discharge is in practice almost always registered.

¹⁰ The floating charge is arguably an exception.

person whose debt it is desired to secure."¹¹ Although the example given is that of a security over a personal right, the statement's reference to "incorporeal moveable" property in general is correct. If Hortensius has shares in XYZ plc and wishes to use them as collateral for a loan from Myfanwy, this can be achieved only by transferring the shares to her, so that she is the new shareholder. He is thereby wholly divested,¹² and in place of his rights to the shares he has a personal right against her, in relation to the shares, the most important element of which is that she must re-transfer the shares to him when he pays off the loan.¹³ The same is true for IP rights.

5.14 It is also true for simple debts. Cassandra owes £100,000 to Romulus, payable after 12 months. This claim is an asset for Romulus and he wishes to use it as collateral for a loan of £75,000 from Myfanwy. This can be achieved only by assigning the claim to Myfanwy, so that Romulus is wholly divested, and no longer has any legal relationship with Cassandra. If the debt due by Cassandra matures before Romulus has paid Myfanwy, the consequence will be that Cassandra will pay the whole £100,000 to her, not to Romulus, for Romulus is no longer Cassandra's creditor. If that happens, Myfanwy deducts £75,000 for herself and pays over the balance of £25,000 to Romulus. It is a familiar criticism of *fiducia cum creditore* that it goes beyond what the parties really want.¹⁴ (It would, it is true, be possible for Romulus to assign only £75,000 of the debt, because partial assignation is lawful. In practice this almost never happens.)

5.15 Assuming that Romulus pays off his debt to Myfanwy before the debt from Cassandra matures, Myfanwy will assign the claim back to him: this is called re-assignment or, more usually, retrocession.¹⁵ This is the opposite of what happens with proper security, where the security is a mere encumbrance, and the debtor always holds the title. In proper security, reconveyance is unnecessary and indeed is impossible, because the creditor, lacking title, cannot convey the title back to the former debtor. In improper security reconveyance is necessary and is the only possible method.

5.16 As just mentioned, for incorporeal moveable property, improper security is the only type of security that is allowed in our law (other than the floating charge). This is a matter of common law: common law does not recognise the possibility of a proper security in incorporeal moveable property. For corporeal property the position is the opposite; in general only proper security is competent, and improper security is incompetent. This is true for both heritable and moveable property. But this is not because of any common law rule, but because of statute. Thus if Aeneas owns land and disposes it to Charmian for the purpose of security, the conveyance is a nullity under the Conveyancing and Feudal Reform (Scotland) Act 1970.¹⁶ For corporeal moveable property the position is substantially the same, but slightly more complex. Section 62(4) of the Sale of Goods Act 1979 does not simply say, as the matching provision for land says, that any transfer for the purpose of security is void. It says: "the provisions of this Act about contracts of sale do not apply to a transaction in the

¹¹ W M Gloag and J M Irvine, *The Law of Rights in Security, Heritable and Moveable, including Cautionary Obligations* (1897) p 469. Since debts are obligations, it was not necessary to mention them separately.

¹² *Farstad Supply A/S v Enviroco Ltd* [2011] UKSC 16. See Chapter 7.

¹³ It is a matter for agreement between them whether she passes to him the dividends, or, alternatively, takes them for herself in reduction of the debt. The contract is likely to say that she must vote as he directs. See also Companies Act 2006, sch 6, para 7 and sch 7, para 8.

¹⁴ *Farstad Supply A/S v Enviroco Ltd* [2011] UKSC 16. See Chapter 7.

¹⁵ The verbal form is "retrocede", but "retrocess" is also sometimes seen.

¹⁶ Section 9.

form of a contract of sale which is intended to operate by way of mortgage, pledge, charge, or other security." Thus instead of annulling such a transfer, it disapplies the Act. But that comes close to a prohibition, for, apart from the Act, ownership of corporeal moveable property can be transferred only by delivery, and in cases where delivery is convenient to the parties they may as well use proper security (pledge). Thus section 62(4) strikes at improper security for corporeal moveable property. Thus to repeat: in broad terms, for corporeal moveable property the only security is proper security and for incorporeal moveable property the only security is improper security. As for the floating charge, it does not fit neatly into this analysis, and is discussed later.

5.17 The following table shows the distinction between proper and improper security where the property is corporeal property. In the case of incorporeal property there is debate as to whether one should speak of real rights and ownership. For those who think that such terminology is appropriate, the table will apply equally to incorporeal property.¹⁷

	Debtor's right	Creditor's Right
Proper security	Real (ownership)	Real (subordinate)
Improper security	Personal	Real (ownership)

Improper security by grant and by reservation - retention of title in sale

5.18 Improper security may be by grant, as in the examples given above. The debtor begins by holding title and then, in security of a loan, transfers title to the creditor. Can improper security arise by reservation as well as by grant? In a sense it can. Aeneas owns a car and sells and delivers it to Claudia on credit. Because he is worried that she may fail to pay, leaving him as a mere unsecured creditor, he may insist that the sale contract contains a clause whereby ownership will not pass unless and until the price is paid. This is called a clause of retention, or reservation, of title, "title" here meaning ownership. Such clauses, valid at common law, continue to be valid under the Sale of Goods Act 1979. Their effect is that if Claudia fails to pay the price, the car cannot be attached by her other creditors, because it is not hers, and it can be recovered from her or, if she has become bankrupt, from her trustee in sequestration. The retention of ownership is very like a security right. The situation can be analysed as being one in which Aeneas has given her a loan wherewith to pay him the price, and, to secure that loan, he has taken a security right in the car. That is how the position is handled in the UCC/PPSAs. Though the contract says that Aeneas remains owner until payment, the arrangement is, in the UCC/PPSAs, "recharacterised" so that Claudia is treated as owner and Aeneas is treated as the holder of a mere security right.¹⁸

5.19 But neither Scots nor English law adopt that approach. Not only is ownership recognised as remaining in Aeneas, but his reserved ownership is not regarded as being an improper security right. For example, suppose that he were to recover possession of the car

¹⁷ G L Gretton, "Ownership and its Objects" (2007) 71 *Rechtszeitschrift* 802 discusses this issue.

¹⁸ For the UCC/PPSA approach see Chapter 13 and Chapter 21.

and resell it. Suppose that the price that Claudia should have paid but did not was £10,000 and that Aeneas resells the car for £12,000. He keeps the profit, and does not account to her for it. Had his right been regarded by the law as being an improper security right, he would have had to account to her for the profit.¹⁹ The same would be true if he had not yet delivered it (with title still being retained).²⁰ The UCC/PPSAs approach is thus removed from our law not by one but by two steps. Had it been removed by one step it would have treated Aeneas as holding an improper security. But in fact that approach goes one step further and treats him as holding a proper security with Claudia being the owner.²¹

5.20 Hire purchase is treated in the same way, even though in a functional sense HP looks more like security than simple sale with retention of title.

5.21 Thus whilst our law will in some types of case recognise improper security by grant, improper security by reservation seems not to exist. (Though presumably something like it could be constructed by deliberate contractual choice.) Arrangements such as hire-purchase function to some extent as security rights, which is why they are sometimes called quasi-securities, but they cannot be classified under our law as improper securities.

The problem of demarcation

5.22 There exists the problem of demarcating improper security from other arrangements. Take two cases. (i) X Ltd owns office premises. It sells the property to Y Ltd for the market value. At the same time Y Ltd grants to X Ltd a 25-year lease at market rent. X Ltd does not have the right to buy the property back. Y Ltd does not have the right to compel X Ltd to buy the property back. This is an everyday sale-and-leaseback transaction and is clearly not a security arrangement. (ii) X Ltd owns office premises. It sells the property to Y Ltd for 60% of market value. There is a three-year leaseback from Y Ltd to X Ltd. The rent is not a market rent but a rent that matches what market interest would be on the sum paid by Y Ltd to X Ltd. The contract between the parties says that X Ltd must buy the property back after three years at the original price (and not at the market value as it will be at that time). If at that time X Ltd fails to buy the property back then Y Ltd will, says the contract, terminate the lease, sell the property, pay to itself from the proceeds the original price, and pay the balance (less expenses) to X Ltd. This arrangement is clearly an improper security and as such would be invalidated by section 9 of the Conveyancing and Feudal Reform (Scotland) Act 1970. Similar examples could be set up for moveables, with the relevant statutory provision being section 62(4) of the Sale of Goods Act 1979.

5.23 It is evident that there can exist a whole spectrum of possibilities. The two examples given in the previous paragraph represent the two ends of the spectrum. But between the two ends there can be many contractual structures, and with some of them it will be difficult to know whether they should be characterized as securities or not. What if X Ltd has the right to buy back the property, but not the duty? Or the obligation but not the right? How relevant is the original sale price? Since a security is something that secures a debt, the test

¹⁹ The leading case in relation to the propositions in the text is *Armour v Thyssen Edelstahlwerke AG* 1990 SLT 891, [1991] 2 AC 339.

²⁰ If Aeneas sells the car to Claudia, with ownership passing immediately, but has not yet delivered it, then the law confers on him a proper security in relation to the unpaid price. This is the seller's lien: Sale of Goods Act 1979 s 41. Being a possessory security it is lost if and when he delivers the car to her.

²¹ This is a slightly oversimplified account of the UCC/PPSAs. The nuances can be found in Chapter 13 and Chapter 21.

should perhaps be whether there is a debt owed by X Ltd to Y Ltd, which is in effect the same as the question of whether X Ltd has the obligation to buy the property back. But it cannot be said that the caselaw establishes any clear line of demarcation.²²

5.24 A demarcation problem also exists for systems that regard *retained* title as being a security, as is the position in the UCC/PPSA systems. For example, in those systems even a lease by X to Y may be regarded as a sale by X to Y with a security interest retained by X. Such systems then have the task – which experience suggests is complex and messy - of demarcating "true" leases from "quasi-security" devices. This issue does not arise in Scots law as it currently stands, but would arise if the UCC/PPSA approach were to be adopted. But "precautionary" or "better safe than sorry" registration is possible in the UCC/PPSA systems (as it is in relation to the UK company charges registration scheme), whereby a registration can be made in case it turns out that the transaction falls one side of the line rather than the other.

Arrestment and proper security

5.25 The common law's rejection of the possibility of a proper security over incorporeal moveable property may be subject to one exception, namely arrestment. If X is Y's creditor and Y is Z's creditor, and X arrests in the hands of Z, it may be that X thereby acquires a subordinate right of security in the Y/Z claim.

Multiple securities

5.26 In the case of proper security, the owner can grant more than one security over the same asset. (Though sometimes there is a contractual prohibition on this.) The securities rank by order of creation: *prior tempore potior jure*. But there is an exception in the case of standard securities and floating charges. If an all-sums security is granted, and the debtor then grants a postponed security to another creditor, the latter is at risk of losing the benefit of its security in the event that the first creditor makes further loans, thereby eating up the "equity" in the collateral. That fact would make it difficult for such debtors to grant further security, and so for that reason, where there is a second security following on an all-sums security, a notice can be served on the first creditor, the effect of which is to preserve the existing equity for the benefit of the second creditor.²³

5.27 In the case of improper security, multiple security is impossible, for title is vested in the first creditor. That fact can be inconvenient, though it can be got round by a circuitous arrangement.²⁴ Suppose that Jason holds a life assurance policy and assigns it in security to Isolde. What Jason now has is a right to reacquire the policy from Isolde, on repaying the loan. This right itself can be used as collateral. Jason can assign this right²⁵ to Perseus as security for a loan from the latter. The assignation is intimated not to the insurance company

²² Section 62(4) is discussed further in Chapter 6.

²³ Conveyancing and Feudal Reform (Scotland) Act 1970 s 13; Companies Act 1985 s 464(5); Bankruptcy and Diligence etc (Scotland) Act 2007 s 40(5). However, the effect of these provisions is in practice weakened by the fact that it is common for first-ranking secured creditors to insist, in the loan contract, on a clause forbidding the debtor to grant further security without the creditor's consent.

²⁴ In addition to the arrangement here described, we understand that trusts are also used.

²⁵ Not the policy itself, for Isolde is the sole holder of the policy, and *nemo plus juris ad alium transferre potest quam ipse habet*.

but to Isolde. If Jason wishes to grant a third security, then what he assigns is his personal right against Perseus, with intimation being made to the latter.²⁶

Accessoriness

5.28 A security right is a right that is "accessory" to the right that it secures.²⁷ The principal is the claim – almost always a monetary claim – and the security right can exist only in relation to that claim.²⁸ "The note [= the claim] is the cow and the mortgage the tail. The cow can survive without the tail, but the tail cannot survive without the cow."²⁹ The principle does not mean that the security giver has to owe the debt. One person can give security for another's debt.³⁰ What is required is that a debt exists, either *in esse* or at least *in posse*.³¹ This principle is one derived from Roman law and is accepted in most legal systems. But it can give rise to difficulties.³²

5.29 German law has pioneered non-accessory security in relation to land, and some other legal systems have followed that lead.³³ We understand that there can be situations where a company wishes to raise money on the security of certain assets, without being contractually liable on the loan, so that if it defaults, the creditor can enforce against the collateral, but, if the collateral proves insufficient, the lender cannot sue the debtor company for the shortfall. In practice, the accessoriness principle can, we think, be circumvented by a contractual agreement that the lender will not enforce the claim by personal action. Nevertheless we ask:

3. Should non-accessory moveable security be competent?

Transfer by debtor

5.30 The fact that in proper security the debtor is not divested not only allows the grant of postponed security, but also allows the debtor to transfer the title outright to someone else. For example if X pledges a gold watch with a pawnbroker, X can sell the watch to Y. This does not affect the pawnbroker's security right. Nor does it alter X's liability under the loan contract. Y obtains ownership of the watch, but subject to the pawnbroker's right of pledge.

²⁶ *Ayton v Romanes* (1895) 3 SLT 203. See further G L Gretton and K G C Reid, *Conveyancing* (3rd edn 2004) ch 20.

²⁷ For discussion, see Andrew J M Steven, "Accessoriness and Security over Land" (2009) 13 EdinLR 387.

²⁸ For illustrative cases see *Trotter v Trotter* 2001 SLT (Sh Ct) 42 (no secured obligation), *Johnson (Nisbet's Creditors) v Robertson* 1791 Mor 9554 (secured obligation a *pactum illicitum*), *Rankin v Arnot* 8 July 1680 Mor 572 (secured obligation discharged by payment), *Cameron v Williamson* (1895) 22 R 293 (similar) and *Albatown Ltd v Credential Group Ltd* 2001 GWD 27-1102 (secured obligation discharged, though not by payment).

²⁹ This quotation is from an Arizona case, *Best Fertilizers of Arizona Inc v Burns* 117 Ariz 178, 571 P 2d 675 (App 1977).

³⁰ This does not involve the security giver in personal liability. Suppose that X borrows £1,000,000 from Y. In security of that loan, Z, another company in the same group as X, grants Y security over its land. The land is worth £750,000. If X defaults, Y can sell Z's land, and thus recover £750,000. But if that is not enough to pay off the X/Y debt, Z is not liable. (Of course, it would be possible for Z *also* to grant a personal guarantee.)

³¹ On a narrow interpretation of the principle, there has to be a debt, albeit an unmatured or contingent debt. But the modern interpretation is that all that is needed is a contemplated debt. Thus X can grant to a bank a security for an overdraft on an account, and this is valid even if the account at that time is not overdrawn. Likewise, if it is overdrawn, and later returns to credit, the security is not extinguished, but will be available to cover a future overdraft. In short, on the modern view security can be granted for future debt. We take it that this position is uncontroversial.

³² See paras 5.32 ff below.

³³ It may be that the accessoriness principle no longer applies in the USA. See American Law Institute, *Restatement of the Law, Third: Property: Mortgages* (1997) para 1.1. And see Grant S Nelson and Dale A Whitman, *Real Estate Finance Law* (4th edn 2001) ch 2.

That does not mean that Y is liable for the debt. Y is not liable, but if the debt is not paid Y's right to the property may be lost. (The foregoing outlines the general law. In practice there are sometimes contractual prohibitions on transfer, as there are sometimes contractual prohibitions against the granting of postponed security.)

5.31 If the security is improper the debtor cannot transfer the asset itself but can transfer the personal right to reacquire the asset on repayment of the debt.

Transfer by creditor and the issue of accessory rights

5.32 The creditor's claim can be transferred by assignation, intimated to the debtor. The security right can be transferred at the same time. A security right is accessory to the principal, which is the claim.³⁴ So if a secured claim is assigned, the security should accompany it: *accessorium sequitur principale*. Civil codes often so state.³⁵ Although the general idea is clear, the details can be problematic, especially with standard securities.

5.33 Suppose that Jack owes Jill money, and the debt is secured by a standard security. The Conveyancing and Feudal Reform (Scotland) Act 1970³⁶ provides for the assignation of standard securities. It would be more precise to speak of assigned claims together with the security for the claim, for the claim is the principal and the security is the accessory. Does the registration of the assignation in the Land Register mean that intimation is not needed? If it is still needed, does that mean that the debt is, for the time being, unsecured, because the security is now held by the new creditor but the claim is still held by the old creditor? What if the debt is assigned, with intimation, but not the security?³⁷ What if a security is assigned but not the secured debt?³⁸ The law in this area is obscure.³⁹ Where the transfer of a security right calls for some specific act, such as registration,⁴⁰ a rule saying that an assignation of a claim carries with it securities for that claim cannot work perfectly.

5.34 Similar issues can also arise with retention of title in sale, which functions in a security-like manner. Jack sells and delivers goods to Jill on credit, retaining title until payment. He then sells the debt to Fred.⁴¹ That leaves the title to the goods dangling.

5.35 In some cases it may not be desired by the parties that the security should follow the claim. For example, suppose that W owes several debts to X. There is a security that covers all the debts. X assigns just one of the claims to Y. It may well be that X and Y agree that X should retain the whole security. That should be competent. So too should it be possible for X to assign an individual claim, or part of any claim, to Y, with Y having a pro rata benefit of

³⁴ See para 5.28 above.

³⁵ Eg French Civil Code art, 1692: "*La vente ou cession d'une créance comprend les accessoires de la créance, tels que caution, privilège et hypothèque*"; German Civil Code § 401: "*Mit der abgetretenen Forderung gehen die Hypotheken, Schiffshypotheken oder Pfandrechte, die für sie bestehen, sowie die Rechte aus einer für sie bestellten Bürgschaft auf den neuen Gläubiger über.*" Likewise DCFR III – 5:115(1): "The assignment of a right to performance transfers to the assignee not only the primary right but also all accessory rights and transferable supporting security rights."

³⁶ Section 14.

³⁷ Cf *Baillie v Laidlaw* (1821) 1 S 108 and *Anstruther v Black* 1626 Mor 829.

³⁸ There are two reported cases: *McCutcheon v McWilliam* (1876) 3 R 565 and *Watson v Bogue* 2000 SLT (Sh Ct) 125. They are not easy to reconcile.

³⁹ For discussion see Andrew J M Steven, "Accessoriness and Security over Land" (2009) 13 EdinLR 387.

⁴⁰ We have already mentioned standard securities. Another example would be the transfer of floating charges under s 42 of the Bankruptcy and Diligence etc. (Scotland) Act 2007.

⁴¹ See Ross G Anderson, *Assignation* (2008) paras 2-20 and 2-21.

the security. The present law permits this result,⁴² but the details of the law have never been worked out.

Fixed and floating

5.36 The distinction between floating and fixed security is the distinction between the floating charge and all other types of security. To this there are two possible qualifications. One is that the seldom-used security right under the Agricultural Credits (Scotland) Act 1929⁴³ may be a floating security. So, possibly, is the landlord's hypothec.⁴⁴

5.37 The distinction is important in insolvency because fixed and floating charges are treated differently. The floating charge can be trumped, to some extent, by unsecured claims. In the first place, the "effectually executed diligence" of another creditor will trump an uncrystallised floating charge.⁴⁵ In the second place, a floating charge is trumped by the preferential creditors such as employees in respect of arrears of salary.⁴⁶ In the third place, assets that would otherwise be available to meet the claim of the floating chargeholder are subject to the "prescribed part" in favour of the unsecured creditors.⁴⁷ And a floating charge, unlike other charges, is subject to the expenses of an administration.⁴⁸

5.38 The insolvency legislation does not define what it means by "floating". In Scots law that does not matter much because, subject to possible questions about agricultural charges and the landlord's hypothec, it is clear that floating charges are floating and other securities are fixed. In English law, by contrast, the issue has given rise to much litigation. In 2005 the House of Lords held that the test is whether the debtor has the power to deal with the charged assets in such a way as to remove them from the ambit of the charge, without the creditor's consent.⁴⁹ If yes, the charge is floating, and if not, it is fixed. If Scots law is in future substantially remodelled, the fixed/floating distinction will be an important one, in the sense that it will be important to be clear whether any new type of security right would be fixed or floating for the purposes of insolvency law. Of course, it would in theory be possible for any report emerging from this project to recommend major changes to the insolvency legislation. But from a practical point of view it is necessary, not least because of the need to keep the project within manageable limits, to take insolvency law as by and large a fixed point of reference.

Possessory and non-possessory security

5.39 The distinction between possessory and non-possessory security arises for corporeal property, but not for incorporeal property, because incorporeal property is not capable of being possessed, because of its incorporeality.⁵⁰ The delivery to the creditor constitutes the

⁴² *Lowe v Greig* (1825) 3 S 543; *Ewart v Latta* (1865) 3 M (HL) 36 at 42 *per* Lord Westbury; *McMillan v Smith* (1879) 6 R 601 at 604 *per* Lord Inglis.

⁴³ See Chapter 6.

⁴⁴ For the status of the landlord's hypothec see *Grampian RC v Drill Stem (Inspection Services) Ltd* 1994 SCLR 36.

⁴⁵ Companies Act 1985 s 463, Insolvency Act 1986 ss 55 and 60 and (although not yet in force) the Bankruptcy and Diligence etc (Scotland) Act 2007 s 45.

⁴⁶ Insolvency Act 1986 s 59.

⁴⁷ Insolvency Act 1986 s 176A.

⁴⁸ Insolvency Act 1986 sch B1 para 99(3).

⁴⁹ *National Westminster Bank plc v Spectrum Plus Ltd* [2005] UKHL 41, [2005] 2 AC 680.

⁵⁰ This is, at least, the standard view. There are those who argue that there is a sense in which incorporeal property can be possessed.

external act that satisfies the publicity principle. For corporeal heritable property the issue does not arise: security is constituted by registration, not possession.

5.40 The law does not generally allow non-possessory security over corporeal moveable property. The most important exception is the floating charge. There are also some exceptions in maritime law. The landlord's hypothec is another exception. The question of whether the law should be more favourable to non-possessory security over corporeal moveable property is one of the major issues for consideration.

Notification and non-notification security

5.41 For security over personal rights (eg security over receivables) a parallel distinction exists between notification and non-notification security. Our common law does not recognise non-notification security. There has to be intimation to the account party. A major statutory exception now exists in the form of the floating charge.

Express, tacit and judicial

5.42 Security rights divide into express, tacit and judicial.⁵¹ Express securities are those voluntarily granted by the debtor, tacit securities are those arising by force of law in defined circumstances, and judicial are those arising from the order of a court. The third area is essentially the law of diligence. Tacit securities are mainly liens, such as the lien of a repairer for the repair bill, and presuppose possession by the creditor. In certain cases the law recognises non-possessory tacit securities, namely certain cases in maritime law, and also the landlord's hypothec. This project is concerned only with express security rights.⁵²

⁵¹ This conventional trichotomy is in fact incomplete, because there are also extrajudicial charging orders.

⁵² The same approach is taken in the UCC/PPSAs.

Chapter 6 The current law in outline: security over corporeal moveable property

Introduction

6.1 As explained in Chapter 5, security rights in corporeal moveable property are, subject to one possible exception,¹ proper security rights, which is to say that the debtor remains owner and the creditor has a subordinate real right of security.

6.2 Security over corporeal moveable property sometimes arises by force of law (ie tacit security rights). Where the creditor has possession the security is called a lien. An example is the repairer's lien. For example, if a car is put in for repair, the repairer has a lien over the car for the unpaid repair bill. The lien is possessory, so it would disappear if the repairer were to hand the car back to the owner before the bill was paid. In shipping law there are certain cases where a creditor has a non-possessory tacit security over the ship. For example, seamen have a security over the ship they work on in security of their wages. These non-possessory maritime securities are usually called maritime liens, though the term is inexact, because liens are possessory. They should be called maritime hypothecs. There is also the landlord's hypothec, which is a security over the tenant's goods in security of the rent. This project is not concerned with tacit security rights.

6.3 Express security over corporeal moveable property falls under the following headings: (i) pledge, (ii) agricultural charge, (iii) floating charge, (iv) maritime security rights and (v) aircraft mortgage. These topics represent the first section of this chapter. The second section deals with quasi-security over corporeal moveable property.

FIRST SECTION: PROPER SECURITY

Pledge²

6.4 Pledge is a possessory security.³ The pledger keeps the right of ownership – unless and until the security is enforced – and the creditor acquires a subordinate real right of security. In the event of default there is a power of sale, but the authority of the court is needed, unless the debtor consents. The debtor's consent can be given in the original security agreement, and naturally this is what ordinarily happens.

6.5 Below we say something of two particular areas of importance, the first being the typical case of pledge in commercial practice, and the second being pledge in the consumer context.

¹ Pledge of bills of lading, discussed below.

² See in particular Andrew J M Steven, *Pledge and Lien* (2008).

³ Sometimes the term is used to include non-possessory security over corporeal moveables. Even more broadly, it is sometimes used to cover security rights over incorporeals too. But we use the term in its ordinary Scottish sense.

6.6 The fact that possession must be given up rules out the use of this security in many types of case, especially commercial cases. The debtor cannot afford to give up possession of property needed in its business, whilst the creditor may lack storage facilities. The fact that pledge requires delivery to the creditor was one of the main motivations for the introduction of the floating charge, the other being that security over claims requires intimation.

6.7 If the owner, X, begins the story with indirect possession (civil possession), then pledge can be effected by transferring to the creditor the indirect possession. This often happens when goods are in the custody of a shipping company, or of a warehouse company, for such cases do not give rise to the problems just mentioned: the creditor does not have storage problems while the debtor does not have the use of the goods anyway. Of course, such pledges are convenient only for the period of the transit, or only for the period of the warehousing.

6.8 In *Hamilton v Western Bank*⁴ it was held that where a delivery order is transferred by way of security, the result is that ownership of the goods passes. In other words, the security is an improper security. As a result the transferor no longer has any real right. The contrary view, that the lender would receive only the subordinate real right of pledge, with the borrower keeping the real right of ownership, was rejected. Although the case involved a delivery order rather than a bill of lading, it has always been accepted that the decision was of general application. Thus it was held that the "pledge" of a bill of lading does not result in a true pledge.

6.9 In England and Wales, a similar view was at first taken. But eventually the House of Lords rejected that view, holding in *Sewell v Burdick*⁵ that a pledge of a bill of lading is a true pledge, the reason being that a bill of lading represents the civil possession of the goods in question but does not necessarily represent their ownership. But that decision, being about English law, is not binding in Scotland, and *Hamilton v Western Bank* has never been overruled, at least expressly. Whether it might have been repealed by implication is considered in the next paragraph.

6.10 In *North Western Bank, Limited v John Poynter, Son, & Macdonalds*⁶ a bill of lading that had been pledged (or "pledged") was transferred back to the pledger for the purposes of selling the goods, the pledger undertaking to hold the goods in trust for the pledgee. The case came up through the Scottish courts but was eventually held to be subject to English law. It was taken for granted both in the Court of Session and in the House of Lords that the pledge was a true pledge, albeit that *Hamilton* was not expressly overruled. It was also held that the pledge survived the transfer back to the pledger. Dr Rodger (Lord Rodger of Earlsferry) has argued that *Hamilton* cannot now be regarded as good law and that accordingly the pledge (in the narrow sense) of bill of lading is competent.⁷

⁴ (1865) 19 D 152.

⁵ (1884) LR 10 App Cas 74.

⁶ (1894) 22 R (HL) 1; [1895] AC 56.

⁷ Alan Rodger, "Pledge of Bills of Lading in Scots Law" 1971 Juridical Review 193. Professor Gretton has expressed the same view: G L Gretton, "Pledge, Bills of Lading, Trusts and Property Law" 1990 Juridical Review 23. For further discussion see Andrew J M Steven, *Pledge and Lien* (2008) ch 8.

6.11 *Poynter* raises another issue.⁸ The general law of pledge is clear that if the pledged goods are returned to the pledger, the right of pledge is extinguished. For example, Erskine notes that "in pledge of moveables, the creditor who quits the possession of the subject loses the real right he had upon it."⁹ The reason for this rule is apparent: if the policy of the law relating to pledge is that the pledgee should have possession, that policy is defeated if a mere temporary delivery¹⁰ suffices. If that is the law, the effective outcome is non-possessory security. Dr Rodger¹¹ takes the view that the decision in *Poynter* was in this respect unacceptable.¹² But he says that the harm done was limited because the decision has been a dead letter. It is true, as he says, that the decision has seldom been cited. But in commercial practice it has been accepted as settling the law, as the legal basis for trust receipt financing.¹³

6.12 Trust receipts use the language of trust. That suggests that if X pledges a bill of lading to Y and Y then hands it back on trust, X is now the trustee, and so owner of the goods, while Y, being the beneficiary of a trust, has no real right, and so is not a pledgee any longer. If that is right, the whole law of pledge becomes irrelevant, and the question becomes this: can the owner of goods (X), by declaring a secret trust, defeat the rights of his creditors? In *Poynter* the House of Lords did not shed light on this issue, an issue that might be regarded as rather basic.

6.13 Reform options in relation to pledge of bills of lading are discussed in Chapter 15.

Pledge and the Consumer Credit Act 1974

6.14 Sections 114 to 122 of the 1974 Act form something like a code for the law of pledge in consumer cases. They do not apply to non-consumer cases. Some parts of the code are expressly limited to regulated consumer credit agreements, but others are not, and seem to deal with all pledges, including pledges between persons engaged in commerce. This seems to have been a drafting mistake, and when these sections were brought into force the Commencement Order did so "only in respect of articles taken in pawn under a regulated consumer credit agreement."¹⁴ For other cases these sections are thus not in force and presumably never will be.

6.15 In general, if a pledger fails to repay the secured loan, the pledgee (pawnbroker) enforces by sale. If the sale achieves a surplus, the surplus belongs to the (ex) debtor.¹⁵ This is straightforward and sensible. (And simply reflects the common law.) But there is an exception. If the debt is a small one (currently defined as up to £75¹⁶) enforcement is not by sale but by forfeiture, ie the article passes into the pledgee's ownership.¹⁷ It is curious that

⁸ For an earlier and similar decision, see *McDowal v Annand and Colhoun's Assignees* (1776) 2 Pat 387, a case that has been generally overlooked, but noted by Dr Steven in his "One Hundred Years of Gloag and Irvine" 1997 *Juridical Review* 315 at 324.

⁹ Erskine, *Inst*, 3,1,33. See also Andrew J M Steven, *Pledge and Lien* (2008) para 6-64.

¹⁰ Thus in *Poynter*, the bill of lading was pledged on 4 April 1892 and redelivered on 12 April 1892.

¹¹ Alan Rodger, "Pledge of Bills of Lading in Scots Law" 1971 *Juridical Review* 193.

¹² Gloag and Irvine expressed unease about the decision: W M Gloag and J M Irvine, *The Law of Rights in Security, Heritable and Moveable, including Cautionary Obligations* (1897) pp 200 to 201.

¹³ Though the decision's status in Scots law might be open to debate because of the view taken by the House of Lords that English substantive law was applicable.

¹⁴ Consumer Credit Act 1974 (Commencement No 8) Order 1983 (SI/1983/1551) art 2(2).

¹⁵ 1974 Act s 121.

¹⁶ 1974 Act s 120(1)(a).

¹⁷ Section 120(1)(a).

this is so even if the article is worth much more than the debt. Suppose that Adam borrows £70 from Eve and in security of the loan he pledges a painting, which both parties believe to be of only moderate value. He fails to redeem within the redemption period. At that stage Eve has the painting valued by an expert, and it turns out to be from the hand of a well-known artist and is worth £10,000. Can Adam still redeem? The answer is that he cannot, because the painting has been forfeited. Does Eve now owe him £9930? That would be equitable, but the Act makes no such provision. Furthermore, the forfeiture provisions state that forfeiture is to operate "notwithstanding anything in s 113."¹⁸ The meaning of section 113 is obscure but it is probably merely declaratory of the common law rule that a creditor cannot obtain a windfall gain from security, ie cannot use the security right to recover more than 100% of what is owed. That (ie the disapplication of section 113) confirms the inference that Eve does indeed make a windfall gain, at Adam's expense, of £9930. It should be noted that section 121, which deals with "realisation" is inapplicable in the case of forfeiture for a small debt.

6.16 Indeed, it has been so held, in relation to predecessor legislation, in a case of 1834.¹⁹ Elizabeth Wilson ("widow Wilson") borrowed three shillings from a pawnbroker, and in security of the loan she pledged a pelisse. She missed the redemption date by three days. The pawnbroker sold the pelisse for 25 shillings. She claimed from him 21 shillings, being the price he had obtained minus the loan (three shillings) and other costs (one shilling). His reply was that the loan had been for less than ten shillings – the threshold figure that is today £75 – and that accordingly the pelisse had been forfeited to him. Hence when he sold it he sold for his own account and was free to take the whole proceeds. The court held that the legislation did indeed mean what the pawnbroker claimed it meant. This statutory rule, which is less protective of the debtor than is the common law, remains part of the law to this day.²⁰

6.17 It is also puzzling that there is no provision about reduction of the debt for the value of the article. If ownership of a £40 article is forfeited because a loan of £70 has not been repaid, is the debt now (a) zero (b) £30 or (c) £70? The legislation is silent.²¹

Forfeiture (outwith the context of the Consumer Credit Act)

6.18 Statutory forfeiture has just been mentioned. But there is also the possibility of forfeiture by agreement. The issue arises for security over corporeal moveable property in general, not only for pledge. Thus it would arise equally if a new non-possessory security is introduced. But it is convenient to deal with the issue here. Post-classical Roman law prohibited forfeiture clauses as being unfair.²² That prohibition has been generally received into modern European systems.²³ Scots law also adopted the prohibition of the first Christian Emperor, albeit with some initial hesitation. Stair wrote that "our customs did formerly sustain such clauses ... but since our custom hath more closely followed the Roman law in this

¹⁸ Section 120(1)(a).

¹⁹ *Henderson v Wilson* (1834) 12 S 313.

²⁰ We return to this issue in Chapter 15.

²¹ We return to this issue in Chapter 15. The issues raised in these paragraphs might perhaps be tackled by a bold court: cf *Hull v Campbell* [2011] CSOH 24.

²² This happened late in Roman law, by legislation in AD 326 (Constantine). See *Codex* 8.34.3. For discussion see Reinhard Zimmermann, *Law of Obligations* (1990) p 224. The terms for a forfeiture clause used by legal writers are *pactum commissorium* or *pactum legis commissariae*.

²³ For a comparative study see Mauro Bussani, *Il problema del patto commissorio: studio di diritto comparato* (2000). English law also followed the civil law. The standard study is R W Turner, *The Equity of Redemption* (1931). For an overview of the Scottish authorities see Ross G Anderson, *Assignment* (2008) para 11.41.

point.²⁴ Erskine took the view that Scots law follows Roman law.²⁵ Hume was of the same view.²⁶ Bell remarks that the *pactum commissorium* "has always been discountenanced in Scotland."²⁷ As far as we are aware, forfeiture clauses are seldom or never used in current practice.

Power of sale

6.19 In Consumer Credit Act cases the pledgee has a power of sale in the event of default. At common law – which applies in non-consumer cases – the rule is that the pledge agreement can validly authorize the pledgee to sell in the event of default,²⁸ but that if the agreement is silent the pledgee has to apply to the court for power to sell.

6.20 Where there is enforcement, the general common law of security applies. For example any surplus belongs to the (ex-) debtor or those in right of the (ex-) debtor. If there is a shortfall the (ex-) debtor remains liable. The selling pledgee is bound to get the best price reasonably obtainable, and so on.

The agricultural charge

6.21 The agricultural charge is a security, introduced by the Agricultural Credits (Scotland) Act 1929, in the wake of similar legislation for England and Wales, the Agricultural Credits Act 1928. It enables agricultural co-operatives to grant a floating non-possessory security to a bank.²⁹ The effect is similar to a floating charge, though one important difference is that whereas a floating charge can cover property of every type, the agricultural charge is limited to "stocks of merchandise".³⁰ Under the legislation as passed, agricultural charges had to be registered.³¹ This requirement was repealed by the Financial Services and Markets Act 2000 (Consequential Amendments and Repeals) Order 2001.³² We do not know the reason for the repeal, which is contrary to the general policy of the law, namely that secret security rights are undesirable.³³ Agricultural charges appear to be rare, though since registration has been abolished there is no way of verifying frequency of use.

6.22 Agricultural charges appear no longer to be enforceable outside insolvency since the 1929 Act provides only for enforcement by sequestration for rent,³⁴ a process that no longer exists.³⁵ Placing the debtor into insolvency seems a disproportionate means of enforcement.

The floating charge

6.23 The floating charge is a security over corporeal moveable property, but also over other types of asset, including land. It is outlined in Chapter 9.

²⁴ Inst 4,18,5. But elsewhere he wrote that "our custom doth not reject such clauses", though they could not take effect of their own force, but only by decree. Inst 1,13,14.

²⁵ Inst 2,8,14 and 3,1,33.

²⁶ *Lectures*, IV, 5.

²⁷ *Commentaries*, 2, 270.

²⁸ Andrew J M Steven, *Pledge and Lien* (2008) para 8-11.

²⁹ Section 5. For the definition of "bank" for this purpose, see the Financial Services and Markets Act 2000 (Consequential Amendments and Repeals) Order 2001 (SI 2001/3649), article 217.

³⁰ Section 5.

³¹ Section 8.

³² Article 216.

³³ See Chapter 11.

³⁴ 1929 Act, s 6(1)

³⁵ Bankruptcy and Diligence etc (Scotland) Act 2007 s 208.

Maritime security rights

6.24 Little is said here on this subject, since shipping law lies outwith the scope of this project. Non-possessory registered security can be granted under the Merchant Shipping Act 1995.³⁶ At common law, a non-possessory security over a ship can be granted without registration in certain defined circumstances. This is called - to the delight of generations of law students - a bond of bottomry. Such bonds appear to be obsolete in practice. There is also the parallel non-possessory unregistered bond of respondentia, over the cargo, which also appears to be obsolete in practice.³⁷ It may be that these two types of bonds should be formally abolished, but shipping law is, as we have said, outwith the scope of this project. Finally there are the so-called maritime liens,³⁸ which are non-possessory unregistered securities over ships that arise by operation of law. These exist in favour of seamen for their wages, salvors for the salvage claim, etc.

Aircraft mortgage

6.25 The Mortgaging of Aircraft Order 1972 provides for a registered non-possessory security over aircraft. The registration scheme is limited to "mortgages": it is not a register of title, and is in that respect different from the Shipping Register. In this project we do not think it appropriate to undertake a general review of the law about aircraft mortgages. But in Chapter 17 we raise the possibility of two minor reforms, on purely Scottish points.

SECOND SECTION: QUASI-SECURITY DEVICES

Title finance

6.26 Devices have been developed that function rather like securities. These are (a) retention of title in sale, ie sale with ownership not passing until payment, (b) hire purchase, (c) finance leasing and (d) sale by debtor to creditor with retention of possession. These devices are sometimes known as title finance because the title (ie ownership) of the goods is held by the creditor. (By contrast, in a security in the narrow sense, it is the debtor who holds the right of ownership, while the creditor holds a subordinate – ie non-ownership – right in the property.)

6.27 In the first three, the story begins with someone who wishes to acquire goods without paying the full price up front. The three differ among themselves in the form of contract used: the contract of sale, the contract of hire-purchase and the contract of hire. In the fourth case, the story begins with someone who already owns something and who wishes to use it to generate finance without, however, having to part with possession.

³⁶ Sch 1 paras 7 to 14. The register is kept by the Registrar General of Shipping and Seamen: s 8.

³⁷ For bonds of bottomry and of respondentia see W M Gloag and J M Irvine, *Law of Rights in Security, Heritable and Moveable, including Cautionary Obligations* (1897) ch IX.

³⁸ Being non-possessory they are not liens, for in our law a lien is definitionally a possessory security.

Retention of title in sale³⁹

6.28 The common law allowed ownership to be reserved in a sale (retention of title⁴⁰) until some condition is met, typically payment of the price. In that it follows Roman law, which not merely allowed retention of title but actually made a clause of retention of title an implied term in every sale contract. The common law about the sale of goods was replaced by the Sale of Goods Act 1893 (now Sale of Goods Act 1979), but the legislation continued to permit retention of title.⁴¹ At one stage there was uncertainty as to whether title could be retained only for the price (simple retention of title) or whether it could be retained for all sums due by the buyer to the seller. The argument was that all-sums retention operates as a security interest and that the policy of the law is against non-possessory security interests. It was eventually decided that retention of title, even for all sums, is not a security interest except in a very broad sense.⁴²

6.29 The way a retention of title clause is enforced is, in principle, by rescission of the contract on the ground of non-payment. As a result of the rescission, the buyer no longer has the right to retain the goods. The seller may resell. If that happens, and a higher price is obtained, the seller need not hand over the surplus to the buyer, because retention of title is not a security. Again, because it is not a security the seller could opt not to resell, but simply to retain the goods. We say that rescission is "in principle" the method of enforcement. In practice the threat of rescission is often enough. If the buyer has gone into a formal insolvency process, often the buyer's insolvency representative will agree to pay for the goods in order to be able to retain them, for the goods may be necessary to carry on the business, which, in turn, may be desirable so as to achieve a going-concern sale.⁴³

6.30 Retention of title may be used simply as between supplier and customer. Or it may involve a financing party. For example, a dealer is approached by a customer, who wishes to buy on credit. The dealer sells the goods to a financing party, who then in turn resells the goods to the customer, on retention of title.

6.31 Sometimes a buyer (X) sells before title has passed. Does the next buyer (Y) obtain a good title? The law here is complex, and perhaps too complex to be satisfactory.

(a) The basic rule is that since the seller⁴⁴ is not owner, ownership does not pass.⁴⁵

(b) But there is an exception contained in section 25(1) of the Sale of Goods Act 1979. Assuming that the goods have been delivered to Y and that Y is in good faith, Y does become the owner.

³⁹ See generally Michael Bridge (ed), *Benjamin's Sale of Goods* (8th edn 2010); Gerard McCormack, *Reservation of Title* (2nd edn 1995); Roy M Goode (ed Simon Mills) *Goode on Proprietary Rights and Insolvency in Sales Transactions* (3^d edn 2009); P S Atiyah, John Adams and Hector MacQueen, *Atiyah's Sale of Goods* (12th edn 2010).

⁴⁰ Also called reservation of title, or retention of ownership. In consumer transactions it is generally known as conditional sale.

⁴¹ Section 17. Sometimes s 19 is cited in this connection, but it deals merely with a special case.

⁴² *Armour v Thyssen Edelstahlwerke AG* 1990 SLT 891, [1991] 2 AC 339.

⁴³ A valuable empirical study of retention of title is Sally Wheeler, *Reservation of Title Clauses: Impact and Implications* (1991).

⁴⁴ That is to say, the seller in the second sale, ie X.

⁴⁵ Sale of Goods Act 1979, re-enacting the common law which is, as Ulpian says (D 50, 17, 54): *nemo plus iuris ad alium transferre potest quam ipse habet*.

(c) There is, however, an exception to the exception. If the second sale is one that falls under the Consumer Credit Act 1974 then section 25(2) applies, which disapplies section 25(1).

(d) But there is an exception to the exception to the exception. If the property in question is a motor vehicle, then the second buyer prevails.⁴⁶

(e) Finally, there is an exception to the exception to the exception to the exception. If the second buyer is a trade buyer, the original seller prevails.⁴⁷

Hire-purchase

6.32 As with sale on retention of title, hire-purchase (HP) may involve two parties or three. In practice the latter is the more usual: ie the supplier sells the goods to the financing party who then enters in a HP contract with the customer. HP differs from retention of title not in property terms (in both the customer has only a personal right while the contract is running, and in both the customer may eventually acquire ownership) but in terms of contract. In the first the contract is simply an ordinary contract of sale. In the latter the contract is one of hire-purchase. The relationship is one of hire, but with a purchase option.

6.33 Enforcement is by rescission, as with retention of title.⁴⁸ If the customer sells the goods before acquiring title, the rules are rather simpler than the corresponding rules for retention of title. The buyer does not acquire title, with one exception: where the property in question is a motor vehicle, and the buyer is a private buyer, and has acted in good faith.⁴⁹

Finance leasing⁵⁰

6.34 In finance leasing (also called financial leasing, or capital leasing) one person leases equipment to another for all or most of the term of its life expectancy. The contrast is with an operating lease, in which the term is substantially less than life expectancy. In an operating lease the goods will be returned to the lessor with plenty of life left in them. The hire of a car for a week is an operating lease. The distinction between finance leases and operating leases is not a distinction of private law, but a commercial distinction based on accounting and tax considerations.

6.35 A finance lease is in economic terms similar to a sale, in which the price is paid by instalments, and in which the financing party is "secured" by retained title, so that if the lessee were to become insolvent, the contract could be rescinded and the goods could be repossessed. Finance leasing is also similar to HP, but in finance leasing there is no option to buy: the contract is a contract of hire. (But the practice is for the contract to provide for the lessee to sell the equipment at the end of the term as agent for the owner, and to receive commission on sale amounting to almost the whole - eg 95% - of the sale proceeds.)

⁴⁶ Hire-Purchase Act 1964, s 27(2). It is curious that the rules about motor vehicles are to be found neither in the Sale of Goods Act 1979 nor the Consumer Credit Act 1974 but in the Hire-Purchase Act 1964.

⁴⁷ Hire-Purchase Act 1964, s 27(3).

⁴⁸ But subject to Insolvency Act 1986 sch B1 paras 43(3) and 72.

⁴⁹ Hire-Purchase Act 1964, s 27.

⁵⁰ See eg Roy M Goode, *Commercial Law* (4th edn 2009, ed Ewan McKendrick) ch 28. And we are grateful to R Bruce Wood for information about finance leases.

6.36 The UCC characterises some leases as sales with reservation of a security interest, but in fact the UCC distinction does not coincide with the finance/operating distinction.⁵¹

Transfer to creditor with retention of possession

6.37 In the preceding arrangements, someone wishes to acquire goods without having to pay their value, at least immediately. There is also the possibility that someone owns goods and wishes to use them to raise finance, without having to part with possession.

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

6.39 All such arrangements are subject to a problem: section 62(4) of the Sale of Goods Act 1979, which provides that "the provisions of this Act about contracts of sale do not apply to a transaction in the form of a contract of sale which is intended to operate by way of mortgage, pledge, charge, or other security."⁵² This does not say that such a sale is void. It merely says that the Act does not apply to such sales. That means that, like other transfers to which the 1979 Act does not apply, such as donations, the common law applies, with the result that delivery is necessary for ownership to pass.⁵³

6.40 Of course, much depends on how the expression "intended to operate by way of mortgage, pledge, charge, or other security" is interpreted. A sale at fair value, followed by a lease on ordinary commercial terms, would be unaffected by the provision. At the other extreme, the provision would strike at a sale at undervalue⁵⁴ coupled with a contract binding the seller to buy back. But there are cases in between where it is uncertain how the law would be applied. The 1979 Act does not define "security". At all events, what can be said is that if what the parties want is a non-possessory secured loan, they have a major problem.

⁵¹ For the UCC's definition of "finance lease" see UCC § 2A-103(g). For the case where a lease is regarded as giving rise to a security interest see § 1-203.

⁵² A similar provision was also in the Sale of Goods Act 1893. Compare s 9 of the Conveyancing and Feudal Reform (Scotland) Act 1970 which invalidates transfers of ownership of heritable property that are made for the purpose of security. Previously, the transfer of ownership for the purpose of security (the *ex facie* absolute disposition) had been common.

⁵³ The common law, following Roman law, requires delivery for the transfer of the ownership of corporeal moveable property. The common law continues to apply in so far as not ousted by statute. For a review of s 62(4) (and its predecessor, s 61 of the Sale of Goods Act 1893) and the relevant caselaw, see G L Gretton, "The Concept of Security" in D J Cusine (ed), *A Scots Conveyancing Miscellany* (1987) and Scott Styles, "Debtor-to-Creditor Sales and the Sale of Goods Act" 1995 *Juridical Review* 365. The views in the latter differ from those expressed here. See also David Carey Miller, *Corporeal Moveables in Scots Law* (2nd edn 2005) ch 11. A case that reached the House of Lords is *Armour v Thyssen Edelstahlwerke AG* 1990 SLT 891 (holding that s 62(4) does not affect retention of title clauses). Section 62(4) and its predecessor play virtually no part in English litigation. It is almost as if it had a "Scotland only" proviso. Parallel issues in England are litigated on the question of whether the arrangement is a registrable charge. On this see such cases as *Re George Inglefield Ltd* [1933] Ch 1, *Stoneleigh Finance Ltd v Phillips* [1965] 2 QB 537, *Welsh Development Agency v Export Finance Co Ltd* [1992] BCC 270; [1992] BCLC 148 and *Orion Finance Ltd v Crown Financial Management Ltd* [1996] BCC 631, [1996] 2 BCLC 382. (Litigation in this form could not happen in Scots law because the Scottish provisions in what is now Part 25 of the Companies Act 2006 differ from the corresponding English provisions in that they do not mention charges over goods.)

⁵⁴ The reason for the undervalue is that typically a lender will expect "collateral margin" ie that the value of the collateral should exceed the amount of the loan. That provides a margin of safety.

6.41 Because section 62(4) does not invalidate the transactions to which it refers, but merely disapplies the Act to them, leaving them to the common law, what sometimes happens is that the goods are delivered to the financing party and immediately re-delivered.⁵⁵ We quote from the Business Finance Report:⁵⁶

"One interviewee explained that in one transaction involving a bus company that wished to raise finance through a sale and leaseback of the buses it owned, the financier had to let (hire) a warehouse for one night so that the buses could be driven in and out of the warehouse in order that delivery to the financier be effective. Another example related to a boat. The financier required to have an agent nail a note to the boat's mast in order to 'take delivery' of it. The agent had to wait at a pier for the boat to arrive, and was on the boat only as long as it took to attach the note to the mast."

6.42 Whether this sort of arrangement works is not quite certain. It might be argued that the delivery is too transient to be regarded as valid.

6.43 Another approach is for a two-step arrangement. (i) The company (Company A) that owns and possesses the goods sells them to another company in the same group (Company B). If the sale is genuine, title passes without delivery.⁵⁷ (ii) Company B now pledges the goods to Bank C, by transferring to Bank C its right, as against Company A, to uplift the goods, ie constructive delivery. This is intimated to Company A. If there is a rolling programme whereby Company A sells incoming stock to Company B, combined with a power granted by Bank C to Company A to sell the stock free of the pledge, then the result comes close to being a floating charge over the stock. This approach may be effective, but seems not to have been tested in the courts.

6.44 The awkwardness of the arrangements just outlined is apparent. Later in this discussion paper we suggest a new system of non-possessory security that would do directly what these arrangements attempt to do indirectly.

⁵⁵ For this idea see G L Gretton, "Security over Moveables without Loss of Possession" 1978 SLT (News) 107.

⁵⁶ *Business Finance and Security over Moveable Property* (Scottish Executive Central Research Unit, 2002), para 3.130.

⁵⁷ Sale of Goods Act 1979 s 17.

Chapter 7 The current law in outline: security over incorporeal moveable property

Introduction

7.1 This chapter outlines the current Scots law about secured transactions in relation to incorporeal moveable property, focusing on the issues of particular relevance to the project. As with the preceding chapter, no attempt is made at a comprehensive statement of the law.

7.2 This chapter is divided into two sections, the first dealing with personal rights and the second with intellectual property rights, with a preliminary paragraph on goodwill.

7.3 The floating charge is of particular importance as a security over incorporeal moveable property, but because it covers, or can cover, assets of every type it is dealt with separately.¹

Goodwill

7.4 Goodwill is neither a personal right nor an intellectual property right. But something should be said about it. It can be an asset in an economic or accounting sense. But its existence is not in legal terms an independent existence: it is a quality that is attached to a business, aspect of a business or business premises. As in a sale, so in a secured transaction, it cannot be dealt with independently, and its value is captured as part of that to which it attaches.

FIRST SECTION: PERSONAL RIGHTS AS COLLATERAL

Improper security is the only competent form

7.5 As noted in Chapter 5, whereas for corporeal property it is in general competent to grant security only by way of proper security, for incorporeal moveable property the opposite is the case: the security cannot be proper but has to be improper. To this floating charges appear to be an exception.

7.6 Since an assignation in security is an assignation,² the general law of assignation applies.³ That includes, for example, the principle *assignatus utitur jure auctoris*. For example, X provides goods on credit to Y, and then assigns the unpaid price to Z, as security for debts owed by X to Z. Y finds the goods to be disconform to contract. Y can plead this as a ground for refusing to pay Z. Again, if in a contract there is a prohibition of assignation, that prohibition will apply just as much to an assignation in security as to an

¹ Chapter 9.

² For the general law of assignation, see Chapter 4.

³ See Chapter 4. (Contrast South African law on this point, discussed in Appendix B.)

outright assignation. Or again, just as outright assignation needs to be intimated, so does an assignation in security. Assignation in security is not a distinct institution from assignation. It is the identical institution. What distinguishes assignation in security from outright assignation is purpose. In the former, the title acquired by the grantee is to be used for the purpose of security.

Personal rights: general

7.7 Most incorporeal moveable property consists of personal rights (claims) of one sort or another, ie rights held by one person against another for something to be performed (eg payment of money) or, occasionally, a forbearance.⁴ In all cases the right is pressed into service as collateral by assigning it.

Contractual rights

7.8 The typical personal right arises out of contract. Such a right can be assigned in security. For example if X provides goods or services on credit to Y, X can assign the unpaid price to Z, as security for debts owed by X to Z. Z has now replaced X as Y's creditor.

Cash collateral

7.9 It sometimes happens that X owes bank Y money, that Z (perhaps a company in the same group as X) has an account with the bank that is in credit, and that the parties agree that the bank should have a security over that credit balance, to secure the X/Y loan. In practice that is done by contract: Z's right to withdraw its money is subject to restrictions. That is not, despite appearances, a form of set-off. It would be set-off if Z had given a cautionary obligation (guarantee) to Y in relation to the loan to X, for the effect of such a guarantee would be that Y would have a claim against Z, but in the situation being discussed, Z is not a guarantor, merely a third-party security provider.

7.10 In English law, this possibility can be utilised, but it is also possible for Z to grant to Y a charge over the Y/Z bank account.⁵ This is known as a chargeback. Apart from the floating charge, there appears to be no such possibility in Scots law.⁶

Beneficial rights in trusts

7.11 The right of a beneficiary in a trust is a species of personal right, the debtor in the right being the trustee. A beneficiary grants security over the beneficial right by assigning it.

Company shares and bonds

7.12 The same is true for company shares, corporate bonds and public sector bonds. X, who holds such shares or bonds, can transfer them to Z as security. The result is that Z is

⁴ Whereas most acts are positive, such as payment, a forbearance is negative. Just as a person can by contract agree to act in a certain way, so a person can by contract agree not to do something, ie to forbear.

⁵ *Re Bank of Credit and Commerce International SA (In Liquidation) (No.8)* [1998] AC 214. See Roy M Goode, *Commercial Law* (4th edn 2009, ed Ewan McKendrick) p 652 ff for an overview of English law in this area.

⁶ On Scots law see Ross G Anderson, "Security over Bank Accounts in Scots Law" (2010) *Law and Financial Markets Review* 593.

the new holder. Z is registered as such.⁷ The transferee's right is constituted by registration,⁸ so that a mere agreement is insufficient. Thus in our law no equivalent to the English equitable charge is available. It is Z, not X, who is entitled to receive dividends or interest, to vote at shareholder meetings and so on. Naturally, any dividends must either be credited to the debt, or handed over to X.

7.13 This view of matters has been confirmed by the Supreme Court in *Farstad Supply A/S v Enviroco Ltd.*⁹ Though this came up through the English courts, a central issue was the effect of a transfer of shares by way of security that had happened under Scots law. Since the creditor had been registered as the shareholder in place of the debtor, it was held that the debtor had ceased to be the shareholder, and that accordingly the company whose shares were in question had ceased to be a subsidiary of the debtor company. As Lord Collins said, "under Scots law the only way in which a fixed security over shares can be taken is by fiduciary transfer of the shares to the creditor (*fiducia cum creditore*)."¹⁰

7.14 If the proposals in this discussion paper were to be enacted, then there would be a free choice. (i) The parties would be free to do what is done under current law, as in *Farstad*. Or (ii) the parties would have an option to handle matters differently from the outset. They would be able to create and register a security right that would leave the debtor as holder of the shares in question. The position would thus be nearer to that of English law, where one can have either a legal mortgage of shares (much as in *Farstad*) or – and this is what Scots law at present does not allow – a security right that does not involve title transfer. (In English law the latter is done by way of equity. Under our proposals it would be done using civil law software, but the *practical* results would be similar.)

Intermediated securities

7.15 Intermediated securities are where, for convenience, shares or bonds are not held directly but indirectly. For example a company issues shares and an investor wishes to buy some of these shares. The investor could hold the shares directly, but the alternative is that the shares are held by an intermediary, on behalf of the investor. The intermediary is thus the shareholder, not the investor. The intermediary receives the dividends and promptly passes them over to the investor, and if the investor decides to sell the shares, the intermediary will sell them and will pass the proceeds of sale over to the investor. Such an arrangement does not mean that the investor cannot use the investment as collateral. The investment consists of a personal right against the intermediary, and that personal right can be used as collateral. Subject always to the terms of the investor/intermediary contract, the investor can simply assign the personal right to a lender. The position in Scots law thus seems more straightforward than that in English law and some other systems in which the position of the investor is regarded as a bundle of rights, some of them being contractual rights against the intermediary and others "proprietary" rights in the underlying investments.¹¹

⁷ Except in the case of bearer shares or bearer bonds. Though bearer shares are common in some jurisdictions, their validity in the UK is doubtful given the obligation on companies to maintain registers of members: Companies Act 2006 ss 113 and 114. Bearer shares are not the same as share warrants.

⁸ Cf *Morrison v Harrison* (1876) 3 R 406.

⁹ [2011] UKSC 16.

¹⁰ Para 4.

¹¹ See further Joanna Benjamin, *Interests in Securities* (2000), and the Financial Markets Law Committee's report, *Property Interests in Investment Securities* available at <http://www.fmlc.org/papers/fmlc1_3_july04.pdf>.

SECOND SECTION: INTELLECTUAL PROPERTY AS COLLATERAL

Intellectual property rights: introduction

7.16 Assignment normally concerns three parties. Thus in the commonest example of assignment, the transfer of a monetary claim, there are the original creditor, the new creditor, and the debtor. Intellectual property rights are incorporeal property, but their assignment involves two parties only, not three. (Though there may be implications for third parties, as where a copyright has been licensed by X to Y, and thereafter X assigns the copyright itself to Z.)

7.17 As noted earlier, the common law does not recognise the possibility of *proper* security over incorporeal moveable property. For such property, security has to be improper, ie by way of assignment for the purpose of security. This is equally true of security over intellectual property rights. For example, if X holds copyright in a book and wishes to use that copyright as collateral for a loan from Y, that can be done, but only by way of an assignment in security, so that the copyright is transferred to Y, subject to X's personal right against Y for a re-transfer if and when the loan is repaid.

7.18 Three enactments make provision – at least to some extent - for security rights over intellectual property rights: the Registered Designs Act 1949, the Patents Act 1977 and the Trade Marks Act 1994. The drafting differs. In all cases, if the grantor is a company, registration under Part 25 of the Companies Act 2006 is necessary. That adds a layer of complication.

Intellectual property rights: applicable law¹²

7.19 In general terms, the law that governs a security right is the law of the place where the property in question is situated: the *lex situs* (the *lex rei sitae*). Thus if a French company owns land in Japan and wishes to grant security over it for a loan, Japanese law governs. That principle applies also to intellectual property rights, for such rights can normally be allocated to a particular country. But within the United Kingdom the legislation does not attribute intellectual property rights to a particular legal system. Moreover, for registered intellectual property, there is only a single register.

7.20 If English and Scots law about rights in security were the same, this issue would matter little. But they are not the same. Nor is there any "UK" law of security rights that could be appealed to. Hence it is important to know, when a security right is to be created over UK intellectual property, whether that security is being created under English law or Scots law.¹³ No definite answer exists, but the predominant view seems to be that the law applicable to security rights over intellectual property depends on the situs of the property and that the situs of intellectual property, as between England and Scotland, is determined by the

See also the UNIDROIT *Convention on Substantive Rules for Intermediated Securities* of 2009. The UK has not ratified.

¹² The international private law issues surrounding security rights over intellectual property have attracted little attention. For example there is little in James J Fawcett and Paul Torremans, *Intellectual Property and Private International Law* (2nd edn 2011), Stefan Leible and Ansgar Ohly (eds), *Intellectual Property and Private International Law* (2009) or Jurgin Basedow (ed), *Intellectual Property in the Conflict of Laws* (2005).

¹³ Or the law of Northern Ireland, which is, however, similar to English law in relation to security rights.

domicile of the holder of the intellectual property.¹⁴ Thus if a patent were obtained by an English company, and that company then wished to grant a security over it, English law of security would apply. If, years later, the patent were assigned to a Scottish company, and the Scottish company wished to grant a security, it would be the Scottish law of security that would apply. (In the case of a company, domicile is determined by the registered office.) This rule generally delivers a clear answer, but there are still loose ends, as where UK intellectual property is held by, eg, a Dutch company which then wishes to grant security over it. An alternative to the domicile test is a "closest connection" test, though that often fails to give a clear answer.¹⁵

7.21 Often the issue does not matter. But it can matter. For example, in English law a security can be granted in more than one way, including the fixed equitable charge, which leaves title vested in the granter. In Scotland, by contrast, security over incorporeal property can be granted only by a transfer of title for the purpose of security. (Or by way of floating charge.)

Registered Designs Act 1949

7.22 Section 15B(6) of the Registered Designs Act 1949 says that "a registered design or application for a registered design may be the subject of a charge (in Scotland, security) in the same way as other personal or moveable property."¹⁶ Section 19 says that a security interest can be registered in the Register of Designs. If it is not so registered, that does not mean that it is invalid. The section says it is valid or invalid at the discretion of the court. The Act appears to say nothing about questions of ranking.

Patents Act 1977

7.23 Section 31(3) of the Patents Act 1977 says: "Any patent or any such application, or any right in it, may be assigned and security may be granted over a patent or any such application or right."¹⁷

7.24 Section 33 of the Patents Act 1977 says:

"(1) Any person who claims to have acquired the property in a patent or application for a patent by virtue of any transaction, instrument or event to which this section applies shall be entitled as against any other person who claims to have acquired that property by virtue of an earlier transaction, instrument or event to which this section applies if, at the time of the later transaction, instrument or event—

(a) the earlier transaction, instrument or event was not registered, or (b) in the case of any application which has not been published, notice of the earlier

¹⁴ "An English patent is a species of English property of the nature of a chose in action and peculiar in character" says Lord Evershed in *British Nylon Spinners Ltd v Imperial Chemical Industries Ltd* [1953] Ch 19 at 26. This seems the right approach. Likewise one could say that "a Scottish patent is a species of Scottish property of the nature of incorporeal moveable property and peculiar in character." Nowadays some intellectual property statutes in fact say something of the sort. They are quoted below.

¹⁵ For the domicile test see David P Sellar, "Rights in Security over 'Scottish Patents'", (1996) 2 Scottish Law & Practice Quarterly 137. Alistair Orr and Tom Guthrie, "Fixed Security Rights Over Intellectual Property in Scotland" [1996] 18 European Intellectual Property Review 596 does not discuss the domicile test.

¹⁶ This matches s 24(5) of the Trade Marks Act 1994, below. There is nothing equivalent in the Patents Act 1977.

¹⁷ This section applies to Scotland. The equivalent section for elsewhere in the UK is s 30.

transaction, instrument or event had not been given to the comptroller, and (c) in any case, the person claiming under the later transaction, instrument or event, did not know of the earlier transaction, instrument or event.

(2) Subsection (1) above shall apply equally to the case where any person claims to have acquired any right in or under a patent or application for a patent, by virtue of a transaction, instrument or event to which this section applies, and that right is incompatible with any such right acquired by virtue of an earlier transaction, instrument or event to which this section applies.

(3) This section applies to the following transactions, instruments and events:—

(a) the assignment or assignation of a patent or application for a patent, or a right in it; (b) the mortgage of a patent or application or the granting of security over it;..."

7.25 This provision is not easy to understand and we are not sure that we do understand it. It seems to say that a later transfer (assuming the transferee to have been in good faith) trumps an earlier unregistered transfer. There seems to be no requirement that the second transfer be registered. So competing transfers seem to rank in *reverse* date order, unless either (i) the first was registered or (ii) the second was affected by bad faith. The provision applies only to a person "who claims to have acquired the property", words that suggest that rights less than "the property" itself are not covered. But the final words quoted suggest otherwise. The word "mortgage" does indeed indicate the transfer of the property, albeit for the purpose of security, but the addition of the words "or the granting of security" suggest that something less than the "acquisition" of "the property" may suffice to engage the provisions.

Trade Marks Act 1994

7.26 Section 24(5) of the Trade Marks Act 1994 provides that "a registered trade mark may be the subject of a charge (in Scotland, security) in the same way as other personal or moveable property."¹⁸ Section 25(2) says "the granting of any security interest (whether fixed or floating) over a registered trade mark or any right in or under it" is capable of being registered in the Register of Trade Marks. Section 25(3) says: "Until an application has been made for registration of the prescribed particulars of a registrable transaction— (a) the transaction is ineffective as against a person acquiring a conflicting interest in or under the registered trade mark in ignorance of it ..."

Registered IP: must security be registered?

7.27 In respect of registered intellectual property subject to Scots law, the standard view is that, unless and until there is registration, the grantee has only a personal right. So no security can exist before registration. For example, James McLean has written that if "an assignation is executed and delivered but not registered" then "such a security is clearly not perfected as a real right and the status of such as assignation is, it is submitted, analogous to that of a delivered but unrecorded standard security ... and that of a delivered but

¹⁸ This matches s 15B(6) of the Registered Designs Act 1949, above.

unregistered share transfer."¹⁹ Alistair Orr and Tom Guthrie have written that for "patents, registered designs and trade marks, compliance with the statutory provisions regarding registration will be necessary in order to obtain a real right in the property."²⁰ A similar view has been taken by David Sellar.²¹ The analysis in the previous paragraphs suggests the possibility of a different view, namely that the legislation contemplates that a security can be created without registration, but that unless and until it is registered it lives a precarious life.

Conclusions on intellectual property

7.28 The first step is to determine whether Scots law is applicable. As has been seen, there is uncertainty as to how that is to be determined, but some answer must exist. If Scots law applies, then the security can be created only by means of an assignation in security, or by means of a floating charge. A security right that is something less than a transfer of title is possible in England. It is competent in Scotland for corporeal property but not, in general, for incorporeal property.²² (The exception is the floating charge.) Whilst an assignation in security may be either (i) overtly in security or (ii) *ex facie* absolute, in either case the effect is to transfer the right to the grantee, for the purpose of security. In some cases, such as copyright, the question of registration does not arise.²³ In cases where the intellectual property is itself registered, registration of the assignation is competent, and, to the extent discussed above, necessary.

¹⁹ James McLean, "Security over Intellectual Property - A Scottish Perspective" [1988] 10 European Intellectual Property Review 115 at 115.

²⁰ Alistair Orr and Tom Guthrie, "Fixed Security Rights Over Intellectual Property in Scotland" [1996] 18 European Intellectual Property Review 596 at 597.

²¹ David P Sellar, "Rights in Security over 'Scottish Patents'", (1996) 2 Scottish Law & Practice Quarterly 137.

²² This discussion paper provisionally suggests that Scots law should be reformed to allow security over incorporeal property without title transfer. See Chapters 18 and 19.

²³ Though assignations of any kind may in practice be registered in the Books of Council and Session.

Chapter 8 The company charges registration scheme

Some English legal history

8.1 The company charges¹ registration scheme² cannot be understood except in the context of English legal history. English law traditionally did not accept the publicity principle.³ For example transfers of land and mortgages of land were effected by private act.⁴ Matters began to change in the second half of the 19th century. Registration of land rights, including mortgages, began to be introduced from 1862.⁵ Non-possessory security over goods began to be registered from 1878.⁶ The second half of the 19th century saw the birth of the modern system of company law, and there was increasing concern that companies could charge their assets in secret. This concern led to section 14 of the Companies Act 1900, which, with various adjustments over the years, continues today as Part 25 of the Companies Act 2006. Thus in England there were separate registration regimes according to whether the debtor was or was not a company.

Scotland is added

8.2 Until 1961 the system did not apply to Scotland. It was extended to Scotland by the Companies (Floating Charges) (Scotland) Act 1961. That Act introduced the floating charge, and evidently it was necessary for floating charges to be registered. But the 1961 Act did not merely provide for the registration of floating charges. It adopted the whole English system. So for example after 1961 if a company granted a security over its land, not only did that security have to be registered in the Register of Sasines (or now the Land Register) but also in the Companies Register. In making this change the 1961 Act followed the Eighth Report of the Law Reform Committee for Scotland,⁷ which recommended the introduction of floating charges. The report recommended the introduction of the English system of registration, but gave no explanation.⁸

8.3 The list of registrable charges is as follows:⁹

¹ The English term "charge" is used in the legislation. Lord Fraser noted: "The word 'charge', in the sense of a lien or security, is not . . . a term of art in Scots law." *Scottish & Newcastle Breweries Ltd v Liquidator of Rathburne Hotel Co Ltd* 1970 SC 215 at 219. The legislation does not define it. The word can hardly have its English meaning, for the English law of charges is very different.

² See generally Gerard McCormack, *Registration of Company Charges* (3rd edn 2009) though this is from an English standpoint.

³ For the publicity principle see Chapter 11.

⁴ There were some qualifications. In the 18th century a deeds registration system was introduced for Middlesex and Yorkshire. But the process stopped there. No other county was ever brought into the system.

⁵ Land Registry Act 1862. The measure failed in practice. Progress began to be made as a result of the Land Transfer Act 1897. Even so, most conveyancing was unregistered until fairly recently.

⁶ Bills of Sale Act 1878.

⁷ Cmnd 1017 (1960).

⁸ See para 50.

⁹ Companies Act 2006 s 878(7).

"(a) a charge on land or any interest in such land, other than a charge for any rent or other periodical sum payable in respect of the land,

(b) a security over incorporeal moveable property of any of the following categories—

(i) goodwill, (ii) a patent or a licence under a patent, (iii) a trademark, (iv) a copyright or a licence under a copyright, (v) a registered design or a licence in respect of such a design, (vi) a design right or a licence under a design right, (vii) the book debts (whether book debts of the company or assigned to it), and (viii) uncalled share capital of the company or calls made but not paid,

(c) a security over a ship or aircraft or any share in a ship,

(d) a floating charge."

8.4 One difference between the Scottish rules and the English rules is that the provision for England and Wales includes in the list of registrable charges "a charge created or evidenced by an instrument which, if executed by an individual, would require registration as a bill of sale."¹⁰ That is rather cryptic, but refers to non-possessory security over goods. There is no equivalent provision in the Scottish rules, no doubt because in Scots law such security is not competent anyway. (But this perhaps overlooks the fact that a Scottish company could presumably grant non-possessory security over goods it has in England and Wales.)

8.5 In 2004 this Commission recommended that the decision be reversed, ie that the company charges registration scheme was a bad one and should be abolished, though with provision for the registration of floating charges.¹¹ Our views have not changed since 2004, and for the sake of brevity we will not here explain in detail the defects of the system.¹²

Charges registration is an extra requirement

8.6 The registration of a company charge is a requirement that is additional to the ordinary requirements of law as to the constitution of the security. For example if a company grants a standard security, the security must be registered both in the Land Register and in the Companies Register. But in the case of the floating charge there has been no separate method of registration. In other words, the *only* registration of floating charges is under the company charges registration scheme. This will, however, change when Part 2 of the Bankruptcy and Diligence etc (Scotland) Act comes into force, for it will establish a new Register of Floating Charges.

¹⁰ Companies Act 2006 s 860(7)(b).

¹¹ Scottish Law Commission, *Report on Registration of Rights in Security by Companies* (Scot Law Com No 197 (2004)). The recommendation that there should be a new system for registering floating charges was implemented by Part 2 of the Bankruptcy and Diligence etc (Scotland) Act 2007, though this is not yet in force. The recommendation that the company charges registration scheme should be abolished was not accepted by the DTI.

¹² See also G L Gretton "Registration of Company Charges" (2002) 6 EdinLR 146. The system is also criticised south of the border, but there the approach is rather different. Views are divided as to whether the system is essentially sound, needing only some tinkering, or whether it should be replaced by a UCC/PPSA-type system. In Scotland, by contrast, the system has few defenders. Our 2004 Report recommended its abolition *simpliciter*.

8.7 As noted in Chapter 9, certain floating charges are exempted from registration altogether, ie are secret security rights.

Changes effected by the Companies Act 2006

8.8 The Companies Act 2006 made certain changes but the substance of the scheme was unaltered. One significant change is to be found in section 893. Under the scheme, there often has to be double registration. Section 893 allows the Secretary of State to make an order whereby registration in the Companies Register will no longer be necessary provided that a system is in place for the transmission from the "special register" (eg Land Register) to the Companies Register of the registered information. The effect of such an order would be that those searching the Companies Register would still be able to obtain the same information as at present. No section 893 order has yet been made but the Department for Business, Innovation and Skills has confirmed that it intends to make such an order in relation to the Register of Floating Charges, the idea being that such an order would be timed so as to coincide with the activation of that register.

8.9 Also to be noted is section 894, allowing the Secretary of State to amend any provision of Part 25. As noted in Chapter 10, the Government is contemplating using section 894 to amend Part 25 of the 2006 Act.

Debtor-based not situs-based

8.10 The system is debtor-based not situs-based. Thus if a Scottish company grants to a Japanese bank security over land that the company owns in Japan, and that security is duly registered as required by Japanese law, the security is nevertheless declared invalid by the company charges registration scheme if there has been no registration of the security in the Companies Register in Edinburgh. (Of course, whether Japanese law would accept the extraterritorial operation of Scots law is another matter.) Conversely, if a security is granted over assets situated in Scotland by a foreign company, the company charges registration scheme is in principle inapplicable, though over the years there have been some exceptions to this rule.¹³

"Particulars" only

8.11 What is registered is not the charge itself, or a copy of it, but rather "particulars" of it, and accordingly it is the "particulars" that those who search the register will find.

Relevant to validity but not ranking

8.12 The sanction for non-registration is invalidity. The invalidity is not absolute. In the first place, registration can happen any time within 21 days after creation, and, with the consent of the court, at any time thereafter. Thus an unregistered charge is valid (provided of course it satisfies any other requirements of law) for 21 days. If at the end of the 21 days it has not been registered it moves from validity to invalidity, but it may thereafter move back from invalidity to validity at the discretion of the court. Moreover, the invalidity is qualified in another way. A charge that has not been registered within the 21 day period is "void ...

¹³ For the current law see the Overseas Companies (Execution of Documents and Registration of Charges) Regulations 2009 (SI 2009/1917). The UK Government intends to abolish the exceptions: <<http://www.bis.gov.uk/assets/biscore/business-law/docs/g/10-1319-government-response-consultation-registration-of-charges.pdf>>.

against (a) the liquidator of the company, (b) an administrator of the company, and (c) any creditor of the company."¹⁴ This complicated formula differs from simple nullity in ways that are not fully understood, even though the rule has been in place since 1961.

The "invisibility" issue

8.13 The 21 day "invisibility period" is a problem for floating charges, since registration in the Companies Register is the only form of publicity that they have.¹⁵ It has been a source of complaint almost from the beginning.¹⁶ The Murray Report recommended reform but nothing was done. The Bankruptcy and Diligence etc (Scotland) Act 2007 will, when it comes into force, address the problem.

8.14 The company charges registration scheme does not in general have any relevance to ranking. (An important exception exists for floating charges,¹⁷ discussed in Chapter 9.) Those who favour the introduction of a UCC/PPSA-type of system give as one of their reasons the convenience of the UCC/PPSA's basic rule of ranking by date of registration.

¹⁴ Companies Act 2006 s 889.

¹⁵ See further *AIB Finance Ltd v Bank of Scotland* 1993 SC 588.

¹⁶ An early example is David Bennett, "A Judicial Wet Blanket Upon the Register of Charges" 1967 SLT (News) 153, writing of the invisibility period as "a built-in deficiency" (p 154). There may be earlier examples. W W McBryde and D M Allan, "The Registration of Charges" 1982 SLT (News) 177 has been much cited. For our views, see Scottish Law Commission, *Discussion Paper on Registration of Rights in Security by Companies* (Scot Law Com DP No 121 (2002)); and Scottish Law Commission, *Report on Registration of Rights in Security by Companies* (Scot Law Com No 197 (2004)).

¹⁷ Companies Act 1985 s 464, prospectively repealed by the Bankruptcy and Diligence etc (Scotland) Act 2007.

Chapter 9 The current law in outline: floating charges

Introduction

9.1 The floating charge originated in English law in the second half of the 19th century.¹ English law divides security rights into "legal" and "equitable" and the floating charge is an equitable, not a legal, security. It was adopted into Scots law by the Companies (Floating Charges) Act 1961.² This statute was later replaced by the Companies (Floating Charges and Receivers) Act 1972. The current legislation is to be found in the Companies Act 1985, these provisions being, however, prospectively repealed and replaced by Part 2 of the Bankruptcy and Diligence etc (Scotland) Act 2007. The main reason for the introduction of the floating charge was the fact that before 1961 there existed no non-possessory security over corporeal moveables, and no non-notification security over claims. The 1961 Act was exiguous, not explaining what the floating charge was or how it worked, and later legislation has not been more helpful. Much of the law is inferential.

Can be granted only by companies etc

9.2 A floating charge can only be granted by certain entities, most notably companies.³ The word "company" has a broad though not precisely defined meaning.⁴ Neither a natural person nor an ordinary partnership⁵ can grant a floating charge. There is no restriction as to who the creditor is. The creditor could be, and very occasionally is, a natural person.

Can cover assets of any type

9.3 A floating charge covers the whole assets of the company, whether real or personal, corporeal or incorporeal, moveable or immovable, in Scotland or elsewhere, present or future. But a floating charge can be restricted to part only of the assets. For example, a motor retail company might grant a floating charge over its vehicle stock. Such "limited asset" floating charges are uncommon but far from unknown.⁶

¹ See generally Robert Pennington, "The Genesis of The Floating Charge" (1960) 23 Modern Law Review 630.

² The 1961 Act implemented the Eighth Report of the Law Reform Committee for Scotland, Cmnd 1017 (1960). For more background see R B Jack, "The Coming of the Floating Charge to Scotland: an Account and an Assessment" in D J Cusine (ed), *Scots Conveyancing Miscellany: Essays in Honour of Professor J M Halliday* (1987).

³ There are certain others. See for example the Limited Liability Partnership Regulations 2001 (SI 2001/1090) reg 4 and sch 2; European Economic Interest Grouping Regulations 1989 (SI 1989/638) reg 18 and sch 4.

⁴ Section 47 of the Bankruptcy and Diligence etc (Scotland) Act 2007, following the previous legislation, says that "'company' means an incorporated company (whether or not a company as defined in section 1(1) of the Companies Act 2006."

⁵ As opposed to an LLP, which can. A limited partnership under the Limited Partnership Act 1907 cannot grant a floating charge.

⁶ See eg Hamish Patrick, "Receivership of Foreign Based Companies" 2010 SLT (News) 177.

Extraterritorial effect

9.4 The extraterritorial effect of a floating charge is contrary to the usual principle that security rights are a matter for the law of the situs. Thus if a Scottish company has land in Utopia, and wishes to grant a security over it to a bank, it is for Utopian law to determine how that is to be done. But English "equity" applies extraterritorially,⁷ and this was adopted when the floating charge itself was adopted in 1961. Hence a Scottish company that owns land in Utopia can grant security over that land by means of a floating charge. Since Utopian law will not recognise security over land in Utopia granted under foreign law, this purported extraterritorial effect might seem empty of substantive force. Nevertheless it can work, to some extent. Suppose that the company becomes insolvent. A liquidator (or administrator) is appointed in Scotland. Most legal systems take the view that it is for the law of the domicile to determine who can act on behalf of a juristic person. Hence Utopian law (and so the Utopian courts) is likely to allow the liquidator to sell the land. The liquidator takes the money back to Scotland, and it will be distributed on the basis that the charge validly included the property in Utopia. But the sale will be subject to all rights recognised by Utopian law. So, for example, if a creditor has attached the land, the liquidator's power of sale will be subject to that attachment.

"Floating" nature

9.5 Assets acquired by the company automatically fall under the charge, without the need for any further juridical act of charge by the debtor, and assets disposed of are automatically freed from the charge, without the need for any juridical act of discharge by the creditor. The fact that a transferee takes free from the charge is not because of any principle protecting good faith buyers. Indeed the transferee may know of the existence of the charge. The idea is that the charge is over the assets for the time being. So long as the company stays in business, the charge continues to "float" in the manner described, and so long as the "floating" continues the effect of the charge is very limited. But a floating charge can cease to float. When it ceases to float it "crystallises" or (synonymously) "attaches".⁸ The former term is used in England, and in practice in Scotland too, but the Scottish legislation uses only the latter term.⁹

9.6 In Scots law there is normally no room for doubt whether a security is or is not a floating charge. The position in England is different. The courts have often had to decide whether a particular charge is fixed or floating, the reason for the litigation almost always being that the insolvency legislation treats floating charges less favourably than fixed

⁷ See *Re the Anchor Line (Henderson Brothers) Limited* 1937 Ch 483, holding that English floating charges cover Scottish assets. This is because a floating charge is a security "in equity", not "at law". (Securities "at law" do not operate extraterritorially.) Equity operates personally against anyone subject to the jurisdiction of the English courts, and it is through that fact that the "personal" nature of equitable rights can attain proprietary extraterritorial effect. Thus if an English company owns land in Japan and grants over it an English mortgage, the English courts will regard that as effective in equity. Another example of the extraterritorial operation of equity is *Richard West and Partners (Inverness) Ltd v Dick* [1969] 2 Ch 424, about the sale of land in Scotland, applying the "rule in *Penn v Lord Baltimore*" (1750) 1 Ves Sen 444 (land in Pennsylvania and Maryland). Cf T M Yeo, *Choice of Law for Equitable Doctrines* (2004). There are those who think that the Scottish courts would not necessarily recognise the extraterritorial operation of English equity, except in so far as required by statute, and would thus agree with the remarks of Lord Keith in *Carse v Coppen* 1951 SC 233.

⁸ "The pot-pourri of metaphors is entertaining. It floats, sleeps, shifts, hovers, swoops, and finally crystallises." George W Wilton, *Company Law: Principal Distinctions between the Laws of England and Scotland* (1923) p15.

⁹ The reason is not known to us. "Attach" has other meanings, so it was perhaps an odd choice.

charges.¹⁰ In *Re Spectrum Plus Ltd*¹¹ the House of Lords held that the key test is whether the debtor has the power to dispose of charged assets without the creditor's consent.

Registration

9.7 Under current law, floating charges are subject to the company charges registration scheme discussed in Chapter 8. That scheme is unsatisfactory in a number of ways, not least the problem of the 21 day invisibility period. When Part 2 of the Bankruptcy and Diligence etc (Scotland) Act 2007 comes into force, floating charges will acquire their own register the Register of Floating Charges. In the new legislation the problem of the 21 day invisibility period will disappear. It is a matter of regret that these provisions have still not been brought into force.

9.8 The policy of H M Treasury is that certain types of floating charge should be exempt from registration, including registration in the new Register of Floating Charges. There are two such provisions. (i) Sections 252 and 253 of the Banking Act 2009, exempting from registration floating charges in favour of "central institutions" and (ii) the Financial Markets and Insolvency (Settlement Finality and Financial Collateral Arrangements) (Amendment) Regulations (SI 2010/2993), regulation 5, exempting from registration floating charges in so far as they are financial collateral arrangements.¹² This promotion of secret security rights seems to us contrary to public policy.¹³

Attachment

9.9 The legislation provides that when a floating charge "attaches" it takes effect as if it were a "fixed" security.¹⁴ Thus for land it becomes a deemed standard security, for a claim it becomes a notionally intimated assignation, and so on. One steps into a make-believe world of imaginary registrations in the Land Register, imaginary notices to account debtors, imaginary deliveries of goods, and so on.¹⁵ Thus the legal nature of a floating charge is as unclear after attachment as before.

9.10 Attachment can happen in three ways: liquidation (winding up), administration and receivership. However, as a result of the Enterprise Act 2002, floating charges granted after 5 September 2003 are generally not enforceable by receivership. But there are numerous exceptions,¹⁶ so that the overall picture is highly complex. The three methods just mentioned are the only ways in which attachment can happen. (By contrast, in English law "automatic crystallisation" is also possible.) A complication is that in administration, unlike liquidation and receivership, crystallisation does not happen automatically, but only at the option of the

¹⁰ See below.

¹¹ *National Westminster Bank plc v Spectrum Plus Ltd* [2005] UKHL 41, [2005] 2 AC 680.

¹² See Chapter 2.

¹³ Another regrettable move away from the publicity principle has been the abolition of the registration requirement for agricultural charges. See Chapter 6.

¹⁴ Companies Act 1985 s 463, Insolvency Act, 1986 s 53(7) and (prospectively) Bankruptcy and Diligence etc (Scotland) Act 2007 s 47.

¹⁵ On this issue see such cases as *Forth & Clyde Construction Co Ltd v Trinity Timber & Plywood Co Ltd* 1984 SC 1, *Ross v Taylor* 1985 SC 156 and *Myles J Callaghan Ltd v Glasgow District Council* 1987 SC 171. For dicta about attachment converting a floating charge into a real right, see *National Commercial Bank of Scotland Ltd v Liquidators of Telford Grier Mackay & Co Ltd* 1969 SC 181.

¹⁶ The 2002 Act did not disallow receivers, but only administrative receivers, for the definition of which see s 251 of the Insolvency Act 1986. For the numerous exceptions see s 72B ff of that Act. The resulting situation is a mess. Yet another exception concerns industrial and provident societies: see *Re Dairy Farmers of Britain Ltd* [2009] EWHC 1389 (Ch).

administrator.¹⁷ Another complication is that if the holder of a fixed security realises the property, and there is a prior-ranking floating charge in favour of another creditor, it appears that the other creditor must be paid off first from the sale proceeds, even though the charge is unattached. This is one of the many areas of the law of floating charges where the inadequate conceptual structure becomes apparent.

9.11 The general principle of ranking of security rights is *prior tempore, potior jure* – earlier by time, stronger by right. English floating charges obey the opposite rule. If X grants a floating charge to Y and *later* a fixed charge to Z, Z has priority over Y. The same may be true where the second charge is floating, but here the authorities seem less clear.¹⁸

9.12 When the floating charge was introduced to Scotland, the ranking rule that was enacted was different. It was provided that as between competing floating charges the rule would be *prior tempore, potior jure*. As between a floating charge and a later fixed charge, the latter would prevail, as in English law, but that this result could be excluded by a contrary provision in the floating charge.¹⁹ In practice of course almost all floating charges contain such a clause. Part 2 of the Bankruptcy and Diligence etc (Scotland) Act 2007 prospectively repeals and replaces the existing provisions, re-enacting their general substance, but in a more rational manner.²⁰

The practical weaknesses of the floating charge

9.13 Floating charges are less attractive to lenders than are fixed charges. Hence the floating charge is used as a long stop, to catch what cannot be caught, or cannot conveniently be caught, by fixed security. There are a number of reasons why floating charges are less attractive.

- (a) Any floating charge must be registered. By contrast, only some fixed charges require registration.²¹
- (b) A floating charge, unlike a fixed charge, is subject to the claims of the preferential creditors.²²
- (c) A floating charge, unlike a fixed charge, is subject to the "prescribed part".²³ This is a sum of money taken from the paws of the floating chargeholder and made available to the unsecured creditors.

¹⁷ On this strange complication, see David Cabrelli, "The curious case of the 'unreal' floating charge" 2005 SLT (News) 127.

¹⁸ For discussion of the subject see eg Louise Gullifer (ed), *Goode on the Legal Problems of Credit and Security* (4th edn 2008).

¹⁹ It is difficult to resist the conclusion that the drafters did not understand either the English law or the effects of what they were drafting. The current provision about the ranking of floating charges is s 464 of the Companies Act 1985 but it is, as mentioned above, prospectively repealed by the Bankruptcy and Diligence etc (Scotland) Act 2007. Few people have ever read s 464 and understood it by the light of mere reason.

²⁰ One point to be footnoted is that floating charges on both sides of the border are postponed to subsequent security rights if the latter arise by operation of law.

²¹ Companies Act 2006 s 878. For the English provision, which is nearly but not quite the same, see s 860(7). As noted in Chapter 10 there are proposals to amend both sections.

²² Insolvency Act 1986 s 40 (receivership); Insolvency Act 1986 s 175 (liquidation); Insolvency Act 1986 sch B1 para 65 (administration).

²³ Insolvency Act 1986 s 176A. For discussion, see *QMD Hotels Ltd Administrators, Noters* [2010] CSOH 168; 2011 GWD 1-42.

(d) The rules for challenging floating charges that have been granted in the run-up to liquidation are severer than the corresponding rules that apply to other types of charge.²⁴

(e) A floating charge, unlike other charges, is subject to the expenses of an administration.²⁵

(f) An administrator's power to deal with property subject to a floating charge is more extensive than in the case of other types of charge.²⁶

(g) The debtor company can alienate the charged assets, in such a way as to remove them from the scope of the charge, without the chargeholder's consent. That is not the case with fixed charges.²⁷

(i) "Effectually executed diligence" carried out by other creditors before attachment does not trump a fixed charge but does trump a floating charge.²⁸

The conceptual weaknesses of the floating charge

9.14 Some years before the introduction of the floating charge, Lord President Cooper said: "a floating charge is utterly repugnant to the principles of Scots law."²⁹ Some years after its introduction, Lord Cameron remarked: "It was said of the Treaty of Versailles of 1919 that it 'contained all the seeds of a just and durable war.' It could readily be said of this statute³⁰ that its provisions are well designed to provide a rich variety of issues for decision in delicate and prolonged litigation."³¹ "The theoretical basis of the floating charge is unfamiliar, and even alien, to the general law of Scotland" said Lord Fraser.³² The uncertain nature of the floating charge after crystallisation has already been mentioned. There is also uncertainty as to its nature before crystallisation.³³

9.15 Not everyone has been critical, but nevertheless there has been much criticism.³⁴ Some of the criticism has been about the very idea of a universal security right, which is seen as too favourable to banks and too unfavourable to ordinary creditors. The other line of criticism has been aimed not at the overall policy objective, but at the inadequate conceptual

²⁴ Insolvency Act 1986 s 245.

²⁵ Insolvency Act 1986 sch B1 para 99(3). (*Re Nortel GmbH* [2010] EWHC 3010, [2011] Pens LR 37 illustrates the significance of this rule.) In England and Wales the same is true of liquidation expenses: Insolvency Act 1986 s 176ZA.

²⁶ Insolvency Act 1986 sch B1 para 70.

²⁷ In English law an exception would be where there is a fixed equitable charge and there is a buyer who takes without notice.

²⁸ Companies Act 1985 s 463; Insolvency Act 1986 ss 55 and 60; Bankruptcy and Diligence etc (Scotland) Act 2007 s 45. The precise meaning of this rule is not entirely clear and has been the subject of much litigation. See Scott Wortley, "Squaring the circle: revisiting the receiver and 'effectually executed diligence'" 2000 Juridical Review 325.

²⁹ *Carse v Coppen* 1951 SC 233 at 239.

³⁰ Companies (Floating Charges and Receivers) (Scotland) Act 1972.

³¹ *Lord Advocate v Royal Bank of Scotland Ltd* 1977 SC 155 at 173.

³² *National Commercial Bank of Scotland Ltd v Liquidators of Telford Grier Mackay & Co Ltd* 1969 SC 181 at 184.

³³ Scott Styles suggests that it is a "conditional real right". In a broad sense that is no doubt the case. See Scott Styles, "The Two Types of Floating Charge: The English and the Scots" (1999) 4 Scottish Law and Practice Quarterly 235 at 240. English law also finds the nature of the pre-crystallised floating charge problematic: see for instance Sarah Worthington, "Floating Charges: The Use and Abuse of Doctrinal Analysis", in Joshua Getzler and Jennifer Payne (eds), *Company Charges: Spectrum and Beyond* (2006).

³⁴ See for example G L Gretton, "Reception Without Integration? Floating Charges and Mixed Systems" (2003) 78 Tulane Law Review 307.

structure of the floating charge. Whether those who object to the floating charge as a matter of policy are right or wrong, the practical reality is that abolition would not command general support. The live question is whether, given the technical shortcomings of the floating charge, something better might be devised, something that would deliver, in practical terms, more or less what the floating charge can deliver, but deliver it better.³⁵

9.16 The obvious candidate would be something based on, and suitably adapted from, the UCC/PPSAs. Under the UCC/PPSAs a functional equivalent of the floating charge is possible, the floating lien. It seems better in a technical sense, and more capable of cohering with a civilian system of property law than the floating charge, which ultimately makes sense only on the basis of the law/equity divide.

The land issue

9.17 The floating charge was introduced to deal with problems about creating security over moveables, corporeal and incorporeal. Nevertheless, the legislation provided that the floating charge could cover heritable property. The wisdom of this may be doubted. The floating lien of the UCC/PPSAs does not cover immoveable property. Nor do the general charges of German law³⁶ and the legal systems that have borrowed from German law. In our law many of the problematic cases thrown up by floating charges have involved heritable property,³⁷ and there is no doubt that many conveyancers would be happy to see floating charges no longer apply to heritable property. The Murray Report made the same points,³⁸ and asked consultees whether they thought that in future floating charges should not be capable of covering land.

³⁵ Thus David Cabrelli, "The Case against the Floating Charge in Scotland" (2005) 8 EdinLR 407 discusses the possibility of abolishing the floating charge with the idea of replacing it with something better.

³⁶ *Sicherungsübereignung* and *Sicherungsabtretung*. The former is rather like a floating charge over the business's corporeal moveable property, and the latter over its incorporeal moveable property. The analogy with the floating charge should not be pushed too far, but is nevertheless apparent.

³⁷ *Sharp v Thomson*, 1997 SC (HL) 66 came close to reducing Scots property law to chaos because of what was seen as the need to cope with the effects of floating charges. On this case see Scottish Law Commission, *Report on Sharp v Thomson* (Scot Law Com No 208 (2007)).

³⁸ At paras 4.15 to 4.18.

Chapter 10 Previous reviews of the law

Introduction

10.1 The law of secured transactions has acquired a reputation of being often reviewed but never actually reformed. Apart from the introduction of the floating charge, which happened in 1961¹ following a report of the previous year,² there is much truth in this. Since 1961 there has been little significant change in the law covered by this project. In the present chapter we give an overview of official reviews since 1960. Several of the reports mentioned in this chapter advocated the adoption of a system based, at least in broad terms, on the UCC/PPSA approach. That approach is outlined in Chapter 13.

Outright assignation

10.2 The law of outright assignation as such has not hitherto been reviewed.³ However, the Crowther Report, the Diamond Report and the Halliday Report,⁴ recommended the adoption of a UCC/PPSA-type system, and a part of the UCC/PPSA package is the rule that in certain types of case an outright assignment must be covered by a registered financing statement in order to be effective against third parties.⁵ As applied to Scotland, that would have meant that, in such cases, (i) an outright assignment protected by a registered financing statement would have been effective against third parties even if unintimated and (ii) an outright assignment not protected by a registered financing statement would have been ineffective against third parties even if intimated.

10.3 But in none of these reports is there any focus on outright assignments. The focus of them all is on secured transactions.

The Crowther Report

10.4 The Crowther Report was published in 1971.⁶ Some of its recommendations were implemented by the Consumer Credit Act 1974. Part 5 of the Report urged the adoption of a system based on UCC-9.⁷ No draft bill was attached to the report.⁸

¹ Companies (Floating Charges) (Scotland) Act 1961.

² Eighth Report of the Law Reform Committee for Scotland, Cmnd 1017 (1960).

³ We have not traced any review underlying the Transmission of Moveable Property (Scotland) Act 1862.

⁴ For these, see below.

⁵ As is noted in Chapter 13, the UCC/PPSA-type system is mainly about secured transactions. It thus covers all assignments that are for the purpose of security. But it also covers certain outright assignments.

⁶ The Report of the Committee on Consumer Credit, Cmnd 4596 (1971) chaired by Geoffrey Crowther. A member of the committee was Roy M Goode, who remains to this day the great champion for the adoption in the UK of legislation based on the UCC.

⁷ The title of the report included the word "consumer". But the report's recommendation that a UCC9-type system be adopted was not limited to consumer transactions.

⁸ The same was true of the 1960 report (above) that led to the Companies (Floating Charges) (Scotland) Act 1961. The same was also true of the Diamond Report (below) and of the Halliday Report (below). The Murray Report, though in fact not a final report, did have a draft bill. Law Com Report No 296 also had draft legislation (not a bill, but draft "Company Security Regulations").

10.5 One point of difference from the UCC/PPSAs approach was that securities over consumer goods would have been excluded from registration. (But security over road vehicles would have been registrable, even if owned by consumers.⁹) That would not have meant that consumer goods would have been outwith the scheme, merely that registration would not have applied.

10.6 Although there would have been a new register, the company charges registration scheme would have been retained, thereby requiring double registration of secured transactions.¹⁰

10.7 Ships and aircraft, to the extent that they are subject to special legislation for security rights, would have been excluded from the new system.¹¹ The question of security over intellectual property rights was not substantively discussed. The same is true about security rights over corporate shares and bonds. Little was said about the floating charge, and it is unclear exactly what the Crowther Committee envisaged its future to be.¹² Little was said about questions of international private law. These comments are not made as criticisms. No doubt it was intended that further work was to be carried out.

10.8 Whilst the view was taken that the law should in broad terms be the same on both sides of the border, the Committee considered that the substantial differences in the background law as between England & Wales and Scotland meant that it would be desirable for there to be two separate statutes.¹³

Government response to Crowther

10.9 In 1973 the Government responded to the Crowther Report with a White Paper, *Reform of the Law of Consumer Credit*.¹⁴ This said very little about Part 5 of the Crowther Report. One comment was that the Government "were not convinced that the possible benefits of the Committee's recommendations to the credit industry and to some consumers would outweigh the possible social disadvantages to others."¹⁵ The "possible social disadvantages" were not specified. The White Paper added that the Government "will be prepared to reconsider this issue" in future. The White Paper expressly rejected the idea that HP should be recharacterised. "While the Government accept that in many cases hire-purchase is ... little more than a legal fiction, there are many transactions, particularly in the business field, where the intention is that there should be a hiring agreement which may or may not, at the option of the hirer, end up as an outright sale."

⁹ Paras 5.7.28 to 5.7.42 of the Crowther Report deal with motor vehicles.

¹⁰ Crowther Report para 5.7.44 ff.

¹¹ Crowther Report para 5.7.43. This paragraph in fact says that aircraft should be *included* in the new scheme. But the report predated the Mortgaging of Aircraft Order 1972, and it is clear from the terms of para 5.7.43 that, had the 1972 Order already been passed, aircraft would have been excluded from the new scheme.

¹² Crowther Report para 5.7.77 says that the floating charge would continue but that it would be necessary to "accommodate" it in the new system. For Diamond's brief comments on this passage in Crowther, see Diamond Report para 16.7.

¹³ Crowther Report para 5.2.21.

¹⁴ Cmnd 5427.

¹⁵ This and the following quotations are from para 8, which seems to be the only paragraph in the White Paper dealing with part 5 of the Crowther Report.

The Halliday Report¹⁶

10.10 After the Crowther Report, there was some concern in legal circles in Scotland as to how a UCC9-type system could work in the context of Scots law. For example, Professor Walker argued that the system would be complex and, moreover, would not cohere with the general principles of the law.¹⁷ This Commission then set up a working party (the Halliday Committee¹⁸):

"To consider the legal and technical problems which would arise or be likely to arise in the creation in Scotland of a system of security over moveable property in relation to all types of loans and to make recommendations in that respect."

10.11 The reference to "the creation in Scotland of a system of security over moveable property in relation to all types of loans" was rather opaque given that such a system already existed. The intention was to refer to the creation of a system based on the UCC/PPSA approach, as recommended by the Crowther Report. The word "loans" was perhaps inexact, because evidently the Committee was expected to consider – and in fact did consider – non-loan types of credit, such as HP. And whilst the reference did not ask the Committee to express any views as to the desirability of a UCC/PPSA-type approach, but only to consider the issues that might arise in the event that such an approach were to be taken forward, the Committee in its report went further than that, and recommended that a UCC/PPSA-type of approach should indeed be adopted in Scotland. It seems not to have shared the concerns expressed by Professor Walker.¹⁹

10.12 Whilst the Committee favoured a UCC/PPSA-type of approach, a major qualification was that it recommended the exclusion from the scheme of important types of property, going in this respect further than the Crowther Report. The exceptions were:²⁰

(i) Consumer goods. Hence hire-purchase of consumer goods would have continued as before.²¹ (But the report accepted the principle of recharacterisation in respect of non-consumer goods.²²) "We accept that in the area of consumer transactions there are grounds for misgiving as to the introduction of a facility for loans to consumers which might make such transactions easier to the ultimate detriment of some consumers, and that the comparatively recent detailed legislative provisions for hire purchase and consumer credit should continue in operation at least until experience has demonstrated their utility or disclosed any serious deficiencies. In the area of commercial transactions, however, the situation, especially in Scotland, is substantially different."²³

¹⁶ *Report by the Working Party on Security over Moveable Property*, 1986. Available on the SLC website.

¹⁷ D M Walker, "Crowther's Consumer Credit Chaos Contemplated" 1972 SLT (News) 81.

¹⁸ The committee's chair was John (Jack) Halliday, a former Scottish Law Commissioner. For some account of the history hereabouts, see C K Davidson, "The Scottish Law Commission 1965 – 1995" (1995) 1 *Scottish Law and Practice Quarterly* 18 at pp 21 to 22. Davidson notes the "unsympathetic" attitude to Scotland of the Department of Trade and Industry.

¹⁹ To which no reference was made.

²⁰ Halliday Report para 31.

²¹ Although the reference is to consumer goods, in substance the reference is to cases where the debtor is a consumer. Goods that are ultimately for consumer use (and so consumer goods *ratione rerum*) are non-consumer goods (*ratione personarum*) in transactions by a wholesaler.

²² Halliday Report para 31. This is to be commended for its clarity as to how recharacterisation would work. See also an interesting criticism of the Crowther Report in para 40.

²³ Para 24.

(ii) Security over "equipment" where the loan was below a prescribed amount. The initial sum was suggested as being £5,000.²⁴ The figure would have been tied to the value of the debt, not to the value of the collateral. There is no explanation of why only equipment, and not other types of collateral (such as receivables or inventory) was to be excluded. The effect would have been that non-possessory security over equipment would have been incompetent unless the secured loan was above the prescribed figure. (As opposed to allowing non-possessory security in such cases but dispensing with registration.²⁵)

(iii) Assets in respect of which a system of registered security rights already existed, under other legislation. The examples given were ships, aircraft, patents and trade marks. For the same reason, property capable of being collateral for the purposes of the Agricultural Credits (Scotland) Act 1929 would also have been excluded.

(iv) Company shares, company bonds and public-sector bonds.²⁶

(v) "Commercial paper". The report used this phrase in a sense that is rather broader than usual, to include not only negotiable instruments, but also "bills of lading, delivery orders, warehouse receipts..."²⁷

10.13 Where recharacterisation operated, it would have done so fully, so that full ownership would be vested in the debtor.²⁸ (Unlike the UCC and the PPSAs which divest the creditor for some purposes but not others.)

10.14 The report accepted that assignments of receivables (even if not by way of security) should be registrable.²⁹ But it did not explore the interaction of this new scheme with the existing law about assignment.³⁰

10.15 Whereas in the UCC/PPSA approach a financing statement can be registered before there is any security agreement, the Halliday Report recommended that no registration should be competent before the security agreement had been signed, because that "might open the way to unjustified or speculative filing."³¹ But it did not require that attachment should precede registration.³²

²⁴ This is the figure given in the report. In today's values, adjusted for inflation, the equivalent figure would be much higher.

²⁵ The Crowther Report proposed a comparable rule. But in such cases the non-possessory security would have existed notwithstanding the lack of registration: see Crowther Report para 5.7.27.

²⁶ Given that in the UK bearer shares are unknown, and that bearer bonds are almost unknown (except in the Eurobond market) these cases might be regarded as falling under the previous heading.

²⁷ But there may be some inconsistency, for para 63 of the report says that bills of lading, delivery orders etc *would* be within the system.

²⁸ This is not discussed in any detail, but we think that this is probably what is meant in para 36: "In a case where a hire-purchase or other reservation of title agreement was employed ... the agreement would have effect (notwithstanding its terms) as an immediate sale of the goods to the debtor."

²⁹ Halliday Report para 32.

³⁰ It may be added that the report referred to the proposed new register as the register of security interests (but without capitals). The appropriateness of this might be arguable given that non-security interests would have been registrable. The Crowther Report and the Diamond Report do not seem to use any name. The Murray Report calls the proposed register the register of security interests. But under the Murray Report only security rights would have been registrable in it.

³¹ Halliday Report para 54. The meaning of this comment is not elaborated.

³² Halliday Report para 54.

10.16 Enforcement could be by the creditor as such. Alternatively the creditor could appoint a "receiver in moveables" to enforce. Only certain professionally-qualified persons would have been eligible for appointment.³³

10.17 The report had little to say about floating charges. The question of whether they should continue to exist – given their overlap with the new Article 9 security³⁴ - was not expressly discussed. But the report presupposed that their existence would continue.³⁵ As for ranking, it was recommended that the criterion of preference would have been date of perfection (for the new type of security interest) as against date of crystallisation (for the floating charge), "subject, however, to any conventional ranking agreements."³⁶ Whether this proviso was meant to allow a floating charge to contain a clause that would ensure the charge's priority over a subsequent fixed security – which was the general rule - is unclear. It may be added that the retention of the floating charge as a separate institution would have constituted a major derogation from the UCC/PPSA approach.

10.18 The report said that it was "for consideration" whether, in the case of security rights granted by companies, there should also have to be registration under the company charges registration scheme.³⁷

10.19 The report had fairly detailed provision as to ranking. As to competition with diligence, the recommendation was that the criterion of preference should be the date of the perfection of the security interest. Since the new security interest could cover after-acquired assets, and thus function as a floating lien, this would mean that ordinary unsecured creditors would be in a worse position than they are in relation to a floating charge.³⁸ This point was not discussed.

Diamond Report

10.20 In 1985 the DTI asked Professor Diamond to review the law of security over property other than land. His report appeared in 1989.³⁹ He too recommended the adoption, in both England and Scotland, of a UCC/PPSA-type system. As to floating charges, they would disappear as a separate institution. "If the parties purport to create an 'old-style' floating charge after the new scheme is introduced it would take effect as a security interest under the new scheme".⁴⁰ Diamond said little about the implications of this change. The question of whether a floating charge would still affect immoveable property was not discussed. Nor was the fact that a floating charge under current law was subject to certain limitations to which fixed securities were not subject.

³³ Halliday Report para 65 ff.

³⁴ The Halliday Report recommended (para 34) that, as in UCC-9, the new security right should be capable of covering after-acquired property.

³⁵ As did the Crowther Report, para 5.7.77.

³⁶ Halliday Report para 60(3).

³⁷ Halliday Report para 48.

³⁸ For floating charges the criterion of preference is the date of crystallisation as against the date when the diligence is "effectually executed". For the meaning of this, see Scott Wortley, "Squaring the circle: revisiting the receiver and 'effectually executed diligence'" (2000) *Juridical Review* 325.

³⁹ A L Diamond, *A Review of Security Interests in Property* (Department of Trade and Industry, 1989). He benefited from the large number of responses to his preliminary consultation paper. He also took considerable trouble to inform himself about Scots law and about views in Scotland.

⁴⁰ Diamond Report para 16.12.

10.21 He recommended discontinuation of registration under the company charges registration scheme.⁴¹ As for assets in special registers, such as patents, ships etc, he recommended that security rights should continue to be registrable as before, but that additional registration should be required in the new register. A security right registered solely in (eg) the patents register would still be valid, but would be invalid in the event of insolvency.⁴² Thus in such cases the new register would have adopted a role similar to registration in the Companies Register.

10.22 Diamond agreed with the Crowther Report that whilst the law should be broadly similar on both sides of the border, separate legislation would be desirable.⁴³ "Fundamental differences of principle between the two legal systems would make it impossible to unify the law so as to have a single piece of legislation applicable to both jurisdictions."⁴⁴ He added: "It may well be that the Scottish legislation could be much simpler than that for England and Wales."⁴⁵ He did not explain this intriguing remark.

10.23 The Diamond Report also made recommendations for the reform of the provisions about the registration of company charges contained in Part XII of the Companies Act 1985. These were put forward as merely interim reforms, because the core recommendations would have swept away Part XII altogether. But the report appreciated that the core recommendations could not be put in place for some time.

10.24 The Government rejected the Diamond Report,⁴⁶ and so it was not implemented, except for some of the recommendations about Part XII of the Companies Act 1985, which were implemented by Part IV of the Companies Act 1989. However, Part IV was never brought into force.

Murray Report: introduction

10.25 In 1994 the Murray Report appeared.⁴⁷ Unlike the previous reports, it contained a draft bill.⁴⁸ Whereas the Crowther and Diamond Reports were UK-wide, the Murray Report, like the Halliday Report, was Scotland-only. It rejected the UCC-9 approach.⁴⁹

"On further consideration of the Article 9 model, it became clear that although it afforded a very flexible form of security, it would also result in a very strong, comprehensive security which could have adverse effects for unsecured creditors. In particular, given that it was likely that most businesses would have been required (at least by their most important creditors) to grant the new security over all their moveable property, that could have meant that in practice the moveable property of most businesses would no longer have been available for effective diligence by other

⁴¹ Diamond Report para 12.2.2.

⁴² Diamond Report para 12.3.5.

⁴³ Diamond was very conscious of the Scottish dimension. See paras 8.4.1 to 8.4.8.

⁴⁴ Diamond Report para 8.4.4.

⁴⁵ Diamond Report para 8.4.4.

⁴⁶ See Gerard McCormack, *Secured Credit under English and American Law* (2004) p 67 for an outline of the reasons given by Government. In brief (i) most people (allegedly) wanted no change, (ii) change would (allegedly) be disruptive and expensive and (iii) there was a possibility that matters would be overtaken by EU legislation.

⁴⁷ *Security over Moveable Property in Scotland: a Consultation Paper* (Department of Trade and Industry, 1994). For contemporary discussion of the Murray Report, see Hamish Patrick, "Reform of Security over Moveable Property: Some General Comments" 1995 SLT (News) 42; Andrew J M Steven, "Reform of Security over Moveable Property: Some Further Thoughts" 1995 SLT (News) 120.

⁴⁸ The Draft Floating Charges and Moveable Securities (Scotland) Bill.

⁴⁹ Murray Report para 2.4 to 2.5.

creditors. At least with the current law on floating charges there is the possibility of diligence being carried out before the charge attaches. The potential scope and strength of an Article 9 type of security indicated that it was not an appropriate model for the reform of Scots law; but there were other considerations which led to the same conclusion. In particular, the system of securities law proposed by Professor Diamond would have involved a radical departure from the current law, and would have required, when fully specified, a very complex set of new rules ... Moreover that approach would have involved a system of notice filing ..."

One can identify here three objections to UCC-9: effect against unsecured creditors, complexity, and notice filing. The report did not, however, elaborate on these objections. It did not, for example, consider the possibility of adopting UCC-9 with the addition of more protection to general creditors than Article 9 has. It said very little about UCC-9 and did not mention the PPSAs at all. Although the report did not examine UCC-9 in any detail, what it recommended did in fact have a significant likeness to UCC-9.

10.26 The Murray Report was not implemented. But its influence can be seen in Part 2 of the Bankruptcy and Diligence etc (Scotland) Act 2007, and it has also had an influence on this discussion paper.

Murray Report: the "moveable security"

10.27 The report recommended the introduction of a new "moveable security",⁵⁰ to be created by registration in a new "Register of Security Interests".⁵¹ This was to be kept by the Registrar of Companies.⁵² This new register would have had two parts, one devoted to the new moveable security, and the other to floating charges.⁵³

10.28 The new moveable security was to be available for corporeal moveable property, and would not have required possession by the creditor.⁵⁴ Consumer goods would have been excluded, except in so far as held by a company, such as a manufacturer.⁵⁵ Only corporeal moveable property owned at the time of the security would have been covered.⁵⁶ So if it were desired to cover after-acquired assets, repeated grants of security would have been necessary. The new security was not to extend to the proceeds of a sale of collateral by the debtor.⁵⁷

10.29 The new moveable security was also to be available for incorporeal moveable property.⁵⁸ Intimation would not have been required. For receivables, but not for other incorporeal property, the security would have been capable of covering after-acquired property.⁵⁹

⁵⁰ Murray Report paras 3.4 to 3.5; Draft Floating Charges and Moveable Securities (Scotland) Bill Part II.

⁵¹ Murray Report para 3.11; Draft Floating Charges and Moveable Securities (Scotland) Bill clause 22.

⁵² Murray Report para 3.11; Draft Floating Charges and Moveable Securities (Scotland) Bill clause 22.

⁵³ Murray Report para 3.11; Draft Floating Charges and Moveable Securities (Scotland) Bill clause 22(1).

⁵⁴ Murray Report paras 3.4 to 3.5; Draft Floating Charges and Moveable Securities (Scotland) Bill clause 9.

⁵⁵ Murray Report para 3.5; Draft Floating Charges and Moveable Securities (Scotland) Bill definition of "exempt property" at clause 30.

⁵⁶ Murray Report para 3.4; Draft Floating Charges and Moveable Securities (Scotland) Bill clause 12.

⁵⁷ Murray Report para 3.5; Draft Floating Charges and Moveable Securities (Scotland) Bill clause 9(3).

⁵⁸ Murray Report para 3.4; Draft Floating Charges and Moveable Securities (Scotland) Bill clause 9(3).

⁵⁹ Murray Report para 3.4; Draft Floating Charges and Moveable Securities (Scotland) Bill clause 9(3).

10.30 As well as consumer goods, the new scheme would have excluded any type of property for which an existing statutory scheme established a system of security rights. We quote clause 9(2) of the draft Bill:

"Where provision is made in any statute extending to Scotland for the granting of a right in security (other than a floating charge or an agricultural charge created under Part II of the Agricultural Credits (Scotland) Act 1929) over any moveable property, a moveable security may not be granted over any such property under this Act."

The note on the clause gives as examples ships and aircraft. Intellectual property rights were not considered.⁶⁰ Nor were corporate shares and bonds.

10.31 On default the creditor would have had the right to take possession of any corporeal moveable property covered by the security, and would have had the power to sell.⁶¹ The enforcement provisions for incorporeal property were less well developed.⁶² As well as direct enforcement, the creditor would have had the option to enforce through a receiver.⁶³

Murray Report: floating charges

10.32 The report did not only deal with the proposed new "moveable security". It also proposed changes to the law of floating charges, for the floating charge would have continued to exist as a separate institution.⁶⁴ Some of the proposed reforms are very similar to those eventually enacted as Part 2 of the Bankruptcy and Diligence etc (Scotland) Act 2007. Instead of being registered in the Companies Register, floating charges would be registered in the Register of Security Interests.⁶⁵ As mentioned above, that register would have had two divisions (one for floating charges and the other for the new moveable security), and it would have been kept by the Registrar of Companies. Despite this fact, the new moveable security was not limited to company debtors,⁶⁶ and, moreover, the report recommended that the current rule limiting the power to grant floating charges should be scrapped.⁶⁷ The recommendation was that any debtor should be able to grant a floating charge, but that in the case of a non-company granter the floating charge would be limited to moveables, and would not cover consumer goods.⁶⁸ (The report considered the idea that *all* floating charges should be restricted to moveable property, but in the end did not press that

⁶⁰ Three statutes (Patents Act 1977, Registered Designs Act 1949 and Trade Marks Act 1994) say at least something about security. (See Chapter 7.) So probably these IP rights would have been excluded from the new moveable security, while others such as copyright would have been included. Alistair Orr and Tom Guthrie "Fixed Security Rights over Intellectual Property in Scotland" [1996] 18 European Intellectual Property Review 596 take it that the new moveable security would have covered IP rights of every kind, but they do not mention clause 9.

⁶¹ Murray Report para 3.27; Draft Floating Charges and Moveable Securities (Scotland) Bill clause 17.

⁶² The report merely recommends that where incorporeal property is secured, a receiver should be appointed, "to deal with the complexities which the realisation of such property may entail" (para 3.25). The Draft Floating Charges and Moveable Securities (Scotland) Bill provides that, "references to delivery of property [in the context of taking possession on default] include, where the property is incorporeal property, references to transfer of the rights in such property" (clause 17(7)).

⁶³ Murray Report para 3.25. Section 51 of the Insolvency Act 1986 confers the power on the holder of a floating charge to appoint a receiver over the property subject to the charge. The Draft Floating Charges and Moveable Securities (Scotland) Bill sch 1 para 1(2) would have amended s 51 to confer the same power on the holder of a moveable security. The same suggestion is in the Halliday Report. See para 10.16 above.

⁶⁴ Murray Report paras 3.2 to 3.3; Draft Floating Charges and Moveable Securities (Scotland) Bill Part I.

⁶⁵ Murray Report para 3.11; Draft Floating Charges and Moveable Securities (Scotland) Bill clause 2.

⁶⁶ Murray Report para 3.4; Draft Floating Charges and Moveable Securities (Scotland) Bill clause 9.

⁶⁷ Murray Report paras 3.2 to 3.3; Draft Floating Charges and Moveable Securities (Scotland) Bill clause 1.

⁶⁸ Murray Report para 3.3. The Draft Floating Charges and Moveable Securities (Scotland) Bill clause 1 confers the power to create floating charges; clause 30 defines "exempt property" in the case of companies and non-companies.

idea.⁶⁹) Floating charges would not come into effect before registration, as opposed to the 21-day "invisibility period" that exists under current law.⁷⁰ Any entry in the Register of Security Interests would be copied over from that register to the Companies Register, which is the same as the approach intended for Part 2 of the Bankruptcy and Diligence etc (Scotland) Act 2007.⁷¹

Murray Report: comparison with the UCC/PPSA approach

10.33 The Crowther Report, the Halliday Report and the Diamond Report all recommended the UCC/PPSA approach, subject to certain variations, the most significant of which have been mentioned. The Murray Report rejected the UCC/PPSA approach. For example, it did not recommend recharacterisation. It did not recommend that the floating charge should disappear as a separate institution. It did not recommend that outright assignments of receivables should be registrable. And so on. Nevertheless its recommendations have some likeness to the UCC/PPSA approach. Security without possession, on the basis of registration, would have become competent for corporeal moveables, and security without intimation, again on the basis of registration, would have become competent for incorporeals. The new security right would have been, in the terminology of English law, "fixed" rather than "floating". For receivables, but not for other incorporeals and not for corporeals, the new security right would have covered after-acquired property. Thus the security interest could have functioned as a partial floating lien. As mentioned above, the report rejected the UCC/PPSA in part because its effect as against unsecured creditors was considered to be too strong.⁷² But the new moveable security would have been strong too. It would have trumped diligence executed after the registration of the security. Being a fixed security, it would not have been treated in insolvency in the way that the floating charge is treated.⁷³

International private law in Crowther/Halliday/Diamond

10.34 The three reports said little about international private law, and in particular they said little about whether the new security right should cover foreign assets.⁷⁴ The Halliday Report took the view that the matter would have to be left open until it had become clear what would happen in England & Wales.⁷⁵

Nature of the security over incorporeal property in the Crowther, Halliday, Diamond and Murray Reports

10.35 The Crowther Report, the Halliday Report, the Diamond Report and the Murray Report all recommended the introduction of a registered security that would cover

⁶⁹ Murray Report paras 4.15 to 4.18.

⁷⁰ This latter issue has been a consistent cause of complaint virtually since the first introduction of the floating charge in 1961.

⁷¹ Murray Report para 3.17; Draft Floating Charges and Moveable Securities (Scotland) Bill clauses 23(8) and 23(9). By means of an order under s 893 of the Companies Act 2006. The UK Government has said that a s 893 order will be made in due course.

⁷² "The potential scope and strength of an Article 9 type of security indicated that it was not an appropriate model for the reform of Scots law." Murray Report para 2.5.

⁷³ In particular, the floating charge is subject to preferred claims. For floating charges and their treatment in insolvency see Chapter 22.

⁷⁴ Chapter 27 of the Diamond Report was about foreign companies. But the issue was discussed only on the assumption of the continued existence of the existing law.

⁷⁵ Halliday Report para 50.

incorporeal property such as receivables. In none of them was there an exploration of the inner logic of such a security. Possibly it would have worked as an assignation in security, ie transferring the right to the creditor, for the purpose of security. Or perhaps it would have worked as a security right in the narrow sense, which is to say that the claim would have remained vested in the cedent, with the creditor taking a limited right. (Of course, matters would change in the event of enforcement.) These are points that are not of mere theoretical interest. They have practical implications. The concept of a security right in the narrow sense is discussed further in Chapter 16 below.

Reviews focused on floating charges

10.36 In 1960 appeared the Eighth Report of the Law Reform Committee for Scotland.⁷⁶ This took the view that the Scots law of rights in security over moveable property was deficient, and recommended the introduction of the English concept of the floating charge. There was no mention of the UCC. There was no suggestion of any general reform of the law. The new law would be the existing, unreviewed law, plus the new floating charge. The report was swiftly implemented by the Companies (Floating Charges) (Scotland) Act 1961.

10.37 In terms of the 1960 Report, and the 1961 Act, the only way of enforcing a floating charge was liquidation. In 1970 this Commission recommended that receivership be introduced as an alternative means of enforcement.⁷⁷ This was implemented by the Companies (Floating Charges and Receivers) (Scotland) Act 1972.

10.38 This Commission also published two discussion papers on floating charges, in 1976 and 1986.⁷⁸ Neither led to a report. Neither discussed the UCC/PPSAs.

10.39 In 2004 this Commission published its *Report on Registration of Rights in Security by Companies*.⁷⁹ As mentioned above, there were similarities between this report and what the Murray Report had proposed in relation to floating charges. This led to Part 2 of the Bankruptcy and Diligence etc (Scotland) Act 2007. Part 2 sets up a new Register of Floating Charges. A floating charge would be created on registration in the new register. It would not (as happens under current law) come into existence before registration. Part 2 has not so far been brought into force. The expectation is that it would be brought into force in conjunction with a section 893 order. One recommendation of the 2004 Report that was not implemented was that the company charges registration scheme⁸⁰ should be dismantled, as far as Scottish companies are concerned.

Reviews focused on the company charges registration regime

10.40 As was mentioned above, the Diamond Report recommended reforms to the company charges registration scheme in Part XII of the Companies Act 1985, not as a permanent measure, but as a stopgap approach pending the introduction of UCC/PPSA legislation, which, had it happened, would have swept away Part XII. Part IV of the

⁷⁶ Cmnd 1017 (1960).

⁷⁷ Scottish Law Commission, *Report on the Companies (Floating Charges) (Scotland) Act 1961* (Scot Law Com No 14 (1970)).

⁷⁸ Scottish Law Commission, *Memorandum on Law of Rights in Security: Company Law, Registration of Charges* (Scot Law Com Memorandum No 33 (1976)); Scottish Law Commission, *Memorandum on Floating Charges and Receivers* (Scot Law Com Memorandum No 72 (1986)).

⁷⁹ For the origins of this in the Company Law Review, see below.

⁸⁰ At that time it was Part XII of the Companies Act 1985.

Companies Act 1989 made major changes to Part XII of the Companies Act 1985, some of the reforms being adopted from the Diamond Report. But before Part IV could be brought in force, minds had changed, and in the end it was never brought into force, and was eventually simply repealed.⁸¹

10.41 A few years later – and at the same time as the Murray Report - the DTI published a consultation paper on the same topic, *Company Law Review: Proposals for Reform of Part XII of the Companies Act 1985*.⁸² This canvassed three possibilities, namely keeping the law as it was, keeping it but with reforms, and replacing it by a notice filing system. The third option did not include the adoption of a UCC/PPSA approach. It was limited to the way that company charges were registered. Consultees favoured the second approach.⁸³ No final report emerged and no legislation resulted from this initiative.

10.42 In 1998 the Company Law Review Steering Group was set up. Its final report, published in 2001,⁸⁴ recommended that the registration system for company charges should be changed to a notice filing system.⁸⁵ This was a radical recommendation in itself, but the report went further:

"Although charges created by companies over their assets other than land must far outnumber similar charges created by other debtors, it would not be sensible to consider a notice filing system for company charges without at the same time considering a similar system for all charges over property other than land and for functionally-equivalent legal devices (often termed 'quasi-security' devices). The Crowther Report recognised this clearly. Given the lack of opportunity to discuss our new and more radical proposals and given that their implications for the law of security and 'quasi-security' over property other than land are outside our remit, we have recommended that DTI consult with the Lord Chancellor's Department and the Scottish Executive with a view to the Law Commissions being requested to examine the system for registering company charges and security and 'quasi-security' generally over property other than land. We hope that the Law Commissions will make recommendations for reform to both company law and security over property other than land in both England and Wales and in Scotland, and in doing so will take account of our provisional conclusions on the company law aspects of this issue, as set out in this Chapter."⁸⁶

This was open-ended, strongly hinting in favour of a UCC/PPSA-type system. It remains to add that the report's specific recommendations about the reform of the company charges registration regime were not implemented.

10.43 In 2010 the Department for Business, Innovation and Skills issued a consultation paper, *Registration of Charges Created by Companies and Limited Liability Partnerships* reviewing Part 25 of the Companies Act 2006⁸⁷ and the Government response was published later that year.⁸⁸ Modified proposals were published in 2011.⁸⁹ Whereas Part 25 of

⁸¹ Companies Act 2006 s 1180.

⁸² November 1994. The paper does not bear a "command" number. This consultation ran in parallel with the Murray Report.

⁸³ See *Modern Company Law for a Competitive Economy: Registration of Company Charges* (Company Law Review Steering Group, 2000) para 1.14.

⁸⁴ Available at: <http://webarchive.nationalarchives.gov.uk/+dti.gov.uk/cld/final_report/>.

⁸⁵ Ch 12.

⁸⁶ Para 12.8.

⁸⁷ <<http://www.bis.gov.uk/Consultations/registration-of-charges/>>.

⁸⁸ <<http://www.bis.gov.uk/Consultations/registration-of-charges?cat=closedwithresponse>>.

⁸⁹ <<http://www.bis.gov.uk/assets/biscore/business-law/docs/r/11-862-registration-of-company-charges-issues>>.

the Companies Act 2006 currently says that only specified types of charge must be registered, the Government proposes that this should be changed so that all charges are registrable, other than those specifically exempted from registration. It is also proposed to make "negative pledge" clauses registrable, as they are in Scotland. The intention is "to bring the changes into force in 2012 or 2013."⁹⁰

The references to the two Law Commissions

10.44 The result of the report of the Company Law Review Steering Group was two separate and markedly different references to the Law Commissions. The reference to the Scottish Law Commission was a limited one, and did not ask for a UCC/PPSA-type approach to be considered:

"To examine the present scheme on the registration and priority of rights in security granted by companies and to make recommendations for its reform as it applies to (a) companies having their registered office in Scotland wherever the assets are located; (b) security granted under Scots law by overseas companies and companies having their registered office in England and Wales."

The result of this reference was our *Report on Registration of Rights in Security by Companies*,⁹¹ outlined above.⁹² The reference to the Law Commission of England and Wales was in different and broader terms, to:-

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

This reference did not expressly refer to the UCC and the PPSAs but its terms were such that the Commission was evidently being invited to consider the UCC/PPSA approach.

The Law Commission project

10.45 The Law Commission project was about the law of England & Wales, and not about Scots law. To that extent it was different from the Crowther Report and the Diamond Report. Nevertheless, what happens south of the border in this area of law is evidently of considerable significance for Scotland. Three publications resulted from the project: (i)

⁹⁰ Para 31. For discussion of the DBIS Consultation, see Hamish Patrick, "Charge Registration Reform – Further BIS Consultation" 2011 SLT (News) 81.

⁹¹ Scottish Law Commission, *Report on Registration of Rights in Security by Companies* (Scot Law Com No 197 (2004)).

⁹² Para 10.39.

Registration of Security Interests: Company Charges and Property other than Land (2002),⁹³ (ii) *Company Security Interests: A Consultative Report* (2004)⁹⁴ and (iii) *Company Security Interests* (2005).⁹⁵

10.46 In a nutshell, the first two proposed the adoption, for England & Wales, of a system based on the UCC/PPSAs. But in the light of the fact that, whilst there existed strong support for that approach, there also existed strong opposition,⁹⁶ the final report of 2005 contained more limited recommendations. It abandoned two UCC/PPSA principles: the recharacterisation of conditional sales, hire purchase and finance leases as security interests, and the enactment of a comprehensive code of moveable security law. Another difference from the UCC/PPSA approach was that the floating charge would survive as a separate institution. But the final report kept another important feature of the UCC/PPSA approach, namely that assignments of receivables should be registered.⁹⁷ And it continued to recommend the UCC/PPSA registration system, notice filing.⁹⁸ A new register would be set up, to be called "the Register of Charges and of Sales of Receivables". This would have been kept by the Registrar of Companies for England and Wales. Why the Registrar of Companies? Because the scope of the Law Commission's project was limited to company law. By contrast, a principle of UCC-9 and the PPSAs is that the law of security interests should apply uniformly as between different types of debtor (albeit subject to consumer protection rules) – an approach taken, indeed, by the great majority of countries round the world. But the Commission's intention was that the system, once established for companies, could later be extended to transactions by non-companies. There were good pragmatic reasons for this "one step at a time" approach.

10.47 The DTI published a consultation document, *Economic Impact of the Law Commission's Proposals*.⁹⁹ It seems that no report emerged from this consultation.

10.48 The Companies Act 2006 took up none of the Law Commission's recommendations.¹⁰⁰ On the other hand, the Government has never formally rejected the recommendations. The Lord Chancellor's 2011 *Report on the Implementation of Law Commission Proposals*¹⁰¹ said that "consideration will be given to the rest of the Law Commission's recommendations after decisions have been made with regards to registration of charges."¹⁰²

10.49 Debate continues in England and Wales, between those who think that the current law should be retained, albeit with some minor adjustments, and those who wish to see the UCC/PPSA approach adopted. The "Secured Transactions Law Reform Project" has been

⁹³ Consultation Paper No 164.

⁹⁴ Consultation Paper No 176.

⁹⁵ Law Com Report No 296.

⁹⁶ Not least from two influential bodies, the City of London Law Society and the Financial Markets Law Committee. See Gerard McCormack, "Pressured by the Paradigm: the Law Commission and Company Security Interests" in John de Lacy (ed), *The Reform of UK Personal Property Security Law: Comparative Perspectives* (2010) at p 84.

⁹⁷ Law Com Report No 296, Part 4.

⁹⁸ Law Com Report No 296, Part 3.

⁹⁹ 2005. In fact it appeared before the Law Commission's final report came out.

¹⁰⁰ See Hugh Beale, "The Exportability of North American Chattel Security Regimes: the Fate of the English Law Commission's Proposals" (2006) 43 *Canadian Business Law Journal* 177.

¹⁰¹ <<http://www.justice.gov.uk/publications/docs/report-implementation-law-commission-proposals.pdf>>.

¹⁰² Para 23. This report came out in January 2011, by which time the Government had in fact *already* (December 2010) made its decision about the registration of company charges: see para 10.43 above.

established to campaign for reform on UCC/PPSA lines, formerly chaired by Lord Bingham and now by Lord Saville. Among those active in it are Sir Roy Goode, and also Hugh Beale, who was the lead Commissioner for the project of the Law Commission of England and Wales.

The Business Finance Report

10.50 The Business Finance Report of 2002 is worth mentioning here, even though it was not a law reform project, but a review of the way that the Scots law of moveable security works in practice, especially in relation to small and medium sized enterprises. It is discussed further below, in Chapter 12.

Bills of sale

10.51 In 2009 the Department for Business, Innovation and Skills issued a consultation paper reviewing the possibility of abolishing bills of sale for consumer lending.¹⁰³ This was limited to England and Wales, because bills of sale do not exist in Scots law.¹⁰⁴ Although the consultation document said that the provisional view was in favour of abolition, in 2011 the Government announced that, for the time being at least, abolition would not take place, and that instead the Government would "give the industry a chance to put its own house in order."¹⁰⁵ For more on this subject see Chapter 16.

10.52 In 2005 the Law Commission of England and Wales recommended that "the Department of Trade and Industry, who are already involved in an extensive review of consumer credit law, should examine the question of replacing the Bills of Sale Acts with a more efficient and effective scheme."¹⁰⁶ The consultation mentioned above was not a response to that recommendation, and as far as we are aware, nothing has been done in relation to that recommendation.

¹⁰³ <<http://www.bis.gov.uk/consultations/ban-use-of-bills-of-sale-for-consumer-lending>>.

¹⁰⁴ Despite this fact, we have heard from local authority trading officers that some companies have been making loans in Scotland, taking bills of sale as security. Such bills of sale would be invalid under our law. Presumably such companies are unaware that Scots law is not the same as English law.

¹⁰⁵ <<http://www.bis.gov.uk/Consultations/ban-use-of-bills-of-sale-for-consumer-lending?cat=closedwithresponse>>.

For the quoted words see para 6.

¹⁰⁶ Law Com Report No 296 para 1.53.

Chapter 11 The publicity principle

The publicity principle and third party effect

11.1 Both assignation and security have as their aim effectiveness against third parties. If Clement assigns to Alana a debt due by Donna, that is not merely a matter of contract between Clement and Alana. It affects Donna and other parties too, such as Clement's creditors, or anyone to whom Clement thereafter might seek to transfer the claim. The same is true of security rights. If Jack owns something, and borrows money from Jill, they can agree in a deed witnessed by a thousand notaries that she has a security over the item in question. But that is merely a contract and in principle a contract binds its parties but not third parties. For a transfer to happen, or for a security to be created, something more is needed than simple agreement between the immediate parties. Indeed, a "transfer" that had no effect against third parties, or a "security" that had no effect against third parties, would have little meaning. It would not go one inch beyond contract.

11.2 If transactions are to affect third parties, they should not be secret. The traditional requirement for third-party effect is that there be some external (overt) act in addition to the private agreement.¹ That idea goes by the name of the publicity principle.² There are three reasons for it. (i) One is fairness in relation to third parties. (ii) The second is economic efficiency. If transactions which have third-party effect can be a secret between the contracting parties, then third parties either have to incur costs in sleuthing work to find out about such transactions, or they have to conduct their affairs with their eyes blindfolded. (iii) The third reason is to prevent fraudulent antedating. The notarial system used in many European countries, and indeed elsewhere, operates as a safeguard against fraudulent antedating. In Scotland, registration in the Books of Council and Session serves the same purpose, but in general it is optional. (iv) A fourth – of which the third might be regarded as a particular aspect – is legal certainty.

11.3 The two standard methods of achieving publicity are the transfer of possession (for corporeals) and registration (corporeals and incorporeals). Land registration is the best-known example of the latter. Without it land transactions would be more expensive – an uncompensated loss to social welfare – and would more often result in unfairness and also in litigation.

11.4 The publicity principle is a policy, and the actual law does not always adhere to it. For example, the ownership of goods can pass in a sale by simple agreement, so that the law

¹ "All rights in security ... require for their constitution not only an agreement between the parties but some overt act." W M Gloag and J M Irvine, *The Law of Rights in Security, Heritable and Moveable, including Cautionary Obligations* (1897), at p 8.

² We oversimplify. There can be an external act that does not satisfy the publicity principle. The Dutch "registration" system for moveables involves an external act but does not satisfy the publicity principle: see Appendix B for an outline of Dutch law. And in the transfer of claims, intimation, while an external act, constitutes publicity only to a limited extent. But in principle it does, for it makes it possible for third parties to discover the position by asking the account party whether there have been any intimations.

confers on a contract external effect.³ And, considered as a matter of policy, the relevance of the publicity principle is not absolute. It varies according to the type of transaction. For land the case in favour of the publicity principle is very strong. But for corporeal moveables it is weaker. There is no register.⁴ Even outwith the context of security, there can be possessors who are not owners and owners who are not possessors,⁵ so that the link between possession and ownership is not strong: though possession raises a presumption of ownership, it is a presumption not hard to rebut. A third party can never expect to be certain about title to goods.

11.5 Turning to receivables, the relevance of the publicity principle is less strong. Whereas corporeal moveables are at least visible to third parties, receivables are not. Their very creation is the result of a private act. They can be varied or extinguished by private act. It may be argued that there is nothing unreasonable in allowing them to be transferred, or subjected to security rights, by private act. However, the private nature of receivables, though absolute in the case of natural persons, is not absolute in the case of companies. Companies must produce accounts and must register them in a public register, and those accounts must show the receivables, not, it is true, individually, but as a global figure. The result is that third parties have, at least in theory,⁶ some sort of idea of the collective receivables of a company, and that knowledge can be used and is used by lenders in the assessment of the borrower's financial position.

11.6 The role of the publicity principle thus varies. That fact gives rise to difficulties from the standpoint of law reform. Whilst no one would question the need for strong publicity for land rights, the position is more arguable for corporeal moveables and even more so for incorporeals such as receivables. Different countries vary in their rules. While most legal systems have strong publicity rules for land rights,⁷ for moveables the position is different. One can contrast, at two extremes, (i) German law, and the systems that follow it, and (ii) US law, and the systems that follow it. German law requires no publicity of any kind for securities over corporeal moveables⁸ or receivables, or for the transfer of receivables. UCC-9 and the PPSAs require publicity for all such securities, and also for the outright assignment of receivables.⁹

11.7 Publicity tends to be disliked by those granting security¹⁰ and also by companies selling their invoices. They want privacy, not publicity. ("Privacy" may be seen as secrecy by those to whom the information is inaccessible.) Sometimes it is suggested that publicity could be commercially damaging to debtors. In Germany the no-publicity approach

³ Sale of Goods Act 1979 s 17. The common law, based on Roman law, required delivery. The common law still applies where statute does not oust it. Thus if corporeal moveables are donated, as opposed to sold, ownership does not pass until there is delivery. Father Christmas is aware of this.

⁴ Except for ships and aircraft. The registration of road vehicles at DVLA is administrative. It is not a system of registration of rights in private law. By contrast, in some jurisdictions the registration of road vehicles also has a title (ie private law) function.

⁵ For example, Jack sells his bicycle to Jill. Under the Sale of Goods Act 1979 s 17 ownership passes when they so agree and under s 18 they are presumed to agree that ownership passes immediately, ie even before delivery. In that case, in the interval between the making of the contract and the delivery of the bicycle, Jack possesses but does not own, and Jill owns but does not possess.

⁶ Practice does not fully reflect theory. For example accounts may be filed long after the due date. And receivables are ephemeral.

⁷ English law, with its unregistered equitable securities over land, is a limited exception.

⁸ Other than ships etc.

⁹ Subject to certain exceptions.

¹⁰ For empirical evidence see *Business Finance and Security over Moveable Property* p 92.

continues to be generally regarded as satisfactory.¹¹ Registration is commonly rejected in Germany as bringing with it costs without sufficient countervailing benefits.

11.8 As mentioned above, a key argument in favour of an external act is that there is an efficiency gain. The argument is essentially the same for assets of all types. An external act reduces third party transaction costs and thus has economic benefits that are likely to outweigh the marginally higher transaction costs incurred by the immediate parties in meeting the requirements of the publicity principle. For example, suppose that X Ltd approaches Bank Y to seek asset-based finance, the assets in question being its receivables. The financing might be by the sale of the receivables, or it might be loan finance secured over the receivables. The bank is happy to agree, but naturally it wishes to be sure that the receivables have not already been sold, or made subject to a security. In the same way, if it were asked to make a loan against the security of immoveable property in the occupation of the customer, it would wish to be satisfied about the title to the property, and especially that it was not already subject to a security in favour of another party. If there is an external act, Bank Y can check such matters. For land, it can check the Land Register. For receivables, if there is registration (as in the UCC and the PPSAs) it can check the register.¹² If, as in Germany and systems based on, or similar to, German law, no external act is required, Bank Y cannot be sure of the position. This argument tends to point more to registration than to intimation, because it is easier (and less intrusive) to search a register than to send requests for information to customers who may reply slowly or not at all. This is especially so in the case of bulk assignments, where checking with all the account debtors is unlikely to be commercially feasible.

11.9 Cost is an important issue. The larger the value of the transaction, the less significant is a registration expense. For moveables, therefore, cost tends to be a more significant issue than for land. But registration costs can be kept low provided that the rules are fairly straightforward, and the digital revolution has helped.¹³ It must, however, be borne in mind that the hard cost of registration is not the only cost. There is also the soft cost of staff time taken up in applying for the registration. But this cannot be large, especially if registration is effected online, and we understand that in countries which have adopted the UCC/PPSAs the system is so simple that in most cases it is handled by junior staff. Registration can also *reduce* soft costs. It makes it cheaper for third parties such as potential lenders to discover the true position. And in the event of insolvency it makes it easier and quicker for the liquidator (trustee in sequestration etc) to discover what rights the various creditors have. It is not possible to answer with any sort of precision the question of whether the overall costs (hard and soft) of registration are greater or less than those of non-registration. But if the hard costs can be kept in the region of what is charged in New Zealand,¹⁴ we incline to think that a registration system is more attractive in the sense of being more efficient from an economic standpoint.

¹¹ For a recent robust defence of the German approach, see Hans-Jürgen Lwowski, "Quiet' Creation of Security Interests or Filing" in Horst Eidenmüller and Eva-Maria Kieninger (eds), *The Future of Secured Credit in Europe* (2008).

¹² Though in such systems the information in the register is not very informative. In systems, such as Scots law, it can check with the account party to discover whether there has been any intimation. In practice this seldom happens, because it is cumbersome.

¹³ See further Chapter 20.

¹⁴ See Chapter 20.

11.10 Registration is discussed later in the context of assignment,¹⁵ in the context of security over corporeal moveables,¹⁶ and in the context of security over incorporeal moveables.¹⁷ Different views could be formed for each case, but the possibility of a registration system raises very similar issues in each case.

The publicity principle and the trust

11.11 The trust does not require publicity for its creation.¹⁸ This fact has been pressed into service as a means of circumventing the requirements of Scots law as to publicity. This has happened especially in relation to the sale of receivables¹⁹ in the contexts of factoring and securitizations.²⁰ The seller, typically a company, declares that it holds the receivables in question in trust for the buyer. The aim is something that is comparable to an English equitable assignment. The seller (account creditor) is not divested, as would be the case if there were an intimated assignment. But if the seller enters into an insolvency process, the receivables in question are protected from the liquidator (etc) because they are held in trust.²¹ The same is true in the event that a creditor of the seller arrests the receivables.²² The reason that the trust device is adopted is, of course, to avoid intimation. Intimation is a nuisance. But without it, the buyer is exposed to the risk of the seller's insolvency: the trust exists to defeat the seller's creditors in the event that the seller does become insolvent.

11.12 Moreover, in some cases the seller desires secrecy, because it does not wish the account debtors to be aware of what is happening, fearing that such knowledge might impair its business relationships. Of course, if the seller becomes insolvent, intimation may prove necessary so that the debts can be collected, but in most cases insolvency does not happen.²³

11.13 The courts have varied in their attitudes towards the use of the trust as a device set up to defeat the creditors of the truster. Perhaps the two most notable cases – both Inner House cases and both decided about the same time, but with different members of the bench - are *Clark Taylor & Co Ltd v Quality Site Development (Edinburgh) Ltd*,²⁴ where the attitude was one of hostility,²⁵ and *Tay Valley Joinery Ltd v C F Financial Services Ltd*,²⁶

¹⁵ Chapter 14.

¹⁶ Chapter 16.

¹⁷ Chapters 18 and 19.

¹⁸ In practice trusts are commonly registered. *Inter vivos* trusts are typically registered in the Books of Council and Session, while testamentary trusts are registered in the Sheriff Court Books because all confirmed testaments must be so registered.

¹⁹ And also in trust receipt financing. See *North Western Bank, Limited v John Poynter, Son, & Macdonalds* (1894) 22 R (HL) 1, [1895] AC 56, discussed in Chapter 6.

²⁰ But this is in fact the main reason why trusts are used in such cases. They are used chiefly to avoid the practical problems of intimating to many account parties. Another reason is to deal with unassignable assets.

²¹ The rule that assets that are held in trust are so protected is given statutory form in the context of sequestration: Bankruptcy (Scotland) Act 1985 s 33(1)(b). There is no equivalent provision for other insolvency processes, but the law is nevertheless the same.

²² This rule is a common law one.

²³ The reason that intimation continues to be possible is that the sale agreement, as well as setting up a trust, also contains words of assignment.

²⁴ 1981 SC 111.

²⁵ Thus Lord Emslie says (at 116): "if a condition such as condition 11 (b), designed only to freeze assets of a debtor and to keep them out of other creditors' hands until a particular creditor's debt is paid in full, were to be regarded as constituting a proper trust in accordance with the law of Scotland, and were to be adopted widely by sellers of goods, the damage which would be done to the objectives of the law of bankruptcy and of liquidation would be incalculable."

²⁶ 1987 SLT 207. For contemporaneous discussion see K G C Reid, "Trusts and floating charges" 1987 SLT (News) 113; G L Gretton, "Using Trusts as Commercial Securities" (1988) 33 JLSS 53; D P Sellar, "Trusts and

where the attitude was the opposite. Today the predominant view is that the trusts can be used in the way described.²⁷

11.14 Whatever the existing law may be,²⁸ the policy issue has to be addressed in a law reform project such as the present. For example, in the USA and other countries that have adopted a UCC-type system, the trust device would fail. To be more precise, the trust device would be regarded as a security interest, which would thus be ineffectual against the seller's creditors unless it had been perfected, and in the typical case perfection would mean registration.

11.15 In England and Wales, "declarations of trust without transfer" in relation to moveables must be registered, on pain of nullity.²⁹ The provision does not apply to oral trusts.³⁰ It does not apply to companies.

11.16 As already mentioned, in practice the trust is sometimes used - particularly for receivables - as a quasi-transfer. To what extent it is used as a quasi-security is arguable. But it is so used in at least one context.³¹ And it might be used in others. For example, in some US states it is possible for securities over land to be created by the owner/debtor transferring title to a trustee, who holds for both the debtor and the creditor. The terms of the trust are that the trustee is to allow the debtor possession so long as the payments are kept up. As and when the loan is fully paid off, the trust deed requires the trustee to transfer title to the (ex-) debtor. But if there is default, the trustee is to sell, and pay the creditor from the proceeds up to the amount of the outstanding debt, with any balance payable to the debtor. In this structure there are three parties (two beneficiaries plus an independent trustee) but logically it would also be possible³² for there to be just two parties, with the role of trustee being played either by the debtor³³ or by the creditor. It is also possible for a trust to be used to hold funds for the purpose of an escrow arrangement, or to hold a fund as security for claims that may arise in a complex construction project. These are probably trust securities, using the trust as a convenient legal vehicle.

11.17 If a system based on the UCC/PPSAs were to be introduced, the use of the trust to create security rights would be subject to that system, because the UCC/PPSA rules apply regardless of the outer form that a transaction may be given by the parties. Consequently, if a trust operated by way of security, it would require to be registered, although it is possible to have a very simple system of registration. If a system based on the UCC/PPSAs is not

Liquidators" 1989 SLT (News) 143. And see W A Wilson and A G M Duncan, *Trusts, Trustees and Executors* (2nd edn 1995), ch 4.

²⁷ See for example J St Clair & J Drummond Young in *Law of Corporate Insolvency in Scotland* (3rd edn 2004) ch 12, and R Bruce Wood in Noel Ruddy et al, *Salinger on Factoring* (4th edn 2006) ch 7.

²⁸ It is not clear that the issues have yet been exhaustively studied. For example, there is some authority that any arrangement in which a seller of receivables is allowed to stay in control is open to challenge. For example Hume writes: "If, instead of entering on the use of his right ... the assignee allows all the fruits and profits to remain with the cedent, as before, this shall often be regarded (I do not say always) as evidence of a merely simulate and fictitious conveyance, such as shall not exclude the diligence of the cedent's creditors, nor affect the interest of any third party." (*Lectures* III p 5.) See too *Hope and McCaa v Wauch* June 12th, 1816 FC holding that an intimated assignation means what it says; the account party can no longer pay the cedent.

²⁹ Bills of Sale Act 1878. The quoted phrase is in s 4. And see s 344 of the Insolvency Act 1986.

³⁰ Since the Bills of Sale Acts apply only to *documents*.

³¹ Involving bills of lading. See *North Western Bank, Limited v John Poynter, Son & Macdonalds* (1894) 22 R (HL) 1, [1895] AC 56, discussed in Chapter 6.

³² Subject always to the argument that the law does not allow the trust to be used in this way.

³³ As (perhaps) in *North Western Bank, Limited v John Poynter, Son, & Macdonalds* (1894) 22 R (HL) 1, [1895] AC 56, discussed in Chapter 6.

introduced, the use of the trust would presumably be left to the general law. In our project on trust law, consultees have not shown much interest in introducing a general registration system for trusts although the registration of trust securities raises somewhat different issues.

11.18 If the reforms suggested in this discussion paper were to be introduced, including registration as an alternative to intimation, a reform that might be especially valuable in bulk transfers, and a new form of moveable security right, it may be that the appetite for the use of a trust might weaken. Nevertheless the fact remains that under current law trusts do not sit easily with the publicity principle. In Chapter 21 we ask whether devices that function as security rights should be "recharacterised" by law so that they are regarded by law as being security rights – with the result that their validity would depend on registration. If that approach were to be adopted, trusts that function as securities would be included. An alternative, halfway house, would be not to recharacterise such trusts (ie trusts that function as security rights), but nevertheless to require them to be registered. This possibility too is canvassed in Chapter 21.

Pledge and quasi-security over goods

11.19 Security over corporeal moveables is impossible without publicity, in the form of possession by the creditor.³⁴ But quasi-security devices, such as retention of title in sale, hire purchase, and finance leasing, do not require registration – unlike the position in legal systems based on UCC-9.

Receivables

11.20 For receivables, a sort of middle ground has been adopted by Scots law, whereby intimation to the account debtor is required. This, however, is not full publicity. If the assignation is by a company³⁵ and it is in respect of book debts and it is by way of security, then it must, as well as being intimated, be registered in the Register of Companies.³⁶ This is narrower than the UCC-9 rule in two respects. First, it applies only where the debtor is a company, whereas UCC-9 requires registration regardless of the identity of the assignor. In the second place, UCC-9 requires registration regardless of whether the assignment is outright or by way of security, whereas only assignments in security must be registered in the Register of Companies. This Commission has recommended that the current rule be abolished.³⁷

Floating charges

11.21 Floating charges – which are of particular importance for corporeal moveables and for receivables – must be registered in the Register of Companies. The rules are unsatisfactory from the standpoint of the publicity principle, and following the recommendations of this Commission,³⁸ Part 2 of the Bankruptcy and Diligence etc

³⁴ There are a number of qualifications to this remark. There is the floating charge, the ship mortgage and the aircraft mortgage. There is the agricultural charge under the Agricultural Credits (Scotland) Act 1929. There are the maritime hypothecs (also called maritime liens), and there is the landlord's hypothec.

³⁵ And LLPs etc.

³⁶ Companies Act 2006 Part 25. To be precise, what is registered is a separate document called the "particulars".

³⁷ *Report on Registration of Rights in Security by Companies* (Scot Law Com No 197 (2004)) para 3.25.

³⁸ *Report on Registration of Rights in Security by Companies* (Scot Law Com No 197 (2004)) para 3.25.

(Scotland) Act 2007 sets up a new Register of Floating Charges. It is a matter of regret that this has not yet been brought into force. Floating charges are discussed elsewhere.³⁹

³⁹ Chapters 9 and 22.

Chapter 12 To what extent is the facilitation of moveable security desirable?

Introduction

12.1 The traditional view is that rights in security benefit both creditors and debtors. Thus Roman law: "A security is given for the benefit of both parties: of the debtor in that he can borrow more readily, and of the creditor in that his loan is safer."¹ Thus security will release loans that would otherwise have been unavailable, and even where loan finance would have been available anyway, security will reduce the interest rate. To some extent this is clearly true: as for interest rates, a comparison of credit card interest rates with mortgage interest rates illustrates the point.² But whilst this traditional view remains the dominant one, it is not unquestioned.

The Modigliani-Miller theorem

12.2 In the first place, the Modigliani-Miller theorem,³ also called the capital structure irrelevance principle, is that, subject to certain conditions, a business's value is independent of its debt/equity capital ratios. In other words, it does not make a difference whether a business is financed by debt capital or by equity capital. Of course, as with all economics, the "subject to certain conditions" proviso is important. But in broad terms, the theorem indicates that if the law is changed to make it harder for businesses to raise debt capital, the effect of that change should (subject to certain conditions) be economically neutral. Conversely, if the law is changed to make it easier for businesses to raise debt capital, again the effect should (subject to certain conditions) be economically neutral. What is important is that finance be available to businesses. Whether that finance takes the form of debt or equity does not (in theory) matter. The theorem thus raises some doubt about whether the facilitation of secured transactions should have economic benefit, for the aim of the facilitation of secured transactions is the facilitation of debt finance.

12.3 One of the conditions for the applicability of the Modigliani-Miller theorem is ready access to capital markets. But small and medium-size enterprises typically do not have such access. This suggests that secured credit may be more important to such enterprises than to large ones. And indeed that is what practical experience suggests.

¹ "*Pignus utriusque gratia datur, et debitoris, quo magis ei pecunia crederetur, et creditoris, quo magis ei in tuto sit creditum.*" *Institutiones Justiniani* III, XIV, 4. "*Pignus*" here means security in the broad sense, rather than the narrow sense of possessory pledge.

² The economist Heywood Fleisig, one of the leading campaigners for legislation round the world, and especially in less developed countries, to introduce UCC/PPSA-type security, has written: "In most transitional and developing economies, instituting a modern system of secured transactions would probably reduce the cost of financing movable equipment to a few hundred basis points over government dollar borrowing rate." See his "Economic Functions of Security in a Market Economy" in J Norton and M Andenas (eds), *Emerging Financial Markets and Secured Transactions* (1998) at p 34. Those who doubt this argue that the reasons for high borrowing rates in developing countries lie elsewhere, for instance in difficulties in obtaining court orders, difficulties in enforcing them once obtained, corruption etc.

³ F Modigliani and M Miller, "The Cost of Capital, Corporation Finance and the Theory of Investment" (1958) 48 *American Economic Review* 261. Both Franco Modigliani and Merton Miller won the Nobel Prize for their work in financial economics.

12.4 Of course, the theorem applies only where there is a choice between debt and equity. Companies have that choice. Consumers do not: they cannot issue equity. It is sometimes said that the same is true of businesses that are not incorporated, and that is true in a literal sense, but in Scotland and most other countries incorporation is reasonably quick and easy so that in substance all businesses have the option of equity.⁴ So debt has an importance for consumers that it does not have for businesses. Viewing security as a means of facilitation of debt finance, it follows that security rights have an importance for consumers that they do not have for businesses.

12.5 It is often asserted that credit is indispensable for modern business activity. But not only can businesses in theory finance themselves by equity as well as by debt; in practice many do exactly that.⁵

The law-and-economics debate

12.6 Another source of scepticism about the traditional view arose out of economic analysis in the late 20th century specifically addressed at security rather than at debt finance.⁶ In a nutshell, to quote Professor Schwartz:⁷

"If all creditors are informed, the secured creditor will charge a lower interest rate because it is secured, whereas the unsecured creditors will charge higher interest rates because the pool of assets available to satisfy their claims has shrunk. The debtor's total interest bill is thus unaffected by the existence of security."

12.7 This issue was vigorously debated mainly during the 1980s and 1990s.⁸ The vigour of the debate has since waned somewhat, not because there has been a final resolution of the issues, but rather because of exhaustion. The fact is that businesses often do enter into secured transactions. If one takes the view that what happens in business practice must be economically efficient, then secured debt must be efficient, and the intellectual problem is to show why. But if one does not assume that business practices are *necessarily* efficient, the "puzzle of secured debt" (as it has come to be known) is one of real substance.

⁴ There are minor qualifications, such as businesses that are forbidden by their professional rules to issue external equity. (For law firms the position is about to change, following the Legal Services (Scotland) Act 2010.)

⁵ For example, the Bank of England reports that "26% of SQCs currently have no borrowings". ("The financing of smaller quoted companies: a survey" in 2004 *Bank of England Quarterly Bulletin* 160 at 164.) "SQC" means smaller quoted company.

⁶ "When the newly minted discipline of Law and Economics met the institution of secured credit in the late 1970s, they fell in love." Lynn M LoPucki, "The Unsecured Creditor's Bargain" (1994) 80 *Virginia Law Review* 1887 at 1889.

⁷ Alan Schwartz, "Security Interests and Bankruptcy Priorities: A Review of Current Theories" (1981) 10 *Journal of Legal Studies* 1 at 7 to 8.

⁸ Gerard McCormack, *Secured Credit under English and American Law* (2004) has a useful overview in ch 1, with references. The same is true of John Armour, "The Law and Economics Debate about Secured Lending: Lessons for European Lawmaking?" in Horst Eidenmüller and Eva-Maria Kieninger (eds), *The Future of Secured Credit in Europe* (2008). McCormack (p 3) comments that "the 'efficiency of secured credit' debate has become something of a veritable cottage industry in the US. The literature is truly enormous and a lot of contributions seem to consist of assertions or attempts to demonstrate that most previous contributions to the debate have been flawed." Michael Bridge comments on the "voluminous literature" whose "unifying characteristic, apart from the polemical tone of the debate, is its resolute concentration upon matters theoretical and a refusal or at least a marked disinclination to look at the empirical evidence." (Michael Bridge, "The English Law of Security" in Eva-Maria Kieninger (ed), *Security Rights in Movable Property in European Private Law* (2004) at p 83.) There is much truth in this, though it may be said that one of the problems is that the empirical evidence is not self-interpretative.

12.8 Some scholars have gone further and not merely doubted the economic benefits of secured transactions, but claimed that they are actually economically inefficient. Thus Hudson has argued that banks which can conveniently lend on a secured basis "will inevitably be led into making loans that, from the point of view of the economy as a whole, cannot be justified and result in a misallocation of resources."⁹ LoPucki has written: "Security tends to misallocate resources by imposing on unsecured creditors a bargain to which many, if not most, of them have given no meaningful consent ... Security enables secured creditors and debtors to extract a subsidy from those who involuntarily become unsecured creditors....The deceptive nature of security enables secured creditors and debtors to extract a similar subsidy from relatively uninformed unsecured creditors who predictably miscalculate their likelihoods of recovery."¹⁰ The Roman lawyers were right, according to this analysis, in saying that security benefits both parties, but the benefit is balanced by loss to third parties, and the result is not merely no net benefit, but actual overall loss, because the institution of security makes possible transactions which, absent security, would not have taken place, and which, because of their inherently cost-externalising nature, represent an inefficient allocation of resources.¹¹

12.9 The fact that there is a market demand for security does not of itself prove that security is desirable. There is a market demand for many things that are thoroughly undesirable, and indeed one of the necessary functions of law is to stop people doing what they would otherwise do. It is often said that the policy of legislation in commercial law should be a policy of enablement and facilitation, a policy of making things possible, and a policy of driving down transaction costs. That is true but it is not the whole picture.

Moveables and immoveables

12.10 As useful collateral, there is a difference between moveables and immoveables. The lifespan of immoveables is normally open-ended. But equipment declines sharply in value in the course of a few years, while inventory (stock) often has a very brief lifespan. And at the risk of stating the obvious, immovable property is immovable, but moveable property is moveable, with the result that a creditor seeking to sell non-possessory moveable collateral has to find it first – the "first catch your hare" issue. And whilst the identity of immovable property is never in doubt, so that a creditor can always say "this is the land/building earmarked as my collateral", the identification through time of moveable property may be problematic, even if it is still in the hands of the debtor. One sack of barley or one machine component or one barrel of oil may not be distinguishable from another. (Of course there are

⁹ John Hudson "The Case against Secured Lending" (1995) 15 *International Review of Law and Economics* 47 at 61.

¹⁰ Lynn M LoPucki, "The Unsecured Creditor's Bargain", (1994) 80 *Virginia Law Review* 1887 at 1891. This is the article that contains (p 1899) the celebrated remark: "security is an agreement between A and B that C take nothing."

¹¹ On the other hand, it must be acknowledged that important categories of unsecured creditor obtain other forms of protection. Thus statutory preferences exist in favour of Revenue and Customs and employees, and those with delictual claims are protected by the Third Parties (Rights against Insurers) Act 2010. Suppliers of goods can protect themselves by using retention of title, a quasi-security device; this is not, of course, available to suppliers of services. It should also be borne in mind that most businesses, once established, do not become insolvent, but most businesses do borrow, and the availability of security enables them to obtain cheaper credit. Finally, the availability of security, including quasi-security, operates to benefit those with a long term commitment to the business, notably banks and other providers of finance and long-term suppliers.

important exceptions, such as motor vehicles and most intellectual property rights.¹² These are re-identifiable, though the "first catch your hare" problem still exists.)

The Central Research Unit Report

12.11 In 1999 the Justice Minister made this announcement:

"The Scottish Executive recognises that there is a perception that businesses in Scotland are being inhibited in raising capital because, under Scots law, they cannot create a security over moveable property without giving up possession of that property. In addition, although the mechanism of floating charges is used extensively by companies in Scotland to obtain finance, it is thought to have some disadvantages. In certain circumstances, the floating charge holder may receive less than the debt owed to him. The Scottish Executive also acknowledges that this is an extremely complex issue. Consequently, the Scottish Executive has decided to commission research into the matter. This will determine the extent of problems faced by Scottish businesses."¹³

12.12 The result was the Central Research Unit's *Report on Business Finance and Security over Moveable Property*, published in 2002.¹⁴ It was an empirical enquiry into the extent to which the current law makes life difficult for small and medium-sized enterprises (SMEs). Its value is very high. Its overall conclusion was:¹⁵

"The perception that Scots law creates problems for SMEs has not been backed by systematic evidence. More specifically, when this study was commissioned there was little empirical evidence to support the suggestion that business finance is more difficult to obtain in Scotland because SMEs are unable to grant a non-possessory security over moveable assets, or that it is more difficult for unincorporated Scottish SMEs to obtain finance because they cannot grant a floating charge."

12.13 But the report recognised that ways of circumventing the law have been developed, such as retention of title in sale, hire purchase, finance leasing, the use of the trust device, and the creative use of international private law.¹⁶

"The availability of quasi-security financing, which in effect gives the creditor much the same protection as would a formal security, may have made the issue of the lack of availability of non-possessory security less important. An ability to grant a non-possessory security may have quite limited utility for both borrower and lender, at least in those circumstances where alternative forms of financing are available and appropriate for the business, and which give the creditor equivalent protection."

12.14 Hence it may be that the cases where the Scottish legal practitioner has to say "you can't do that here" are actually rather few. But that does not mean that there is no need for the law to be reformed. If people use the back door because the front door is so narrow, then there is a case either (a) for narrowing the back door too, or (b) for widening the front door.

¹² But IP rights have their own practical problems as collateral. See eg the chapters by Jacqueline Lipton and Iwan Davies in John de Lacy (ed) *The Reform of UK Personal Property Security Law: Comparative Perspectives* (2010).

¹³ Parliamentary Written Answer S1W-1719.

¹⁴ Prepared by Jenny Hamilton, Andrea Coulson, Scott Wortley and David Ingram.

¹⁵ Page 2.

¹⁶ Page 10/11.

12.15 There is also (c) the question of whether, if the front door is widened, the back door should be narrowed. In other words, if a system of non-possessory security is introduced, the question would arise as to whether retention of title, hire-purchase etc should cease to be competent (except as security interests), as is the position in the USA and the PPSA systems.¹⁷ This issue is discussed later.¹⁸

12.16 The debate continues. For example, John Armour has argued strongly for the economic benefits of secured transactions,¹⁹ while Joshua Getzler has argued that:

"The importance of ... secured lending may have been considerably overestimated by lawyers. The history of the late Victorian corporate and financial sectors significantly undermines the thesis that security over receivables and other circulating assets was essential for the health of the economy. Rather it was essential for the profitability of credit banking, and it may be that the law, by meeting the banks' sectoral needs through provision of the floating charge ... may have damaged the longer-term prospects of the economy."²⁰

12.17 English lawyers suggest that the development of the floating charge was a necessary development to support the rapidly developing economy of the late nineteenth century. The German equivalent of the floating charge²¹ developed at the same time, and is explained by German lawyers in the same way. But Scotland did not have the floating charge at that time, nor did the USA: in both it became possible only in the 1960s.²² Yet there was economic development in both countries.

Our position

12.18 The issues are complex, and the experts themselves are divided. We can offer no expert view. Nevertheless we have to adopt a position for the purposes of this law reform project. Although opinion is divided, "there seems to be a growing international consensus that secured credit is a general social and economic good."²³ As to the Modigliani-Miller theorem, we note that that theorem does not say that debt capital is bad, but only that (subject to conditions) it is not preferable to equity capital. Hence, looked at negatively, there is no reason why the law should not be reformed so as to make secured debt financing less difficult to set up. Businesses should be able to choose their debt/equity financing structure. If that choice is constrained by the law, the result may be economic inefficiency, while removal of such constraints cannot in itself be economically inefficient. In other words, the

¹⁷ To say that they are "incompetent" is in substance correct, but technically an oversimplification. If such devices are attempted, they are not void, but rather they are deemed, for the purposes of the legislation on secured transactions, to be grants of a non-possessory security interest. So if Jack sells to Jill purportedly subject to retention of title, the result is that, for the purposes of the legislation on secured transactions, Jill becomes the owner but Jack has a non-possessory security interest.

¹⁸ Chapter 21.

¹⁹ John Armour, "The Law and Economics Debate about Secured Lending: Lessons for European Lawmaking?" in Horst Eidenmüller and Eva-Maria Kieninger (eds), *The Future of Secured Credit in Europe* (2008); "Should we Redistribute in Insolvency?" in Joshua Getzler and Jennifer Payne (eds), *Company Charges: Spectrum and Beyond* (2006).

²⁰ Joshua Getzler, "The Role of Security over Future and Circulating Capital: Evidence from the British Economy Circa 1850 to 1920" in Joshua Getzler and Jennifer Payne (eds), *Company Charges: Spectrum and Beyond* (2006) at p 230-1.

²¹ The combination of the *Sicherungsübereignung* and the *Sicherungsabtretung*.

²² In Scotland, following the Companies (Floating Charges) (Scotland) Act 1961. In the USA as a result of the adoption of the UCC. The first state adoption was in 1954 (Pennsylvania) but general adoption took place in the 1960s.

²³ Gerard McCormack, *Secured Credit under English and American Law* (2004) p 18.

worst outcome of making secured transactions easier would merely be that there would be no overall economic benefit. The best outcome would be that there would be economic benefits. Heads, and the economy does not lose. Tails, and it gains.

12.19 In saying this, we do not mean that there can never be reasons to constrain business choices about debt/equity financing structures. For example, UK company law limits the ability of small businesses to raise equity capital by the "no offers to the public rule", so that businesses that wish to raise equity capital in that way have to adopt plc status.²⁴ Again, there are rules about the capital structures that banks must adopt.²⁵ But it seems to us that such considerations belong primarily to the field of regulatory law rather than private law, and it is with private law that this discussion paper is concerned.²⁶

12.20 As a working hypothesis we accept that security is generally speaking economically beneficial, albeit conscious that this view is a "not proven" one. The view remains the dominant one.²⁷

12.21 The working hypothesis is subject, however, to some provisos. In the first place, the economic analysis of security for *existing* debt – debt that has already been incurred - is different from the economic analysis of security for *new* debt. But the law does recognise this distinction, though perhaps not perfectly so. For if a debtor grants security for existing debt, and later becomes insolvent, that security can, subject to certain conditions, be set aside for the benefit of the general body of creditors.²⁸ This is a matter for insolvency law and is not covered in this project.

12.22 In the second place, the economic studies of the 1980s and 1990s showed that there is a case for protecting involuntary creditors against the effects of security interests. Involuntary creditors, such as the tax authorities, or the victims of delicts, are not in a position to bargain with their debtor. The law does recognise certain creditors as entitled to preferential treatment,²⁹ but the concept of "involuntary" creditor does not play a significant role and in any case, with one important exception,³⁰ there is no protection against security interests. Security interests trump even the preferential creditors, the one exception being the floating charge.³¹ But here too we consider that this is a matter for insolvency law and not for the current project.

²⁴ Companies Act 2006 s 755 ff.

²⁵ These derive ultimately from the Basel Capital Accords. See currently Directive 2006/48 and Directive 2006/49.

²⁶ The same point may be made about securitisation. This discussion paper proposes new rules that would make securitisations rather more straightforward as far as Scots law is concerned. Securitisations were an element in the financial crisis that broke in 2007. If there are problems about securitisations that need to be addressed by the law, it is regulatory law that is relevant.

²⁷ It is a view shared by development agencies such as the World Bank and the European Bank for Reconstruction and Development. For the outlook of these two banks see eg Frederique Dahan and John Simpson (eds), *Secured Transactions and Access to Credit* (2008). And see Heywood Fleisig, Mehnaz Safavian and Nuria de la Peña, *Reforming Collateral Laws to Expand Access to Finance* (2006, published by the World Bank, available online at <[http://www.ifc.org/ifcext/sme.nsf/AttachmentsByTitle/BEE+Collateral+Access+to+Finance/\\$FILE/Reforming_Collateral.pdf](http://www.ifc.org/ifcext/sme.nsf/AttachmentsByTitle/BEE+Collateral+Access+to+Finance/$FILE/Reforming_Collateral.pdf)>).

²⁸ Bankruptcy (Scotland) Act 1985 s 36; Insolvency Act 1986 s 243 and s 245. (And there are also certain common law rules.) Other countries have comparable rules. The ultimate source is the *actio pauliana* of Roman law.

²⁹ Bankruptcy (Scotland) Act 1985 sch 3 part 1; Insolvency Act 1986, s 175.

³⁰ The postponement of the floating charge to certain other claims: see below. Also to be mentioned here is the Third Parties (Rights against Insurers) Act 2010.

³¹ Insolvency Act 1986 s 40 (receivership); Insolvency Act 1986 s 175 (liquidation); Insolvency Act 1986 sch B1 para 65 (administration).

12.23 In the third place, even voluntary creditors cannot plan rationally in relation to security interests held by other creditors if such interests are hidden or latent and thus undiscoverable by ordinary diligence. The "publicity principle" calls for security interests to be overt, ie discoverable by third parties acting with ordinary diligence. This is a familiar theme for security over land, where the rule is that the security cannot affect third parties unless it is publicly registered. The same generally applies to security over moveables, though differences between land and moveables may mean that the publicity principle does not apply to the latter in quite the same way as it does to the former.

Fairness

12.24 Economic efficiency is not the only issue. Another is fairness. (Indeed, the two issues are nearly related.) There are those who argue that even if secured credit is efficient, it can be unfair. Unfairness needs to be considered from two points of view: that of the debtor and that of third-party creditors. In general security is not unfair to the debtor, because the assets put up as collateral would be available to creditors anyway, either by means of diligence or by means of an insolvency process. A risk of unfairness might arise if the law were to allow that assets that are exempt from diligence and insolvency could be used as collateral, which is why we later raise the possibility that the new moveable security should not be able to extend to such assets.³² Unfairness to other creditors is discussed above: we see this as being mainly a matter for insolvency law. One point not so far noted is that the Enterprise Act 2002 amended the Insolvency Act 1986 to provide for the "prescribed part", a sum to be taken out of the hands of a floating charge holder for the benefit of general creditors. This was a pure "fairness" rule.³³ It applies only as against the floating charge, whose all-encompassing nature has so often been regarded as unfair. Once again, we see this as a matter for insolvency law, and in this discussion paper we cannot address insolvency law. However, we do suggest that if a new moveable security is introduced, as we suggest, and if that security is capable of covering after-acquired property, in the manner of the floating charge, we think that it should be subject to the "prescribed part" regime.

³² Chapter 16. We also propose that, as in the UCC/PPSAs, security over future assets should not be allowed in consumer cases.

³³ Which has often been proposed in the USA and elsewhere, but not generally adopted.

Chapter 13 The UCC/PPSA approach

Introduction

13.1 In the USA, private law legislation is mainly a matter for the several states. But a system of "model laws" exists, which promotes a certain amount of uniformity, though it is for each state to decide whether to adopt a model law, and few model laws are so successful as to be adopted by all states. One model law that has achieved particular success is the Uniform Commercial Code (UCC), which is not merely a piece of legislation of high prominence in the USA, but one that has attracted interest worldwide. Two bodies (both independent of government) drafted it, and produce revisions from time to time, namely the National Conference of Commissioners on Uniform State Laws (NCCUSL) and the American Law Institute (ALI). Work began on the first draft in 1942, the model code was published in 1952, and state adoptions began soon thereafter. Eventually all states adopted it.¹ The UCC covers a wide range of law. For example the subject matters of the UK Sale of Goods Act 1979 and the Bills of Exchange Act 1882 are covered. Some areas that are in English and Scots law left mainly to the common law are put into codal form in the UCC, an example being Article 9,² which deals with security rights in moveable property, both corporeal and incorporeal.

13.2 The NCCUSL and ALI every now and again publish (jointly) recommended revisions to the UCC. In practice these are all adopted by the states. The most recent revision of Article 9, which was a major one, was published in 1999 and was adopted by all states in 2001. In this discussion paper we refer to the UCC in its current form.³

The PPSAs etc

13.3 Although the UCC as a whole has not proved a successful export, Article 9 has so proved. The jurisdictions that have adopted it have generally done so in statutes called the Personal Property Security Act.⁴ All the Canadian provinces have adopted PPSAs, except for Quebec, but even in Quebec the new civil code has provisions which in many respects follow UCC-9. New Zealand has done the same, and, more recently, so has Australia.⁵

¹ But Louisiana's adoption of the UCC has been subject to certain exceptions.

² The large-scale divisions of the UCC are called articles. For example, Article 2 is the equivalent of the UK Sale of Goods Act.

³ For accounts of UCC-9 from an external perspective see: Gerard McCormack, *Secured Credit under English and American Law* (2004); Harry Sigman, "Security in Movables in the United States" in Eva-Maria Kieninger (ed) *Security Rights in Movable Property in European Private Law* (2004); Harry Sigman, "Perfection and Priority of Security Rights" in Horst Eidenmüller and Eva-Maria Kieninger (eds), *The Future of Secured Credit in Europe* (2008).

⁴ In some jurisdictions, "Securities" rather than "Security".

⁵ For the history, see Anthony Duggan and Michael Gedy, "Personal Property Security Law Reform in Australia and New Zealand: the impetus for change", (2009) 27 Penn State International Law Review 655. We quote from pp 657 to 658 on how Australia eventually followed the New Zealand lead: "The then Commonwealth Attorney-General, Philip Ruddock, was to be the keynote speaker at a combined Queensland Law Society/Queensland Bar Association symposium in 2005. He arrived early and, to kill time, decided to sit in on one of the presentations currently under way. By chance, the presentation he walked in on was Professor [David] Allan making the case, again, for personal property security law reform. Allan's remarks captured Ruddock's attention and, at the end of the session, in an actualization of every academic's dream, Ruddock introduced himself,

Although the subject matter is, under the Australian constitution, a matter for the states, what happened was that all the states agreed, in the interests of uniformity, to a single Commonwealth (ie federal) statute. This was passed in 2009 and is expected to come fully into force later this year.⁶ The PPSAs are far from being carbon-copies of UCC-9, and moreover they vary significantly as between themselves. But they are like dialects of a single language.

13.4 The influence of UCC-9 has gone further. The European Bank for Reconstruction and Development published a Model Law on Secured Transactions⁷ which was aimed at helping the legal systems of the former Soviet bloc to develop a modern system of secured transactions. The model law was based on UCC-9, though departing from it much more than the PPSAs, not least because the model law was designed to operate in the matrix of legal systems that had civilian systems of property law, rather than systems derived from English law.⁸ The model law has had considerable influence in some of the former Soviet bloc states.

13.5 The DCFR in its Book IX has provisions on secured transactions which are inspired by the UCC/PPSAs and which indeed follow them rather more closely than does the EBRD Model Law.

13.6 The United Nations Commission on International Trade Law has published a "legislative guide", which is a set of recommendations to UN member states as to what their secured transactions law should be. It is very much based on the UCC/PPSAs.⁹

Codal approach

13.7 UCC-9 (and the PPSAs) has a fairly comprehensive set of rules about enforcement, priority etc. The legislation is thus close to being a code for moveable security.¹⁰ That includes the law of possessory pledge. Leading on from the last point, the approach of the UCC is to recognise only a single type of security right, albeit with different sub-types. In the context of the common law world this was a notable development, but is less so from a civil law standpoint. Civilian property law already has a unitary concept of a security right, with a general framework of rules about creation, priority and enforcement. That is not to say that codification would have no value, merely that the need for it is less pressing. For example, later we provisionally suggest the introduction into Scots law of a new type of security right over moveable property. We think that the legislation could be fairly brief, because the general framework of the law of rights in security would automatically apply.

Complexity

13.8 UCC-9 is complex.¹¹ For example, there are something like 30 different categories of collateral, including "accounts", "chattel paper", "consumer goods", "deposit accounts",

congratulated Allan on his presentation and invited him to address the Standing Committee of State and Commonwealth Attorneys-General ... "

⁶ Personal Property Securities Act 2009.

⁷ See further Appendix A.

⁸ The drafting of the EBRD Model Law is impressive, and to anyone with a civilian training it is more accessible than UCC-9 or any of the PPSAs.

⁹ See further Appendix A.

¹⁰ Voluntary security. Security arising by operation of law is not covered.

¹¹ The following remarks are for the most part applicable to the PPSAs as well.

"documents",¹² "equipment", "farm products", "general intangibles", "instruments",¹³ "inventory" and "investment property". This sort of complexity detracts from the qualities of UCC-9 as a model, but it should be stressed that much of UCC-9's complexity is non-essential. A system that broadly follows UCC-9 does not have to have such a multiplicity of categories of collateral. And in other respects too the UCC-9 approach would be capable of some simplification. For example, both the EBRD Model Law on Secured Transactions and the DCFR-IX are simpler and hence more readily understandable, while at the same time adopting, in broad terms, the general approach of the UCC.¹⁴

13.9 Some of the complexity results from the policy of "recharacterisation", especially because recharacterisation under the UCC is not complete, meaning that an asset is deemed to be vested in one person for some purposes and another for another.¹⁵ Some of the complexity derives from the fact that "security interest" is defined as including outright assignments.¹⁶

13.10 The drafters of the UCC did not like the US law¹⁷ of personal (= moveable) property. They thought "title" was an artificial and un-functional concept. The role of "title" is thus reduced to a minimum in Article 9.¹⁸ Instead, a set of functional rules is set out. This lies over the top of the underlying property law, like a tea towel laid over a pile of unwashed dishes. There is not much by way of integration. In the UCC there are, so to speak, two parallel systems in operation, namely general moveable property law and the law of the UCC, with the latter prevailing over the former to the extent of any inconsistency – which is to say, most of the time. An alternative approach would have been integration – to have reformed moveable property law so as to yield the desired results. That was not the choice. Whilst there may have been good reasons for this approach, it does make the UCC/PPSAs less exportable to jurisdictions where a coherent and unified system of property law is regarded as desirable and feasible.

13.11 This approach is one of the sources of complexity, at least to the eye of the outsider. But once again, it is not an essential complexity. The EBRD Model Law takes the objectives of Article 9 and applies them on the assumption that the matrix of general law is civilian. Thus in the EBRD Model Law, where X sells to Y with retention of title, Y acquires ownership, and X has a subordinate real right. To the civilian that makes conceptual sense. It shows that recharacterisation can be fitted in with a civilian system, and the result is actually simpler than in the UCC. We incline to think that the EBRD is more successful in this respect than the DCFR.¹⁹

Outright assignment

13.12 UCC-9 and the PPSAs are about security rights, or, to use their language, "security interests". Perhaps surprisingly, "security interest" includes any interest of ... a buyer of

¹² That is to say, documents of title.

¹³ That is to say, negotiable instruments.

¹⁴ For the EBRD Model Law and the DCFR see Appendix A.

¹⁵ For recharacterisation, see below, and also Chapter 21.

¹⁶ See para 13.12 below.

¹⁷ Strictly speaking each state has its own law, but they are all essentially the same in this respect, except for Louisiana. By "US" we here mean the laws of the various states other than Louisiana.

¹⁸ And elsewhere in the UCC, notably Article 2 (law of sale of goods).

¹⁹ The EBRD was explicitly designed for use in civilian systems. The DCFR was designed for use in any system.

accounts ...[or] a payment intangible."²⁰ So if Clement sells goods on credit to Dugald and then assigns the unpaid price to Archie, what Archie receives is a "security interest" even though the assignation is an absolute (outright) one. This provision is aimed at ensuring that the rules for assigning claims and for granting security over claims are the same, but the device of declaring the grantee to have a "security interest" in both cases tends to cause some confusion, including, at one stage, even to the US courts.²¹ Thus UCC-9 and the PPSAs cover outright assignation as well as security.

13.13 The current version of the UCC contains provisions making it clear that what the buyer of intangibles has is not really a security interest, even though it continues to be so named.²² The rule that assignments of receivables (etc) and security rights over receivables (etc) are to be created in the same way is a natural one, especially because the distinction between absolute assignments and security assignments can be hard to draw.²³ The overall result is that registration is usually necessary, regardless of whether the assignment is absolute or in security.²⁴ Notification plays no role in perfecting the transaction.

13.14 A complication is that the UCC rules about assignment do not apply to all types of claim. For example, if X lends \$10,000 to Y and then assigns the right to payment to Z, the UCC does not apply, and registration is not required.²⁵ Again, "an assignment of accounts or payment intangibles which does not by itself or in conjunction with other assignments to the same assignee transfer a significant part of the assignor's outstanding accounts or payment intangibles" is not registrable.²⁶ To an outsider, the existence of two sets of rules about outright assignment (registration necessary in some cases but not others) seems an unwelcome complexity, and indeed a departure from the UCC's functionalist outlook, for it is not easy to see why law about the assignment of a \$10,000 claim should vary in major ways depending on whether the debt arose because of a loan or because of a sale of goods.

13.15 Although an outright assignment is within the definition of "security interest", that fact engages only parts of the UCC/PPSAs. In particular, the rules about the enforcement of security interests do not apply to outright assignments, but only to assignments by way of security. Hence the reason, mentioned above, for a unitary treatment of the constitution of outright assignments and assignments in security, namely that they are hard to distinguish, is rather nullified by the UCC itself (and the PPSAs) because it itself requires precisely that distinction to be made.

13.16 Any legal system that says that assignation can be effected solely by agreement, without the need for any external act, has to have further rules protecting the account party who is unaware of the transfer, thus resulting in a "limping" transfer, which is effectual for

²⁰ UCC § 1-201. For definitions of these two terms see UCC § 9-102.

²¹ See notably *Octagon Gas Systems v Rimmer* 995 F 2d 948 (10th Circuit 1993).

²² UCC § 9-318.

²³ Nevertheless it sometimes has to be drawn. If an assignment is for the purpose of security, the UCC rules about enforcement (UCC-9, Part 6) apply. If not, they do not.

²⁴ By contrast, under Part 25 of the Companies Act 2006, an assignment of trade receivables by a company is registrable if it is by way of security but otherwise is not registrable. We understand that because it can be arguable whether an assignment is or is not to be regarded as a security assignment, in practice there is a good deal of "to be on the safe side" registration.

²⁵ Nor is notification. As for the rule in *Dearle v Hall* (see Appendix B), that is in force in some US states, but in others the simple priority rule (as in German law) has been adopted. Where the UCC applies, there is no room for the rule in *Dearle v Hall*, for UCC-9 has its own set of priority rules, which are based mainly on date of registration.

²⁶ UCC § 9-309.

some purposes but not for others. Where, as in the UCC/PPSAs, registration is an additional requirement for "perfection", the position tends to become more complex, for it must be borne in mind that intimation does not constitute perfection.

Moveable property only

13.17 UCC-9 covers moveables, corporeal and incorporeal. It does not touch land.²⁷ As already mentioned, this "but not land" approach is a fairly standard approach round the world in relation to security rights that can cover after-acquired assets. The floating charge is the exception.

Not tied to corporate law

13.18 In the UK, the law of rights in security is linked with corporate law in two ways. In the first place, the floating charge can be granted only by companies and certain other entities.²⁸ In the second place, most types of rights in security granted by debtors that are companies or LLPs must be registered in the Companies Register, this requirement being over and above any other requirement of law. Thus for example if a natural person grants a standard security, one registration is required, in the Land Register, but if a company grants a standard security, two registrations are required, one in the Land Register and the other in the Companies Register.²⁹ Neither of these links with corporate law exists in the UCC/PPSAs.³⁰

The crystallised/uncrystallised distinction

13.19 The crystallised/uncrystallised distinction to be found in the law of floating charges has no parallel in UCC-9. In the terminology of English law, a security interest is born "fixed". This brings with it a gain in terms of conceptual simplicity.

The attachment/perfection distinction

13.20 UCC-9 distinguishes "attachment"³¹ and "perfection". As a result of the influence of the doyen of English commercial law, Sir Roy Goode, this distinction is now widely adopted in England and Wales, not only by academics but also by practitioners, though not universally so, and it has not yet reached the statute book.³² The distinction, or something like it, has unsurprisingly been adopted in most systems deriving from UCC-9, including the DCFR, where "attachment" is called "granting"³³ and "perfection" is called "effectiveness as

²⁷ Except in so far as moveables have been attached to land (ie fixtures). But certain PPSAs, such as New Zealand, do not include fixtures.

²⁸ For floating charges, see Chapter 9.

²⁹ For the company charges registration scheme, see Chapter 8. A copy of the "instrument of charge" (ie the whole security document) must also be retained in the company's internal statutory register: Companies Act 2006, s 890.

³⁰ Though in the UCC/PPSAs there are some restrictions on the power of consumers to grant security.

³¹ The US meaning of this term has no connection with "attachment" as used in the Scottish legislation on floating charges, ie crystallisation.

³² But it can be found in the English-language version of the Financial Collateral Directive. See Chapter 2.

³³ DCFR IX-2:106.

against third persons".³⁴ An exception is the EBRD Model Law, which did not adopt the attachment/perfection distinction.³⁵

13.21 UCC-9 says that "a security interest attaches to collateral when it becomes enforceable against the debtor with respect to the collateral."³⁶ This might suggest that attachment happens when the security agreement is entered into. But that is not so. UCC-9 contemplates a three-stage process,³⁷ though those stages may be telescoped in practice.³⁸ The three stages are agreement, attachment, and perfection. Priority depends (subject to certain exceptions) on perfection.

13.22 Agreement means contract. A security interest is said to be "attached" when it is effective between the parties³⁹ and "perfected" when it is also effective against third parties.⁴⁰ There are some puzzles about the drafting. For example, UCC § 9-201 says that "except as otherwise provided ...⁴¹ a security agreement is effective according to its terms between the parties, against purchasers of the collateral, and against creditors." This seems to confer third party effect even without attachment, let alone perfection. A similar puzzle exists in some of the systems inspired by UCC-9⁴² but not all such systems.⁴³

13.23 An attached but unperfected security interest has no effect against most third parties.⁴⁴ In one UCC-9 type system, that of New Zealand, there is an important exception not to be found elsewhere. In New Zealand (as elsewhere) such a security interest is of no effect against *purchasers*.⁴⁵ Nor has it any effect against creditors carrying out *execution*⁴⁶ against the property that is subject to the security interest.⁴⁷ The difference emerges if insolvency proceedings are opened against the debtor. The UCC rule is that an unperfected security interest is of no effect in such proceedings. But in New Zealand it does have effect, though its ranking will be postponed to perfected security interests in the same collateral, even though later in date.⁴⁸ (This New Zealand rule of "not effective against purchaser or against executing creditors but good in insolvency" has a parallel in Scots law: here the

³⁴ DCFR IX-3:101.

³⁵ For the EBRD Model Law, see Appendix A.

³⁶ UCC § 9-203(a).

³⁷ UCC § 9-203(b) sets out the requirements before attachment can happen. For parallel rules in the DCFR see DCFR X-2:106. (Actually UCC § 9-203(b) speaks of enforceability "against the debtor *and third parties*" which is odd because the provision is about attachment not perfection. But in logic it seems not wrong, because the provision is framed in the negative: if a security interest is unattached it does indeed follow that it is unperfected.)

³⁸ These stages are mirrored in many of the UCC-influenced systems, such as the New Zealand PPSA: see s 35 (agreement), s 40 (attachment) and s 41 (perfection). The Australian PPSA is another example: see sections 18 to 22.

³⁹ UCC § 9-203(a): "A security interest attaches to collateral when it becomes enforceable against the debtor with respect to the collateral." There can be a concluded security agreement without attachment, for attachment calls for certain requirements over and above agreement. These requirements are set out in UCC § 9-203.

⁴⁰ The UCC does not seem to state this expressly, but this is the point of the concept.

⁴¹ That is to say, as otherwise provided in the UCC.

⁴² For example, the Saskatchewan PPSA s 10(1) contemplates enforceability against third parties without attachment, let alone perfection. The same is true of s 36 of the New Zealand PPSA.

⁴³ For example the EBRD and the DCFR. The same seems to be true of the Australian PPSA: see s 20.

⁴⁴ For exceptions, see next paragraph.

⁴⁵ In UCC-9-type systems, purchasers from the debtor generally take subject to a perfected security interest. But there are certain exceptions.

⁴⁶ In Scottish terminology, diligence.

⁴⁷ In UCC-9-type systems, executing creditors take subject to a perfected security interest.

⁴⁸ See Michael Gedye, Ronald C C Cuming and Roderick J Wood, *Personal Property Securities in New Zealand* (2002) p 8. On this issue the Australian legislation follows the mainstream UCC/PPSA tradition rather than the New Zealand rule. See s 266 of the Australian Act.

floating charge is subject to a rather similar rule.) Thus "unperfected" does not have quite the same meaning in New Zealand as in other UCC-9 type systems.

13.24 Although perfection is generally explained in terms of third party effect, in the UCC itself mere attachment can in some cases have third party effect. An attached but unperfected security interest is, it seems, effective against a donee, and also against a buyer who (a) is not in good faith and (b) is not a buyer in the ordinary course of business.⁴⁹

13.25 The rule just mentioned means that attachment, without perfection, does create a sort of real right. But this rule does not, however, seem to be followed by all the UCC-9-type systems. For example, it does not appear in the DCFR.

13.26 The idea of a security interest that has broader or narrower third-party effect according to what stage of development it has reached (attached only, or attached and perfected) adds a considerable degree of complexity to the law, and it may be doubted whether that extra complexity has sufficient countervailing value. It may be thought simpler to have a rule that a security right either exists – in which case it has the third party effect defined by law – or it does not, in which case it has failed to achieve third party effect. That simpler approach is adopted in the EBRD Model Law, and it has always been the Scottish approach: for example an unregistered standard security does not have a limping third party effect. An unregistered standard security has no third party effect.

13.27 The idea of a security interest that lacks effect against third parties, is an odd one. The point of a security right lies in its third party effect. It is only because of the third party effect that the parties to the deal wish to add a security right on to their contract. After all, it is not as if it were unenforceable against the debtor's assets *unless* backed by a security.⁵⁰ It is precisely because the parties want something that is *not* merely effective "as between the parties" that security is used.

13.28 Having said that, the idea of an attached but unperfected security interest is not wholly devoid of meaning. The creditor can use the enforcement methods appropriate to that security, as an alternative to diligence, and that may be an attractive option. Diligence can be slow. And it may be that there are assets that are exempt from diligence but not from security. Moreover, as noted above, UCC-9 and the PPSAs confer on an unperfected security interest a very limited degree of third party effect.

13.29 Our provisional view is that the attachment/perfection distinction should not be adopted into Scots law. The traditional approach of our law is that a security right is either effective or not effective. That approach has the merit of extreme simplicity. The attachment/perfection distinction adds greatly to the complexity of a system of security interests, without, we suggest, countervailing benefits. We incline to think that it may exist in the "common law" systems because of the long-standing tradition in those jurisdictions that it

⁴⁹ This limited effect of an unperfected security interest emerges from UCC § 9-317(b) read with UCC § 9-330. On this point see Harry Sigman, "Perfection and Priority of Security Rights" in Horst Eidenmüller and Eva-Maria Kieninger (eds), *The Future of Secured Credit in Europe* (2008), at p 147.

⁵⁰ Debts are enforceable by diligence, and through an insolvency process. The contrary belief is widespread misconception, even among those who should know better. "YOUR HOME IS AT RISK IF YOU DO NOT KEEP UP REPAYMENTS ON A MORTGAGE OR OTHER LOANS SECURED ON IT" say the advertisements. But the same is true for any loan, even unsecured, and the statement thus misleads the public by implying the contrary.

should be competent to create a proprietary agreement by consent, without any external act, a tradition very different from our own.

4. Do consultees agree that Scots law should not adopt the attachment/perfection distinction in any of its various forms?

Modes of perfection

13.30 Perfection can be by means of registration. But in some cases perfection is achieved solely by attachment. The classic example is possessory security, such as pledge of goods to a pawnbroker.⁵¹

The range of third party effect

13.31 At this point some discussion is appropriate about the *range* of third-party effect of a security right. Security is defined by its third-party effect. But there can be different classes of third party, and a security does not necessarily prevail against them all. If a new regime of security rights in relation to moveable property is to be set up, an important area of policy in relation to which decisions will have to be made is the range of third party effect.

13.32 Some security rights have full effect. A standard security is an example. It prevails against (a) someone who buys from the debtor, even if unaware of the security,⁵² and even if the sale is in the ordinary course of the debtor's business.⁵³ (But the security does not prevent the sale.⁵⁴) It prevails against (b) creditors of the debtor who execute diligence against the land. If (c) the owner grants a subsequent security, the first prevails over – ranks in priority to – the second. And (d) in the event of an insolvency process the standard security is good against the liquidator, trustee in sequestration etc.

13.33 At the other extreme is the floating charge. A floating charge (a) does not prevail over a buyer. Sale discharges the charge in relation to the asset sold. (b) A floating charge is defeated by the "effectually executed diligence" of other creditors.⁵⁵ (c) A floating charge sometimes does but sometimes does not prevail over subsequent security rights.⁵⁶ (d) In an insolvency process it is subject to (i) preferential creditors and (ii) ordinary unsecured creditors to the extent of the "prescribed part".

13.34 An enactment on security rights can define the range of affected third parties. As was seen above, the UCC itself gives effect to an attached but unperfected security interest as

⁵¹ See UCC § 9-309 and § 9-313.

⁵² Since standard securities appear on the Land Register, such ignorance would happen only in exceptional cases.

⁵³ In the case of land, sale in the ordinary course of business would apply to a company that develops land and sells it off in individual units. But of course sale in the ordinary course of business is much commoner in the case of moveable property.

⁵⁴ The general principle of the law is that security does not invalidate a transfer. It means, rather, that the security is unaffected by the transfer. But the buyer's title is encumbered by the security. This does not mean that the buyer is personally liable for the secured debt. Personal liability remains unchanged: the seller remains liable and the buyer does not become liable. Real liability (the liability of the asset to be realised to meet the debt) remains unchanged. So if the debt is not paid, the creditor can enforce the security.

⁵⁵ Companies Act 1985 s 463; Insolvency Act 1986 ss 55 and 60; Bankruptcy and Diligence etc (Scotland) Act 2007 s 45.

⁵⁶ See s 464 of the Companies Act 1985 and, prospectively, Part 2 of the Bankruptcy and Diligence etc (Scotland) Act 2007.

against a tiny class of third parties. And even a perfected security interest is sometimes ineffective against certain third parties.

Protecting buyers

13.35 The debtor may be allowed, by the contract, a right to alienate assets free of the security. And even if the contract does not so provide, in some cases a buyer of such assets will be protected anyway. Indeed, this is the basic rule. We quote the UCC:⁵⁷

"(a) Except as otherwise provided in subsection (e),⁵⁸ a buyer in ordinary course of business,⁵⁹ other than a person buying farm products from a person engaged in farming operations, takes free of a security interest created by the buyer's seller, even if the security interest is perfected and the buyer knows of its existence.

(b) Except as otherwise provided in subsection (e), a buyer of goods from a person who used or bought the goods for use primarily for personal, family, or household purposes takes free of a security interest, even if perfected, if the buyer buys (1) without knowledge of the security interest; (2) for value; (3) primarily for the buyer's personal, family, or household purposes; and (4) before the filing of a financing statement covering the goods."

13.36 Thus if there is a non-possessory security interest and the debtor sells, the buyer will in most cases take a title free of the security interest. (But the security interest will typically be shifted to the proceeds of sale.⁶⁰) That makes the security a rather weak one, but of course much the same is true of the floating charge.⁶¹

Security over after-acquired assets – floating liens

13.37 Security over after-acquired assets is allowed, except in relation to consumer goods.⁶² A security interest may secure future debts.⁶³ Here too one sees parallels with the floating charge, though the "consumer" issue is handled not (as with the floating charge) through the identity of the debtor (corporate or not corporate) but rather through the nature of the collateral. Where a security interest covers after-acquired moveable assets in general, thus including both corporeals and incorporeals such as receivables, it is commonly known as a floating lien.⁶⁴ In functional terms a floating lien is similar to a floating charge, except that it does not cover land. But its internal logic is very different, mainly because it does not use the concept of crystallisation. The term "floating lien" is not used in the legislation, because (unlike a floating charge) it is not a distinct type of security right. It is simply a

⁵⁷ UCC § 9-320.

⁵⁸ Subsection (e) is about possessory security interests. In other words if Jack pledges goods to Jill and then sells them to Tim, Tim does not take free. Of course in such a case Jack has not delivered the goods to Tim, because Jill has them.

⁵⁹ This formulation is perhaps misleading, for what is meant is a person who buys in the ordinary course of the *seller's* business.

⁶⁰ UCC § 9-203(f).

⁶¹ The position in German law is broadly similar.

⁶² UCC § 9-204. "(a) Except as otherwise provided in subsection (b), a security agreement may create or provide for a security interest in after-acquired collateral. (b) A security interest does not attach under a term constituting an after-acquired property clause to: (1) consumer goods, other than an accession when given as additional security, unless the debtor acquires rights in them within 10 days after the secured party gives value; or (2) a commercial tort claim."

⁶³ UCC § 9-204(c).

⁶⁴ Here the word "lien" is being used differently from its use in Scots law. In Scots law the word "lien" is confined to possessory securities (except for maritime liens).

security right that happens to have been used to its maximum capacity. The subject of floating liens is returned to in Chapter 22.

Floating charges and the PPSAs

13.38 The floating charge never existed in the USA.⁶⁵ But it did exist in all the jurisdictions that adopted the PPSAs. When those jurisdictions adopted their PPSAs, the legislation did not abolish the floating charge.⁶⁶ But that does not mean that the floating charge survived. The all-embracing nature of the PPSAs meant that the floating charge could not survive. If a debtor now purports to grant a floating charge, that is not void, but takes effect as a PPSA security interest – a floating lien. For example, of New Zealand law it has been said: "Although parties are still free to use a floating charge form of security agreement, this will not have the effect of invoking the old floating charges law. The agreement will instead be governed by the PPSA. The notion of crystallisation has no counterpart under the Act, nor is there any equivalent to the non-specific pre-crystallisation state of existence."⁶⁷

Registration

13.39 The system of registration is called "notice filing". The security agreement itself is not registered. What is registered is a second document, the "financing statement". It contains only the barest information. The registration can happen before or after the security agreement is entered into. Thus the date of perfection may not match the date of registration. Whilst both parties have to agree to the registration of the financing statement, the debtor does not sign it.⁶⁸ Critics say that this opens the door to wrongful registrations. Defenders of the rule argue that it is unrealistic for registry officials to be expected to verify the genuineness of signatures.

13.40 We quote Professor Sigman, one of the leading experts on UCC-9:⁶⁹

"The UCC Article 9 filing system's primary purpose is to provide a simple, inexpensive, easy-to-use and speedy perfection mechanism, compatible with efficient commercial practices, that plays a key role in the priority regime. It also performs two other important functions. First, it supports due diligence on the part of a prospective supplier of credit... It exists to provide warning of the need for further investigation, rather than as the source of data. Second, the filing system also provides a *data certa* to prevent back-dating, without the need for notaries or other expensive formalities. It is equally essential to understand *what filing is not*. It does not create a security interest – that is done by the security agreement... Filing does not evidence the existence of a security interest – indeed, filing of the financing statement may occur even before a security agreement has been entered into. Filing, by itself, does not perfect a security interest. Filing can occur before or after the security interest is

⁶⁵ Before the UCC, nothing like the floating lien or floating charge was possible in the USA: *Benedict v Ratner* 268 US 353 (1925). (A decision about New York law, but accepted in other states too.) For the pre-UCC law see Grant Gilmore, *Security Interests in Personal Property* (1965), one of the classic works on commercial law.

⁶⁶ In those jurisdictions, as in England (but not Scotland), the floating charge was non-statutory, so the question of clearing it off the statute book did not arise.

⁶⁷ Michael Gedye, Ronald C C Cuming and Roderick J Wood, *Personal Property Securities in New Zealand* (2002) para 40.6, and see also pp 10 to 13 of that work. In Canada, the case chiefly cited on this subject is *Royal Bank of Canada v Sparrow Electrical Corporation* [1997] 1 SCR 411. See further Catherine Walsh, "The Floating Charge Is Dead; Long Live the Floating Charge - A Canadian Perspective on the Reform of Personal Property Securities Law" in Agasha Mugasha (ed), *Perspectives on Commercial Law* (1999).

⁶⁸ UCC § 9-509.

⁶⁹ Harry Sigman, "Perfection and Priority of Security Rights" in Horst Eidenmüller and Eva-Maria Kieninger (eds), *The Future of Secured Credit in Europe* (2008), at pp 151 to 152. We return to this passage in Chapter 20.

created, before or after there is a security agreement, before or after the grantor has any rights in the collateral, even before any collateral comes into existence. Filing does not establish the existence of (or provide any information about) a secured claim Filing does not establish the existence of the described collateral or that the grantor has or ever will have any rights with respect to it... A filed financing statement is not connected to any particular transaction or any particular security agreement ... [Filing] is essentially a warning ... a form of advertisement; it indicates only that a security interest may then or thereafter exist in assets that fall within the description provided".

13.41 In the UCC, registration lasts five years whereupon it lapses, unless renewed before the expiry of the five-year period. This is a "decluttering" rule intended to ensure that the register does not become choked with spent entries that have never been formally discharged. The DCFR and New Zealand rules are similar.⁷⁰ In the Canadian PPSAs the rule is that the length of time that an entry may potentially remain on the register is determined by the applicant at the time of registration, with the registration fee varying according to the length of registration requested.⁷¹ In Australia, entries lapse after the shorter of the duration specified in the financing statement or (i) seven years for consumer property or property described by a serial number, or (ii) 25 years in other cases.⁷²

Priorities

13.42 A criticism often made of English law is that the rules about the ranking (priority) of secured transactions over personal property are complex, difficult to discover, and sometimes uncertain, and those who favour the introduction of a UCC/PPSA-type system into English law make this one of their arguments, for the UCC/PPSAs aim at a comprehensive statutory set of rules about priority. The UCC/PPSAs have as their basic rule that priority should be the date of perfection, but there are many qualifications, one of which is the PMSI, noted below.

13.43 We will not here set out the rules, which in any event vary slightly between the systems, but would note one feature, common to all, which seems to us unsatisfactory. In the UCC/PPSAs registration may precede creation. Yet the priority point is the date of registration, not the date of creation. Thus a security can be created with retroactive effect.⁷³ This approach applies both to assignments and to security rights. This approach seems to us self-evidently undesirable.

Recharacterisation and PMSIs

13.44 One of the notable features of the UCC/PPSAs is that retention of title in sale, hire purchase, and certain moveable leases, are "recharacterised", ie regarded as being transfers of title subject to a reservation of a security interest. This subject is examined further in Chapter 21. But one consequence of recharacterisation may usefully be noted here. Suppose that X grants security to Y over both present and after-acquired assets. And suppose that later Z sells goods to X on credit terms, reserving title (ownership) until

⁷⁰ Section 153(1) of the New Zealand PPSA provides for lapse after 5 years or earlier if so specified in the filing statement. The DCFR is the same: DCFR IX-3:325(1) (as read with 3:307(b)).

⁷¹ For example, Ontario PPSA s 51(1), and Saskatchewan PPSA s 44(1) (and Personal Property Security Regulations 1993 reg 4).

⁷² Australian PPSA s 153.

⁷³ This approach is most clearly set out in the DCFR: see DCFR IX-4:101(2)(a) (security) and DCFR III-5:114(2) (assignment).

payment. Under current Scots law, Y's security would be a floating charge, and Z would be protected against Y because the effect of the retention of title would be that the goods would not belong to X until they have been paid for. But the effect of recharacterisation is that Z has a mere security interest, which, being later in time, is trumped by Y's. Because this is regarded as unfair, the UCC/PPSAs have a special rule which seeks to reverse the consequences of recharacterisation by providing that a "purchase money security interest" (PMSI) has superpriority. However, PMSI superpriority is subject to procedural rules which in practice mean that it is not attained. In particular, it is a condition of the UCC that "the purchase-money secured party sends an authenticated notification to the holder of the conflicting security interest" before the debtor obtains possession.⁷⁴

⁷⁴ UCC § 9-324.

Chapter 14 Outright assignation: reform options

Introduction

14.1 This chapter considers reform options for outright assignation. But if, as we propose, it should continue to be competent to assign rights for the purpose of security (assignation in security), the reform options considered in this chapter would also apply to assignations in security.

Scope

14.2 For certain types of incorporeal moveable property there exist special rules about transfer. This is true in particular for negotiable instruments, for intellectual property rights and for company shares. This project would not touch the transfer of such types of property. Such asset types are, however, not excluded from the *security* side of this project. That issue is discussed later.¹

Negotiable instruments

14.3 One of the puzzles of modern commercial practice has been that negotiable instruments are less used than one might expect. Debt that is embodied in a negotiable instrument is assignable without the need for intimation (or registration), and the assignee takes free from defences by the account debtor. It is true that much of the debt that is securitized could not readily be put into negotiable form.² But debt factoring often involves commercial debt that could readily take negotiable form. Yet whilst bills of exchange, and to a much lesser extent promissory notes, are often used in international sales,³ nowadays they are seldom used in domestic sales.⁴ We cannot explain the under-use of negotiable instruments in modern commercial practice, and indeed suspect that there is some market irrationality involved. It is certainly curious that the general law of assignation is sometimes regarded as less than satisfactory because of the nuisance of having to intimate when the law already provides a system of assignation without intimation.⁵ It is sometimes supposed that bills of exchange are simply payment devices. They can be so used, but they can also

¹ Chapter 19.

² In the USA, but not generally elsewhere, mortgage loans involve the use of a promissory note signed by the mortgagor. But such notes are subject to such conditionalities that it seems doubtful whether they would be regarded as truly negotiable in Scotland or elsewhere in the UK. More generally, there may be public policy objections to the use of negotiable instruments to document consumer debt, in as much as negotiability will normally disable an account debtor from pleading defences against a transferee. For the UK see Consumer Credit Act 1974 s 123.

³ It is sometimes supposed that they have been superseded by documentary credits. That is not so: documentary credits themselves commonly use bills of exchange.

⁴ Cheques are sometimes used, but far less than formerly. And since the Cheques Act 1992 they are seldom negotiable.

⁵ It is true that the main corpus of legislation, the Bills of Exchange Act 1882, is out of date. Almost all other member states of the EU enjoy more modern legislation, as does the USA, and as do most other countries round the world. But the current law, though needing an overhaul, is still serviceable.

be used as credit devices, and are commonly so used. This is the basic distinction between sight bills (bills payable on demand) and time bills (bills payable at a future date).

14.4 We merely note the position. That negotiable instruments are today under-used is, of course, not a reason for not reviewing the general law of assignation.

Completing title: dispense with any external act?⁶

14.5 Should Scotland adopt the system that exists in many countries,⁷ whereby transfer is *solo consensu*, ie no external act is required? (By external act is meant an act external to the cedent and assignee themselves.) The fact that the DCFR takes this approach must have considerable weight.⁸

14.6 One argument in favour of this approach is what is regarded as the sheer inconvenience of notification, especially in bulk transfers, for example in factoring and securitizations.

14.7 One counter-argument that would suggest that abolition of the intimation requirement is pointless is that the assignee is normally going to have to intimate *anyway*, because without intimation it will not be possible to collect the debt from the account debtor. (In this chapter we are dealing only with outright assignments, not assignments in security.) So the requirement to intimate is not an onerous one. But this argument, whilst it has some force, is not conclusive. In many commercial arrangements, such as securitisations and invoice discounting, the parties wish X to sell receivables to Y but for X to continue to collect, remitting the proceeds to Y.

14.8 The idea that a claim can be transferred solely by a private act between the parties could also be questioned as being contrary to the publicity principle – the principle that an act that affects third parties should be somehow made public, so that it is discoverable by third parties.⁹ That principle is a sound one. Whether it should apply to outright assignments is open to debate. If Jack owns land and then transfers to Jill, it is clearly right that the transfer should be subject to the publicity principle. Jack's title is itself public. The existence of the property – a sector of the surface of Planet Earth – is public. But receivables are rather different. Their existence is not a physical fact. They come into existence without publicity. Suppose that Alan and Beth have a contract. They are free to alter it without any publicity. Why then should they not also be free to substitute Carla for Alan as Beth's creditor, without publicity? Indeed, intimation is a rather weak form of publicity anyway.

14.9 A reason sometimes suggested for requiring an extra step, some external act, is that it makes fraud more difficult. In particular, when a debtor is in financial difficulties, or has already become insolvent, there is a temptation to falsify the date of a security, ie collusive antedating.¹⁰ If an external act is required, that establishes a date that is externally verifiable. There is, to use continental terminology, a *data certa*. If no external act is required, there is,

⁶ Issues about completing title in outright transfers are very similar to the issues for security over incorporeals, discussed later.

⁷ And some international instruments.

⁸ See DCFR III-5:101 ff. Whereas UCC-9 requires registration for most (though not all) outright assignments, the DCFR requires it only for security assignments.

⁹ See Chapter 11.

¹⁰ In some legal systems, eg the Netherlands, this is regarded as one of the major issues in the law of assignation.

it is sometimes argued, an open door to fraud. Another way in which the requirement for an external act tends to reduce the risk of fraud is where someone seeks to sell (or to grant security over) the same assets to two different parties, each of whom is unaware of the other.

14.10 Perhaps the primary argument in favour of an external act is that it promotes economic efficiency. If X wishes to sell its invoices, or to raise finance by granting security over them, the counterparty wishes to be sure that the invoices have not already been sold to someone else, or been used as collateral for a loan from someone else. Without the need for any external act, this cannot be verified. The lack of a requirement for an external act thus, it is often argued, inhibits the use of receivables (etc) as a financing mechanism. This argument does not persuade everyone. In Germany, where no external act is required, receivables are frequently used as collateral.

14.11 In systems that do not require intimation there has to be a raft of rules that say that an assignment is of no effect against the account debtor who does not know of it. If one takes the DCFR as an example, the practical differences from current Scots law are surprisingly slight. The DCFR says that title passes with the act of assignment, not by notification, but the exceptions come near to eating up the rule.¹¹ Thus if, before notification, the account party pays the old creditor, the payment is valid and the debt is thereby discharged.¹² If a cross-debt arises in this in-between period, set-off operates.¹³ If there is a competing assignment (perhaps because of fraud), the first assignee to notify wins.¹⁴ After such exceptions have been taken into account, the main substantive difference (as to passing of title) between the DCFR and current Scots law concerns insolvency, or, to put it another way, whose creditors can attach the claim during the in-between period. In the DCFR the answer is "the assignee's" while in current Scots law the answer is "the cedent's". On this point the DCFR rule is probably preferable, in terms of fairness to the assignee, though probably not in terms of economic efficiency. As against that, the DCFR rule is purchased, so to speak, at the price of considerable conceptual complexity, as just explained, whereas the current Scots system of "title passes on notification" is simple and easy to understand. It does not, like the DCFR, result in a "limping" transfer, in which title is regarded as being held by the transferor for some purposes and by the transferee for others.

14.12 Our advisory group inclined to the view that there should no longer be any general requirement for any external act, ie that outright assignation should be competent without intimation (and without registration), subject always to rules protecting an account debtor who acts in good faith. But the group also thought that there was a stateable case for requiring registration in certain cases, and in particular for the assignation of receivables by commercial enterprises. That general approach is comparable to that prevailing in the USA, where the UCC requires registration for the outright assignment of receivables and certain other incorporeals, but where neither registration nor notification is required for other types of case.

¹¹ These exceptions assume good faith on the part of the account debtor. But of course good faith almost always exists in these cases.

¹² DCFR III-5:119.

¹³ DCFR III-5:116(3).

¹⁴ DCFR III-5:121.

The link with security rights

14.13 In the USA, the view was taken that because in practice assignments that are intended to be absolute and assignments that are intended to be in security are similar, and indeed may on the outside be indistinguishable, they should be subject to the same regime as to mode of creation. We think that this approach is right, and the advisory group also took that view. Hence this chapter cannot be taken in isolation from the chapters dealing with security over incorporeal moveable property.

Completing title: registration?

14.14 UCC-9 and the PPSAs require registration for the outright assignment of certain types of claim, such as receivables, but not for all types of claim.¹⁵ For these latter types of claim, assignment happens simply by agreement between the two parties concerned. The same approach is generally adopted by the UCC-9-type systems.¹⁶ The logic behind the main rule is that in practice it is notoriously hard to distinguish assignments that are outright from assignments that are in security. Given that assignments in security should be registered (thus the UCC-9 philosophy), outright assignments have to be as well.

14.15 Jurisdictions which have this rule have a special register for secured transactions. In this register are entered not only security interests but also outright assignments of receivables.¹⁷ Such registers are self-financing (through registration fees). The newer ones are electronic and registration fees and search fees are generally low.¹⁸ The fact that such an assignment must be registered does not mean that it is in *other* respects treated as a secured transaction. The UCC says that assignments of receivables must be registered, but it stops there. If the assignment is not for the purpose of security, it is not treated as a security. It will be apparent that the problem of distinguishing outright assignments from assignments for the purpose of security cannot be altogether avoided. The "is this a security?" question can be avoided *ex ante*, at the time of creation, but it cannot be avoided *ex post*. For example, if, following the assignment, the assignor becomes bankrupt, the question has to be asked and answered in order to determine the position of the assignee in the cedent's bankruptcy.

14.16 Obviously where an assignment is registered, the account debtor may be unaware of it. Such account debtors have to be protected when they act in ignorance of the assignment, for instance by paying the original creditor.

14.17 It could be argued that intimation is, as a matter of policy, not good enough. It does not result in full publicity. The argument is that if publicity is wanted, then it should be done properly, by registration. If publicity is not needed, it should be scrapped. Intimation is an unsatisfactory halfway house.

¹⁵ See Chapter 13.

¹⁶ An exception is the DCFR, which allows for consensual transfer across the board. In other words, there is no exception for receivables.

¹⁷ Though as we have mentioned above (para 13.12), the interest of an absolute assignee is, oddly, called a "security interest" in the UCC.

¹⁸ In New Zealand the registration fee is NZ\$3 and the search fee is NZ\$1. See <<http://www.ppsr.govt.nz/cms>>. One NZ dollar = about 50p.

14.18 But an argument in favour of recognising intimation as a competent mode of completion of title is that the account debtor is likely to treat it as such. In English law, and German law, there are assignments which take place though the account debtor thinks the debt is still owed to the original creditor, and there have to be rules protecting debtors in such cases. But in a UCC-9-type system, if there is intimation but no registration then the *converse* problem arises; the account debtor thinks that the right has been transferred, but in fact it has not. All such difficulties can be coped with, but any separation between (a) the person who is in law the true creditor and (b) the person who is believed by the account debtor, and believed with good reason, to be the true creditor, leads to complexities.

14.19 A criticism of UCC-9 and the PPSAs is that registration is required for the assignment of some types of debt but not others.¹⁹ This introduces an element of complexity which may be unjustified. There is clearly a case for saying that the question "how do you assign a money claim?" should have a single answer. On this view, if registration were to be introduced (either as a requirement, or as an optional alternative to intimation) it should apply across the board.

14.20 If registration were to be introduced, either on its own, as in the UCC, or as an optional alternative to intimation, the question would arise as to the position of the account debtor who, in ignorance of the registration, paid the original creditor. Clearly it would be unreasonable to expect debtors to search the register before paying any part of their debt, just in case there had been an assignment. The rule would be that a debtor who paid the original creditor in good faith would be protected.²⁰ Indeed, in rare cases that can, it seems, happen even with intimation, and there the rule seems to be that a debtor who acts in good faith is protected.²¹

14.21 Scots law used to allow an assignee to complete title by registration where intimation was not practical. The rule allowing this seems to have been repealed by mistake in 1988.²² Perhaps it was an idea ahead of its time. It may be noted that registration in the Books of Council and Session can vest a right in a *tertius*.²³ This too is perhaps a forward-looking doctrine.

The "*either* intimation *or* registration" possibility

14.22 One possibility that is that an assignee should have the option to complete title *either* by intimation *or* by registration. This would meet what is perhaps the strongest argument against the current law, which is that intimation is a problem in bulk transfers. Instead of ten thousand intimations there could be one single registration. This approach would not be the same as that of the UCC/PPSAs, for it would be more flexible: the assignee could choose either intimation or registration, according to convenience. Of course, where title was completed by registration, there would have to be rules protecting the account debtor who acted in reasonable ignorance of the registration, for it would be out of the question to expect

¹⁹ See Chapter 13.

²⁰ And pre-notification cross-debts could be set off, etc.

²¹ *Hume v Hume* (1632) Mor 848.

²² See Ross G Anderson, "A Note on Edictal Intimation" (2004) 8 EdinLR 272.

²³ *Carmichael v Carmichael's Executrix* 1920 SC (HL) 195 *per* Lord Dunedin. Compare *Tod's Tr v Wilson* (1869) 7 M 1100, holding that the registration of an assignment in the Books of Council and Session is not an equivalent of intimation.

account debtors to be constantly searching the register. Thus for example, an account debtor who, in good faith, paid the original creditor would be discharged. (See above.)

14.23 It is true that a registered assignment on the lines described would be a "limping" assignment in much the same way as a DCFR assignment, with the resulting conceptual complications. But unlike the DCFR those conceptual complications would be a price paid for something valuable, namely the fact that the assignment would be registered, with the economic benefits that that should bring. (For example, financial institutions making business decisions would have access to better information than under the DCFR.²⁴)

14.24 The law must accommodate both large-scale transactions and "small town" transactions. It must accommodate the sale of a portfolio of ten thousand claims and it must accommodate the transfer of a single claim for a modest sum. Moreover, if registration is introduced as a compulsory requirement, whilst financial institutions will be aware of the new system, small traders may not. They may continue to use intimation and be unhappy if they discover that it is ineffective. One way of dealing with such issues would be to establish exceptions, where registration would not be required.²⁵ But the simpler approach would be simply to allow intimation to continue as an optional method. The UCC also allows assignment without registration for one-off transactions: "an assignment of accounts or payment intangibles which does not by itself or in conjunction with other assignments to the same assignee transfer a significant part of the assignor's outstanding accounts or payment intangibles" does not require registration,²⁶ but that is not the same as the either/or flexibility suggested here, and there may also be difficulties in knowing what counts as a "significant part". This "significant part" exception seems to be absent from the PPSAs.

14.25 The "either/or" approach also removes one difficulty in the UCC/PPSA scheme, which is the situation that results if an assignment has been notified but not registered. Under the "either/or" approach, such an assignment would be fully effective, whereas under the UCC/PPSAs it has a limping effect.

Registration in every case?

14.26 Finally there would be the possibility of requiring registration in every case. Our provisional view is that this would be unwise. As mentioned above, it is not the approach of the UCC/PPSAs.

Evaluation and options

14.27 We seek the views of consultees as to what the law should require as to the manner in which an assignee should complete title.

5. The main options as to completion of title are as follows. Which should be preferred?

²⁴ Here one must stress once more the difference between DCFR and UCC-9/PPSAs. Both require registration for security assignments but the former does not for outright assignments. Yet financial institutions when going through due diligence will be as interested to know about outright assignments as anything else. The same defect exists in the UK company charges registration scheme, which requires the registration of security assignments but not outright assignments.

²⁵ And indeed the UCC and the PPSAs have certain exceptions.

²⁶ UCC § 9-309(2).

(a) **Keep the current law, which requires intimation, albeit with certain revisions.**²⁷

(b) **Abandon the need for intimation. Transfer should happen solely by the mutual consent of the cedent and the assignee. (But with protections for the account debtor who acts in good faith.)**

(c) **Adopt something like the UCC approach: abolish the requirement of intimation, and introduce registration for some cases; for other cases transfer would happen solely by the mutual consent of the cedent and the assignee. (But with protections for the account debtor who acts in good faith.)**

(d) **Maintain the requirement of an external act in all cases, but give the parties the choice of registration or intimation. We provisionally incline towards to this option.**

Assignment subject to a suspensive condition

14.28 We understand that in commercial practice it is often desired to have assignments that are subject to a suspensive condition,²⁸ so that the assignment becomes "live" automatically on the occurrence of a defined event. This seems competent under current law²⁹, but it may be that legislative clarification would be helpful. In some cases the account party may not know whether the condition has or has not been satisfied. Presumably an account debtor who pays in good faith to the cedent is discharged. But it may be that what is (we think) the current law would benefit from legislative clarification.

6. Should there be legislative clarification of the effect of a suspensive condition in an assignment?

Priority

14.29 The current law is that priority/ranking is tied to completion of title. Thus two competing assignments rank according to date of intimation. In a competition between an assignment and an arrestment, the priority point for the former is the date of intimation. The rule is a simple and effective one. It parallels the rule for heritable property where priority is normally by date of registration.

14.30 In most other legal systems the same basic approach is adopted; priority is tied to the date of completion of title. But in some legal systems the priority is defeasible and reversible. English law has this approach, and, following it, the DCFR. If in England³⁰ X assigns to Y and later to Z, Y has priority, because notification is not needed. But if Z notifies first, priority is reversed. This rule is, as we have described it, a priority rule, and not merely a rule for protecting account parties who act in good faith. For example, if Y notifies W (the account party) the day after Z notifies, and before W has acted in reliance on Z's notification, Z still prevails over Y. In the DCFR this rule is explained as a manifestation of the doctrine of good

²⁷ For which see below.

²⁸ Sometimes the English term "condition precedent" is used.

²⁹ For discussion see Ross G Anderson, *Assignment* (2008) paras 10-55 and 10-56.

³⁰ For English law, see Appendix B.

faith acquisition. There is an analogy in, for example, section 24 of the Sale of Goods Act 1979. If Kate owns a bicycle and sells it first to Luke, but does not yet deliver it, and then later, and wrongfully, sells to Mary, and delivers it. Luke acquires ownership on the first sale, even without delivery, but his ownership is defeasible and reversible, because of the sub-rule that whichever of Luke or Mary takes possession first wins, assuming of course that there is good faith.

14.31 This sort of approach tends to produce more complex cases than does Scots law. Take a case at random, assuming that the DCFR rules apply. Deirdre owes money to Chris. Chris assigns to Alastair on 10 May. He also, fraudulently, assigns to Aileen on 20 May. Aileen intimates on 25 May, and Alastair on 30 May. Under the DCFR rules, title passes to Alastair on 10 May, and then passes from him to Aileen on 25 May. What if Fraser, a creditor of Chris, arrests in the hands of Deirdre on 15 May? Then it would seem that Fraser prevails over Aileen (because he arrests before Chris assigns to her). But Aileen prevails over Alastair (because she notifies before he does). And Alastair prevails over Fraser (because when Fraser arrests, title has already passed from Chris to Alastair). Perhaps this priority circle could be resolved, but it illustrates the sort of problems that can arise when a complex system of rules is adopted. No doubt complexity is a fact of legal life and no doubt complexity is sometimes needed. But complexity has a price, and, as with all prices, the question is whether what is purchased is worth the price.

14.32 We incline to think that it is better to have a simple rule that priority is determined by priority of completion of title, and that this should be so regardless of *how* title is completed (with no external act, by means of intimation, by means of registration, etc). To avoid confusion, this rule would not be about the position of the account party. It may be that special rules are needed to protect account parties who act reasonably and in good faith. The rule now being considered is about the competing rights of assignees, arresters etc. But to test the views of consultees, we ask:

7. Do consultees agree that priority should continue to be determined simply by date of completion of title?

Reforming the law of intimation: information duties

14.33 Even if intimation were to cease to be a requirement for completing title, it would continue to exist, because assignees will normally wish the account debtor to pay them, and not pay the cedents. ("Normally" because in some cases this is not so, as in invoice discounting and securitisation.) So even if intimation does not retain its transfer function, it will still have a role and the law may need to be reformed.

14.34 The common law, and the Transmission of Moveable Property (Scotland) Act 1862, made the account party's interests central to the process. The requirements of the law – which financial interests today complain of as being burdensome – meant that it was difficult for the account party not to understand what was happening, and ensured that the account party had means of judging whether the assignation had been validly granted by the cedent. But the erosion of the formalities of the law have made things less satisfactory from the point of view of the account party. For example it is today common for the account party simply to receive a notice saying that the account has been transferred, but without the production of

evidence, or the offer to produce evidence. Moreover the notice may be hidden in small print.³¹ Whether such intimation is valid intimation is not certain, but there is a widespread view that it is valid.³² That includes a recent Inner House decision, *Christie Owen and Davies plc v Campbell*,³³ though it may be that the views expressed in that case were *obiter dicta*.

14.35 As mentioned in Chapter 2, EU requires that where a consumer debt is assigned, "the consumer shall be informed of the assignment ... except where the original creditor, by agreement with the assignee, continues to service the credit vis-à-vis the consumer."³⁴ That does not at present bite on Scots law, because notification is required in every case anyway, regardless of whether the debt is or is not consumer debt. But if it becomes competent for an assignee to complete title by registration, the provision will become relevant.

14.36 Rules imposing information duties on the assignee are common round the world. German law says that the account debtor is not bound to pay the assignee except after delivery of the deed of assignation.³⁵ Rather more fully, the UNCITRAL Convention on the Assignment of Receivables in International Trade provides:³⁶

"If the debtor receives notification of the assignment from the assignee, the debtor is entitled to request the assignee to provide within a reasonable period of time adequate proof that the assignment from the initial assignor to the initial assignee and any intermediate assignment have been made and, unless the assignee does so, the debtor is discharged by paying in accordance with this article as if the notification from the assignee had not been received. Adequate proof of an assignment includes but is not limited to any writing emanating from the assignor and indicating that the assignment has taken place."

14.37 The DCFR has corresponding rules.³⁷ One difference concerns the situation where the (alleged) assignee fails to provide the information. The UNCITRAL rule is that the account debtor is free to pay the original creditor, whereas the DCFR merely states that "a debtor who has made a request under this Article may withhold performance until the request is met."³⁸ That could lead to stalemate, with the account debtor able to refuse to pay anyone. Indeed, the account debtor would not be safe to pay either party. This might be a happy situation for the account debtor, but it might not, for example where the debt bears a high rate of interest. Such situations can of course arise in any legal system, including our own, ie situations where it is uncertain whether a claim has been validly transferred. But if there are clear information duties that will in practice make such cases of uncertainty unusual. This was also the policy of Scots law, with its requirement that the account debtor should be given a copy of the assignation, but the tendency of the courts to admit informal intimation has tended to erode it, and in practice nowadays it is quite common for there to be

³¹ An example which we think is fairly typical is an invoice, A4 size, in which the "intimation" (which says sternly that "this account can only be discharged by payment to" the finance company) is pre-printed near the foot. The "intimation" is printed in letters about one millimetre high, except for the name and address of the finance company, which is about two millimetres high. The name of the company with which the customer has contracted is in large print at the top of the invoice. We think that in practice many customers would simply not notice this "intimation". (We use inverted commas because it may be debated whether this could be a valid intimation anyway, as opposed to a non-binding request to the customer to pay the finance company.)

³² See Chapter 4.

³³ [2009] CSIH 26; 2009 SC 436.

³⁴ Directive 2008/48/EC Art 17(2), transposed by s 82A of the Consumer Credit Act 1974.

³⁵ BGB § 410.

³⁶ Art 17(7). (<http://www.uncitral.org/uncitral/en/uncitral_texts/payments/2001Convention_receivables.html>.)

³⁷ DCFR III-5:120.

³⁸ DCFR III-5:120(4).

an intimation which gives no information, and the account debtor is asked to accept the intimation on the pure say-so of the (alleged) assignee. Whether such intimations are valid is not certain.

14.38 The issue has a consumer protection dimension, more prominent nowadays than formerly. It is common for companies to sell their financial claims against their customers especially where the customer is, or is allegedly, in default. The buyers are debt collection companies. In practice it is not always clear whether the latter is seeking to collect simply as agent for the creditor, or whether there has been a transfer, so it is collecting in its own name. The main issue here is not about the nature of the contract between the originator (eg a secondary bank or a utility company) and the debt collection company. That contract may be a sale contract or an agency contract or an innominate contract. The main issue is whether there has been a *transfer* of the claim. If there has been a transfer, then the debt collection company is the new creditor. If there has been no transfer, then the originator is still the creditor. This issue is important to customers who are being chased for payment: to whom is the money owed?³⁹ It seems unacceptable that customers should be in doubt, or that they should be asked to pay a company that they have not heard of merely on trust. It is true that regulatory law may be engaged here, but consumer protection works most effectively where there is a pincer movement of public regulation and rights in private law.

14.39 The question of information arises whether or not intimation is retained as a requirement for completing title. Indeed, in all the three cases mentioned (German law, the UNCITRAL Convention, and the DCFR), intimation is not a constitutive act.

14.40 There is also the issue mentioned earlier, of a notification that, though sent to the account party, is in small print or otherwise in such a form that it may not bring home to the account party what it is. The problem becomes worse if the document is a large one, thereby imposing on the account party – without compensation – the duty of lengthy and careful reading.

14.41 We ask:

- 8. Should notification, to be effectual, be in such a form as to bring home its meaning to a reasonable account party?**
- 9. Should there be information duties on the assignee?**
- 10. If so, what should they be, and what should be the consequences of failure to perform them?**

Who should intimate?

14.42 Who should intimate? In practice it is the assignee. The reform options are: that it should be the assignee, or that it should be the cedent, or that it should be either (which seems to be the current law⁴⁰) or that it should be both, as a joint act. The last of these possible rules would solve – or rather prevent arising – the problem that the account debtor, faced with an intimation, may be unsure whether his or her creditor really has assigned.

³⁹ If, in fact, it *is* owed. A perennial problem is that of demands for money that is not owed.

⁴⁰ Ross G Anderson, *Assignment* (2008) para 6.30 ff.

14.43 If intimation ceases to be the means whereby title is completed, the "who should intimate?" question becomes meaningless, for title has *already* passed, and intimation is merely a matter of telling the account debtor about something that has already happened: its role is informational, not constitutive. What matters is that the information is given, not by whom.

14.44 To the extent (if at all) that intimation survives as a mode of completion of title, we incline to think that it should be by the assignee. Intimation, as a mode of completing title, is not merely a communication of information. It is a juridical act: it presses a button and the legal universe changes. In other cases involving registration, such as land, or company shares, the registration button is pressed by the grantee. That suggests that it should be the same for assignments.

Special cases: assignation by force of law

14.45 There are certain cases where there is assignation by force of law.⁴¹ An example is sequestration, where the rights of the debtor are, by force of law, assigned to the trustee without the need for intimation.⁴² Another case exists in insurance law. If X causes delictual harm to Y, and Y has insurance for this, and is paid by the insurer, the insurer is "subrogated" to Y's claim against X. This is a form of assignation. We think that the question of whether such rules are satisfactory is not one for this project. Rather it belongs to the law of sequestration etc. Nevertheless we would welcome the views of consultees.

Writing?

14.46 The current law on whether writing is required is discussed elsewhere.⁴³ If writing is to be required, then of course it should be possible for the document to be electronic as well as physical. But the basic question is: should it be required? One argument in favour of writing is that without writing it will be difficult to satisfy the account debtor that the claim has been transferred. As against this, one could argue that an assignee who is so foolish as to take an oral assignation must bear the consequences.

14.47 The DCFR does not require writing either for an agreement to assign, or for an assignation.⁴⁴ We ask:

11. (a) **Do consultees agree that agreements to assign should not be subject to any requirement of form?**
- (b) **Should assignments have to be in writing? If so should they have to be signed by the granter only, or by both parties? (Writing and signature in this case could be electronic as well as paper-and-ink.)**

Mandates etc

14.48 In some cases a mandate will be interpreted as not being a mandate, but as being an assignation. We discuss and criticise this doctrine elsewhere,⁴⁵ and also the associated

⁴¹ *Cessio legis*.

⁴² Bankruptcy (Scotland) Act 1985 s 31.

⁴³ Chapter 4.

⁴⁴ DCFR III-5:110 read with II-1:106.

doctrine that an assignee can sue in the cedent's name. We think these doctrines unsatisfactory. If a creditor wishes to give a mandate to someone else to collect a debt, why should that not be possible, without the arrangement being converted by force of law into an assignment? If a creditor wishes to authorise the debtor to pay a third party, why should that arrangement not be possible?

14.49 As for the doctrine that the assignee can sue in the cedent's name, it is not important in practice. Still, it seems unsatisfactory. The effect of a successful action is that the account debtor *is ordered to pay the wrong person*, ie the person who is not his creditor. (What if X assigns to Y, and Y then raises an action in X's name, and decree is pronounced, and X is now insolvent. Who gets the benefit of the decree: Y or X's creditors?)

14.50 Formerly assignments were chargeable to stamp duty, but mandates were not. Thus mandates were used to circumvent the tax. But this incentive to use mandates disappeared with the abolition of stamp duty on assignments.⁴⁶

14.51 We ask:

12. Do consultees agree that:

(a) The rule that a mandate can operate as an assignment should be abrogated?

(b) The rule whereby an assignee can sue in the name of the cedent should be abrogated?

Anti-assignment clauses⁴⁷

14.52 As discussed in Chapter 4, if a contract has an anti-assignment clause – or, to use academic language, a *pactum de non cedendo* – and one party thereafter purports to assign its rights, the assignment is ineffective.⁴⁸ (The alternative possibility, that the assignment is effective, albeit a breach, is not the Scottish approach.)

14.53 Whilst the same is true in England,⁴⁹ there is a strong tendency nowadays internationally for such clauses to take effect only as between the parties, so that breach merely amounts to a breach of contract, without making the assignment actually invalid. See for instance UCC-9,⁵⁰ the DCFR,⁵¹ the UNCITRAL Convention on the Assignment of Receivables in International Trade⁵² and the UNIDROIT Convention on International Factoring.⁵³ The Law Commission for England and Wales has recommended that English

⁴⁵ Chapter 4.

⁴⁶ See Ross G Anderson, *Assignment* (2008) paras 3-18 and 5-41.

⁴⁷ For the current law, see Chapter 4.

⁴⁸ See *James Scott Ltd v Apollo Engineering Ltd* 2000 SLT 1262.

⁴⁹ *Linden Gardens Trust Ltd v Lenesta Sludge Disposal Ltd* [1994] 1 AC 85. For a special case see *Foamcrete (UK) Ltd v Thrust Engineering Ltd* [2002] BCC 221.

⁵⁰ UCC § 9-406.

⁵¹ DCFR III-5:109.

⁵² Article 9.

⁵³ <<http://www.unidroit.org/english/conventions/1988factoring/main.htm>>. See Art 6.

law should go down the same road.⁵⁴ Some of these provisions apply generally,⁵⁵ whilst others are limited to trade receivables.⁵⁶

14.54 The general rule for *real* rights is that an agreement *de non aliendo* has contractual effect between the parties but goes no further than that, so that it does not invalidate a transfer made in breach of the agreement.⁵⁷ Should that approach be followed for personal rights? The Law Commission for England and Wales has said that "it is obviously true that to prohibit anti-assignment clauses is an interference with freedom of contract. The question, however, is whether the interference is justified."⁵⁸ We doubt whether such a prohibition should in fact be regarded as an interference with freedom of contract. In jurisdictions where such a prohibition has been adopted, parties are still free to agree that there is to be no assignment, and such an agreement is a valid agreement. The issue is, therefore, not about freedom of contract but about the consequences of breach. The proposal would be that an anti-transfer clause should have merely the same effect in relation to the transfer of contract rights as it does for real rights. Thus a creditor who proposed to assign in breach of an anti-assignment clause could be interdicted, and if the assignment had already taken place, damages would be due if any loss could be shown to have followed from the breach. What would change would be that the transfer would be wrongful-but-valid rather than, as now, invalid.

14.55 In this connection we doubt if the cases from the English courts⁵⁹ about the use of trust to circumvent an anti-assignment clause are of much relevance to Scots law. We see no reason why the creditor in an unassignable claim should not become a trustee of that claim. But where that is the case we see no basis for any direct action by the beneficiary against the debtor. An action to enforce the claim would have to be made by the creditor.⁶⁰

14.56 In South Africa the rule is that an anti-assignment clause invalidates an assignment if, but only if, it "can be shown to serve a useful purpose to the debtor."⁶¹

14.57 It has been suggested to us that altering the current law could upset carefully structured contracts. Overall we are not persuaded that a case exists to alter the law. But to test views we ask:

- 13. (a) If a contract between X and Y contains an anti-assignment clause, and nevertheless there is a purported assignment by X of a right arising from the contract, should the effect of the clause be (as under current law) that the assignment of that right is invalid, or should the only consequence be that there has been a breach of contract by X?**

⁵⁴ Law Com Report No 296 para 4.40.

⁵⁵ Such as DCFR III-5:109.

⁵⁶ Such as Law Com Report No 296.

⁵⁷ But in some types of case the "offside goals rule" applies with the result that the transfer is voidable (though not void).

⁵⁸ Law Com Report No 296 para 4.39.

⁵⁹ Such as *Don King Productions Inc v Warren* [2000] Ch 291 and *Barbados Trust Co Ltd v Bank of Zambia* [2007] EWCA Civ 148, [2007] 1 CLC 434.

⁶⁰ See further David Cabrelli, "Can Scots lawyers trust Don King? Trusts in the commercial context" (2001) 6 *Scottish Law & Practice Quarterly* 103.

⁶¹ *Paiges v Van Ryn Gold Mines Estates Ltd* 1920 AD 600 at 615.

(b) Should the rule vary according to the type of case? (For example, that the rule should apply to receivables but not other claims.) If so, which rule should apply to which type of case?

Assignability: other issues

14.58 We have mentioned anti-assignment clauses. There is also the question as to whether some rights should, because of their intrinsic nature, be unassignable. The obvious cases are funds aimed at meeting living expenses, such as wages, salary, pensions and social security rights. In some of these cases there are statutory bars on assignment.⁶² But there are also rights of a miscellaneous nature, such as the right to reduce a contract.

14.59 An issue mentioned in Chapter 4 concerns the case where a contract confers powers on the creditor, such as a power to vary an interest rate. Possibly that bars assignment, or possibly it means that the assignee cannot exercise the power. As well as interest rate variation, there is the question of an arbitration clause in the original contract.⁶³ Much will depend on what the contract says.

14. Do consultees think that the law about assignability, and the effect on assignability of contract terms conferring powers on the creditor, stand in need of reform? If so, how?

The assignment of future and contingent rights

14.60 The current law on the assignment of future and contingent rights is discussed in Chapter 4. There it is noted that the problem of assigning a personal right that does not exist at the time of the assignment, is one that has two aspects, namely the "you can't transfer what doesn't exist" problem and the "nobody to whom to intimate" problem.

14.61 Suppose (for the sake of example) that in future the law says "an assignee can complete title either by intimation or by registration, at the assignee's option." In that case the "nobody to whom intimation can be validly made" problem vanishes. Hence the possibility of *cessio in anticipando* could materialize without any further change in the law. For (i) the "nobody to whom to intimate" issue would disappear, because registration would be a substitute for intimation and (ii) accretion of title would be possible, for the cedent and assignee would have gone through all the steps needed for transfer, the only deficit being the cedent's lack of title.

14.62 However, much would depend on what data would have to be registered. If the legislation required the register entry to identify not only the cedent and the assignee but also the account debtor, then the scope for *cessio in anticipando* would be very limited.

14.63 Technical issues can usually be solved. The basic issue is a policy one: to what extent *should* Scots law make possible *cessio in anticipando*? The effect on third parties should be considered. If Jack, a trader, can assign all future receivables, the law is in effect allowing him to agree with the finance company that his future receivables are to be

⁶² Such as the Social Security Administration Act 1992, s 187 (covering, for example, state pensions, child benefits and job-seeker's allowance); the Pensions Act 1995 s 91 (occupational pensions) and the Police Pensions Act 1976 s 9. For further examples, see Ross G Anderson, *Assignment* (2008) para 10-30.

⁶³ See generally Juan Carlos Landrove, *Assignment and Arbitration: A Comparative Study* (2009).

unarrestable by his creditors, and that agreement will bind them, even though they have not consented to it.

14.64 The issue cannot be considered in isolation. If a new form of security interest over incorporeals is introduced, the question would arise, in connection with such a security interest, whether it should be capable of extending to after-acquired assets. There is more than one set of possibilities here. If, in the event of the introduction of a true security over incorporeals, assignation in security continues to be allowed (which is what we provisionally propose), then one possibility would be to allow security over after-acquired assets in the case of true security, but not allow it in the case of assignation (whether outright assignation or assignation for the purpose of security). This is merely an illustration of one of the range of options.

14.65 The DCFR says that "a future right to performance may be the subject of an act of assignment but the transfer of the right depends on its coming into existence and being identifiable as the right to which the act of assignment relates."⁶⁴ But it further provides that "an assignment of a right which was a future right at the time of the act of assignment is regarded as having taken place when all requirements *other than those dependent on the existence of the right* were satisfied."⁶⁵ This latter provision seems open to question. It seems to involve re-writing the past. X assigns to Y an as-yet-nonexistent claim against Z on 1 May. The claim comes into existence on 1 November. The provision just quoted seems to mean that Z is deemed to have owed the money to Y as from 1 May.⁶⁶ This seems unsatisfactory.

Consumer protection

14.66 If the assignation of future claims is allowed, there may be issues about whether this should be permissible for all types of person, especially since the purpose of such assignations may be security in favour of the assignee. Elsewhere we suggest consumer-related restrictions on non-possessory security.⁶⁷ There is a case for limiting the power of consumers to grant assignations of future rights, and indeed to some extent the law already restricts such assignations.⁶⁸ (And also security over future rights.⁶⁹)

14.67 For completeness, it should be added that any power to assign future rights would still be subject to any rules forbidding assignation.

14.68 We ask:

- 15. Should the law allow a future claim to be assigned (subject to the right in due course coming into being and being identifiable as the claim to which the assignation relates)?**
- 16. If so, do consultees agree that the transfer of the claim should not be deemed to take place before the claim comes into being?**

⁶⁴ DCFR III-5:106

⁶⁵ DCFR III-5:114.

⁶⁶ Cf DCFR IX-4:101 which allows security rights to have a priority that is *earlier than their creation*. This approach derives from the UCC/PPSAs. See Chapter 13.

⁶⁷ Chapter 16.

⁶⁸ See Chapter 18.

⁶⁹ We raise the question of security over future claims in Chapter 18.

17. Should the power of consumers to assign after-acquired rights be restricted?

Policies of Assurance Act 1867

14.69 The Policies of Assurance Act 1867 is discussed in Chapter 4, where the view is expressed that it probably does not apply to Scotland. If there is to be legislation about the law of assignation, it would make sense to tidy up the law by amending the 1867 Act so as to add an express provision confirming that it does not apply in Scots law. We ask:

18. Do consultees agree that the Policies of Assurance Act 1867 should be amended to confirm that it does not apply in Scotland?

Partial assignation

14.70 It is competent to assign part only of a debt. So if Alan owes Beth £100,000, she could assign £60,000 to Charles and the balance she could retain, or could assign it to Dora.⁷⁰ Partial assignations could be a nuisance to the account debtor. They are not common in practice but we are informed that they are by no means unknown.

14.71 The DCFR rule is:⁷¹

- "(1) A right to performance of a monetary obligation may be assigned in part.
- (2) A right to performance of a non-monetary obligation may be assigned in part only if:
 - (a) the debtor consents to the assignment; or
 - (b) the right is divisible and the assignment does not render the obligation significantly more burdensome.
- (3) Where a right is assigned in part the assignor is liable to the debtor for any increased costs which the debtor thereby incurs."

14.72 This seems a sound approach, and a natural development of our existing law. We ask:

19. Do consultees agree that the DCFR rule on partial assignation should be adopted?

Assignatus utitur jure auctoris: general

14.73 The doctrine of *assignatus utitur jure auctoris* is summarised in Chapter 4. The principle – that an assignation cannot impair the account party's rights – is sound and is to be found in other legal systems. The only issue we are aware of is whether a contract might be subject to special rules of interpretation after an assignation, in favour of a good faith

⁷⁰ In English law, partial assignment is not competent, except in equity: *In Re Steel Wing Co Ltd* [1921] 1 Ch 349.

⁷¹ DCFR III-5:107.

assignee, an issue mentioned in our recent discussion paper on interpretation of contracts.⁷² Our provisional view is that no exception should be made to the *assignatus utitur* principle. We incline to think that the law in this area does not stand in need of legislative intervention, but would appreciate the views of consultees on whether any reform is needed, and also on whether it might be of value if the rule were given a statutory form.

20. Is there a need for legislation about the rule commonly known as *assignatus utitur jure auctoris*?

***Assignatus utitur jure auctoris*: waiver-of-defence clauses**

14.74 Waiver-of-defence clauses are explained elsewhere.⁷³ The current law seems to be uncertain, and if the view is taken that it should be clarified, a decision needs to be taken as to what the new law should say. If waiver-of-defence clauses are to be recognised, presumably they should be of no effect against consumers. Under current law it is unlawful for a creditor to take a negotiable instrument⁷⁴ from a consumer, and if one is nevertheless taken, a transferee does not – contrary to the general principles of the law of negotiable instruments – take free of the consumer debtor's defences.⁷⁵ If waiver-of-defence clauses were valid as against consumers, that statutory policy would be subverted. Hence it seems out of the question for the law to give blanket approval to such clauses. The DCFR does not address the issue, but its statement of the *assignatus* principle is in such unqualified terms that it is doubtful whether a waiver-of-defence clause would be regarded as valid.⁷⁶ It should be added that whilst the issue is discussed here in the context of outright assignation, the same issues arise in connection with secured transactions.

21. Should there be legislative clarification as to the effect of a waiver-of-defence clause? If so, what should the law provide about such clauses?

Transfer of entire contracts

14.75 Some legal systems have provision for the transfer of an entire contract, of course on a consensual basis. Thus a contract between D and E becomes a contract between D and F, with F succeeding to both the rights and the obligations of E, and E being discharged of any liabilities to D. The DCFR has a provision:⁷⁷

"(1) A party to a contractual relationship may agree with a third person, with the consent of the other party to the contractual relationship, that that person is to be substituted as a party to that relationship.

(2) The consent of the other party may be given in advance..."

14.76 We incline to think that this issue is already adequately covered by the general law of contract, and that accordingly no legislative intervention is needed. Nevertheless we ask:

⁷² Scottish Law Commission, *Review of Contract Law: Discussion Paper on Interpretation of Contract* (Scot Law Com DP No 147(2011)) paras 7.32 and 7.35.

⁷³ Chapter 4.

⁷⁴ Other than a cheque or bank note.

⁷⁵ Consumer Credit Act 1974 sections 123 to 125.

⁷⁶ DCFR III-5:116.

⁷⁷ DCFR III-5:302.

22. Do consultees agree that there is no need for legislative intervention to deal with the transfer of entire contracts?

Assignment and accessory rights

14.77 Security rights are accessory to the obligations that they secure. In principle, therefore, when a secured claim is assigned, the security should follow the claim. But as noted in Chapter 5 the law is not in a wholly satisfactory state. To promote clarity and certainty, there might be a case for a general provision to the effect that, unless otherwise agreed, assignment carries with it any security that exists for the assigned claim, and that if any further act is needed to vest the security in the assignee, the cedent will perform that act.⁷⁸ Thus, for example, if X owes money to Y, secured by standard security,⁷⁹ and Y assigns the claim to Z, without there being any assignment of the standard security, Z would have the right as against Y to have the security assigned.⁸⁰

23. Should it be provided that unless otherwise agreed, the assignment of a claim carries with it a right to acquire any security that exists for the assigned claim, and that if any further act is needed to vest the security in the assignee, the cedent will perform that act?

14.78 In theory it would be possible to go further, and provide that an assignment of the secured claim automatically gives to the assignee a completed title to the security.⁸¹ This is perhaps the most logical solution. But it would be a radical reform and would trench on the law of standard securities. It would impair the "publicity" value of registration. Whilst we would appreciate the views of consultees, our provisional view is that such a reform should not be considered further in the context of the present project, though it might always be reconsidered in the future.

14.79 A closely connected issue, mentioned earlier,⁸² is what happens if there is a deed assigning the claim and the security, and this is registered in the relevant register, such as assignment of a standard security, registered in the Land Register. At that stage there may have been no intimation to the debtor. If the law continues to be that assignment requires some external act to take effect, should it be provided that the registration transfers the claim? For example, Doris owes money to Chris secured by standard security. He assigns the claim and the security to Audrey and this is registered in the Land Register on 1 June. Should the law be that the assignment of the claim is complete at the same time as the assignment of the security, ie on 1 June, even though there is no notification to Doris until later?⁸³ In more general terms, should the registration transfer the claim notwithstanding that the general requirements of the law as to transfer of claims have not been met? (Any such rule would of course be subject to protections for Doris in the event that she pays Chris in good faith, and so on.) The reason for such a reform would be to prevent a split between the claim and the security.

⁷⁸ This was the view taken by Lord Gifford in *McCutcheon v McWilliam* (1876) 3 R 565: "The conveyance of the debt is implied necessarily in conveying the subject of the security."

⁷⁹ Or other security.

⁸⁰ It may be that this is already the law.

⁸¹ See Ross G Anderson, *Assignment* (2008) para 2-13 ff.

⁸² Chapter 5.

⁸³ It is possible that this might be the current law. But no one can be sure.

24. **Should it be provided that where an assignation is registered in the relevant register (eg the Land Register in the case of a standard security), that registration should suffice to complete the title of the assignee, even though the general requirements for completed assignation of claims have not been met? (Any such rule would be accompanied by protection to the debtor who acts in good faith.)**

Codification?

14.80 In this chapter we have looked at specific issues. Where reform is needed, those issues could be addressed by specific provisions - a Law Reform (Assignation) (Miscellaneous Provisions) (Scotland) Act. New Zealand recently did something of the sort.⁸⁴ The alternative approach would be to codify the law of assignation – a Law Reform (Assignation) (Codification) (Scotland) Act. The arguments against codification would be the usual arguments – the work would be time-consuming, it would generate disputes as to its interpretation, drafting errors would be discovered, and even if it were to be done perfectly, the real gain would be small. The argument in favour of codification would be the usual argument: making the law clearer and more accessible. No one could assert that the current law of assignation is accessible. The debates about codification are eternal because the issues are not perfectly soluble, and that is the case here. A middle view would be that whilst codification would be desirable, it would be better to proceed in two stages, namely to reform the law first, and then, once the reforms had bedded down, and any problems had come to light, to codify as a second step.

25. **Should the codification of the law of assignation be an objective of the present project?**

The term "intimation"

14.81 Scots lawyers are so used to the verb "to intimate" and the noun "intimation" that they forget that to others the usage is odd, because in ordinary speech nowadays "intimation" means something rather different. Intimations are hints, as in Wordsworth's *Intimations of Immortality*. Established legal terminology should not be changed wantonly, but it may be asked whether the time has perhaps come to replace the term, at least as far as legislative language is concerned, by notify/notification. We ask:

26. **Should "intimate/intimation" be replaced by "notify/notification"?**

⁸⁴ Property Law Act 2007, Part 2, Subpart 5, headed "Assignment of things in action".

Chapter 15 Possessory security over corporeal moveable property: reform options

Introduction

15.1 This chapter looks at the law of pledge, ie consensual security over corporeal moveable property constituted by delivery to the creditor. Non-possessory security is looked at in the next chapter. The word "consensual" must be stressed. This project is not concerned with non-consensual security, ie security arising by operation of law. Thus liens, though they are possessory securities over corporeal moveable property, are not covered.

Pledge¹

15.2 Pledge is possessory security over corporeal moveables. Pressure for reform of the law is mainly in relation to the subject of non-possessory security. Nevertheless something needs to be said about possible reforms to the law of pledge.

Pledge of bills of lading

15.3 As noted in Chapter 6, in *Hamilton v Western Bank*² it was held that where a delivery order is transferred by way of security, the result is that ownership of the goods passes, and that whilst the decision involved a delivery order, its ratio is a broad one, including bills of lading. It was also noted that the position is different in English law, and that there is some uncertainty as to whether *Hamilton* can now be regarded as a correct statement of Scots law. We think that on this issue the English approach is clearly preferable. Documents such as bills of lading represent the possession of goods, not ownership of goods. There is no good reason why the transfer of that possession for the purpose merely of security should result in transfer of ownership, any more than when someone transfers possession of a gold watch to a pawnbroker, ownership should pass. *Hamilton* represents an interference with the intentions of the parties and the commercial realities of the situation that cannot, we think, be justified.³

15.4 It was also noted in Chapter 6 that the decision in *North Western Bank, Limited v John Poynter, Son, & Macdonalds*⁴ was the basis for trust receipt financing. What happens is that a bill of lading is pledged to a bank, which then hands it back to the debtor (importer). The case held that this does not extinguish the pledge, but rather the bank then enjoys a non-possessory security. We noted that this seems contrary to principle, and has been criticised as such by Dr Rodger (Lord Rodger of Earlsferry).

¹ For a recent study see Andrew J M Steven, *Pledge and Lien* (2008).

² (1865) 19 D 152.

³ See the papers by Alan Rodger and G L Gretton cited in Chapter 6 for further discussion of these issues.

⁴ (1894) 22 R (HL) 1; [1895] AC 56. For an earlier case see *McDowal v Annand and Colhoun's Assignees* (1776) 2 Pat 387.

15.5 One possibility would be to enact that the delivery of pledged goods by the pledgee to the pledger (and the same in relation to goods pledged through the pledge of the bill of lading) should extinguish the pledge – which indeed might possibly be the law in any case. If there is a practical issue to be addressed for imported goods, that issue should – it might be argued - be addressed in a rational manner rather than by subverting the general law of pledge. For example, if non-possessory security by means of registration is introduced, the bank's position could be protected, easily and cheaply, by registration. In other words, the issue would simply become part of the general law of non-possessory security.⁵

15.6 The two issues for possible law reform are thus:

27. (a) **Should legislation bring Scots law into line with English law (as settled in *Sewell v Burdick*) by providing that the pledge of a bill of lading (or of a delivery order) is true pledge?**⁶
- (b) **Should legislation make it clear that the redelivery of pledged goods (or pledged bill of lading) extinguishes the pledge (but without prejudice to any new system allowing for non-possessory security)?**

15.7 Over the years attempts have been made to replace paper bills of lading with electronic equivalents. A significant step forward was taken in the 2008 UNCITRAL Rotterdam Rules,⁷ which makes provision for electronic equivalents. So far, however, there has been only one ratification.⁸ It may therefore be premature to consider security over the electronic equivalents to bills of lading, but the views of consultees would be welcome.

Pledge and the Consumer Credit Act 1974

15.8 In Chapter 6 we discuss the enforcement provisions of the Consumer Credit Act 1974 and note two anomalies which result in injustice to the debtor. Curiously in both cases the result is inferior, in terms of justice to the debtor, than the common law.

28. (a) **We propose that where, under the pawnbroking provisions of the Consumer Credit Act 1974, ownership of the pledged item is lost because the loan is below the prescribed figure (currently £75), the debt (if more than the value of the item) should be reduced by the value of the item.**
- (b) **We propose that where, under the pawnbroking provisions of the Consumer Credit Act 1974, ownership of the pledged item is lost because the loan is below the prescribed figure (currently £75), but the value of the item exceeds the loan, the loan should be discharged, and the pawnbroker should be obliged to pay the customer the surplus value (subject always to compensation for administrative expenses etc).**

⁵ Cf Diamond Report para 11.5.7.

⁶ As stated above, this may possibly be the law in any case, but legislation would remove the uncertainty.

⁷ Convention of Contracts for the International Carrying of Goods Wholly or Partly by Sea, adopted by the UN in 2008 and signed in 2009.

⁸ Spain.

Power of sale (common law)

15.9 The current law about power of sale by a pledgee is discussed in Chapter 6. There we noted that at common law – which applies in non-consumer cases – the rule is that the pledge agreement can validly authorise the pledgee to sell in the event of default,⁹ but that if the agreement is silent the pledgee has to apply to the court for power to sell. (It is odd that the law seems more protective of the pledger in non-consumer cases than it is in consumer cases.) Many European systems make power of sale an implied term.¹⁰ Application to the court pushes up enforcement costs. There might therefore be a case for making power of sale on default an implied term. On the other hand it might be argued that since an express clause is common in practice, there is no real need for reform of the law.¹¹

29. Is the common law about a pledgee's power of sale satisfactory? If not, what changes are needed?

Forfeiture (outwith the context of the Consumer Credit Act 1974)

15.10 The current law about forfeiture (outwith the context of the Consumer Credit Act 1974) is discussed in Chapter 6. Lenders seldom attempt to use forfeiture clauses. But that might change. In any event, if the law of moveable security is to be reformed, it may be that the opportunity should be taken to establish clear rules on this issue, as most other European legal systems have done. We stress the word "clear" because whilst Scots law has the rule, the details are obscure, no doubt because there has been so little litigation. One issue that has been addressed by many legal systems is this: that a forfeiture clause is not normally oppressive if it is agreed *after* default has happened. The DCFR provision is:¹²

"(1) Any agreement concluded before default providing for the transfer of ownership of the encumbered assets to the secured creditor after default, or having this effect, is void.

(2) Paragraph (1) does not apply:

(a) if the encumbered asset is a fungible asset that is traded on a recognised market with published prices; or

(b) if the parties agree in advance on some other method which allows a ready determination of a reasonable market price.

(3) Paragraph (2)(b) does not apply to a consumer security provider.

(4) Where appropriation is allowed, the secured creditor is entitled to appropriate encumbered assets only for the value of their recognised or agreed market price ..."

15.11 This seems to us a reasonable provision. We ask:

⁹ Andrew J M Steven, *Pledge and Lien* (2008) para 8-11.

¹⁰ Andrew J M Steven, *Pledge and Lien* (2008) para 8-09.

¹¹ Andrew J M Steven, *Pledge and Lien* (2008) para 8-10.

¹² DCFR IX-7:105.

- 30. Do consultees agree that, in cases outwith the Consumer Credit Act 1974, there should be a provision dealing with forfeiture clauses along the lines proposed in the DCFR?**

Codification?

15.12 In Chapter 14, we asked whether the law of assignation should be codified, or whether, for the time being at least, legislation should merely address particular issues. The same question arises for the law of pledge. Such a code would cover creation, discharge, enforcement and so on. If Scots law were to adopt a UCC-9 approach, there would in any event be a general code in which pledge would be included. But if a UCC-9 approach is not adopted, the question of the codification of the law of pledge would have to be considered. We incline to think that, as a technical task, it would be less difficult to codify the law of pledge than the law of assignation. We ask:

- 31. Should the law of pledge be codified?**

Chapter 16 Non-possessory security over corporeal moveable property: reform options

Introduction

16.1 The main issue in this chapter is the possible introduction of a new non-possessory security right over corporeal moveable property. In Chapter 6 we reviewed the current law, noting that in general it requires security over corporeal moveable property to be possessory. We noted the exceptions, and we also noted the possibilities that may exist of using quasi-security devices to circumvent the law. In this chapter we consider the possibility of allowing direct, proper, non-possessory security over such property. Some of the issues discussed in this chapter are also relevant to incorporeal moveable property.

16.2 It is clearly arguable that the current law is unsatisfactory. If it is so often found necessary to use the backdoor, should the front door perhaps be widened? One could run the argument the other way, saying that since business practice has successfully used the back door for years, there is no need to widen the front door. But that reply is unsatisfactory for two reasons. The first is that there is a value in making the law straightforward and making it unnecessary to resort to artificial and non-transparent devices. The second is that the back door is not always available. It is available for acquisition finance. But where the borrower already owns the property, there is the hurdle of section 62(4) of the Sale of Goods Act 1979, mentioned above.

16.3 The current law developed before modern registration systems were available. In the past registration was slow and expensive. Searching was likewise slow and expensive. Hence registration tended to be used only in narrow circumstances, such as land transactions,¹ where the drawbacks were clearly outweighed by the benefits. Today registration and searching can be quick and cheap.

16.4 More than a hundred years ago Gloag and Irvine wrote: "It is open to question whether the rigidity of the law of Scotland on this subject should not now be relaxed by the adoption of a system analogous to the English bill of sale."² That suggestion remains as relevant as ever. It was renewed in the Murray Report. This recommended the establishment of a Register of Security Interests: a non-possessory security over corporeal moveable property could be created by registration in that register.

Is the floating charge not the answer?

16.5 Was the problem not resolved by the introduction of the floating charge in 1961? There are several reasons why the floating charge is unsatisfactory. One is that it can be

¹ Notably the Registration Act 1617.

² W M Gloag and J M Irvine, *Law of Rights in Security, Heritable and Moveable, including Cautionary Obligations* (1897) pp 187-188.

granted only by debtors that are companies (or LLPs). Thus it cannot be granted by partnerships or by natural persons. Another is that the floating charge is designed to cover the whole assets of a company, present or future, or at least a section of such assets, such as the vehicle stock of a motor dealer. It is not suited to the case where the parties wish to set up a non-possessory security over a particular item, such as a particular motor vehicle. Because a floating charge is typically a security over the whole assets of a business, it is subject to special rules that are, as a matter of public policy, regarded as appropriate to a security of that type, such as postponement to the preferential creditors, and also the "prescribed part".³ Such rules are not so appropriate for a security over a particular item, such as a particular road vehicle. Again, the floating charge is inseparably integrated into corporate law and the law of corporate insolvency. For example, it can be enforced only by liquidation, receivership or administration, processes that may make good sense where a whole enterprise needs to be subject to a formal insolvency process, but make little sense where the need is to enforce, to repeat the same example, a security over a particular road vehicle. Indeed, if one were to extend the logic of the floating charge to securities granted by natural persons, the absurd result would be that to enforce a modest security right it would be necessary to make the debtor bankrupt. Finally, and more theoretically, we agree with those who consider the floating charge to lack conceptual coherence. Even after 50 years of litigation, much remains obscure. The obscurity of the floating charge has generated much comment in England, but the position is worse in Scotland, for the floating charge was transplanted to Scotland in 1961 with all its DNA as an equitable security.

Some comparative law

16.6 All legal systems with a UCC-9-type of security regime allow non-possessory securities by registration. For example, if Jack wants to borrow from Jill on the security of his bicycle, but retaining possession, that can be done. Indeed, UCC-9-type systems go further, and prohibit retention of title, financing leasing and HP. "Prohibit" is perhaps too strong a word. If anyone purports to enter into such an arrangement, it is not void, but the law "recharacterises" it as a security transaction.⁴ Some systems that do not derive from the UCC also allow non-possessory security by registration. Some systems, notably Germany and systems influenced by German law, allow non-possessory security without registration. Thus in German law, Jack could transfer ownership of his bike to Jill while retaining possession (*Sicherungsübereignung*). This is not security in the narrow sense, but it functions as security. If Jack repays the loan, he reacquires ownership. If he defaults, Jill can take possession and sell. No registration is required: ie German law does not apply the publicity principle.

16.7 The combination of UCC-9-type systems, which already are in place over much of the world, other systems of registered non-possessory security, and systems of unregistered non-possessory security, mean that Scotland is becoming rather unusual in not allowing non-possessory security – subject to the qualifications mentioned above.

16.8 In English law non-possessory security by means of a registered "bill of sale" has long been an option. In the case of companies, the bill is registered in the Register of

³ For an account of the floating charge, see Chapter 9.

⁴ For recharacterisation see Chapter 21.

Companies.⁵ In other cases it is registered in the Bills of Sale Register.⁶ The UK Government has recently reviewed the law. In the initial consultation paper the Government said it was "minded" to prohibit the bill of sale in relation to consumers.⁷ The main reasons were:⁸

- "Loans issued using bills of sale represent a very expensive form of credit, particularly for a secured loan, and the way they are marketed increases the likelihood of default by vulnerable consumers;
- The legislation is outdated and this increases the likelihood that consumers may not understand the risks and liabilities if they default on loans secured using bills of sale;
- Bills of sale lack the consumer protections associated with other forms of lending, such as the requirement for the lender to obtain a court order before seizing goods in the case of default;
- Bills of sale are associated with unfair debt collection practices and there are few rights open to consumers when a lender seeks to seize their secured assets;
- There is little or no protection for third party buyers if a lender recovers a security, typically a second-hand car,⁹ to which a bill of sale is still attached."

16.9 In 2011 it was announced that, for the time being at least, abolition would not take place, and that instead the Government would "give the industry a chance to put its own house in order."¹⁰

16.10 It is not for us to express a view on an issue that, as such, does not concern Scotland. At the same time, since we are raising the possibility of introducing to Scots law a registered non-possessory security interest, such criticisms of the system in England and Wales cannot be ignored. As to the first issue, if loans at over 400% interest¹¹ are unacceptable, then *that* – excessive interest – is the problem and should be addressed. Banning *security* for such loans seems an irrelevance.¹² As to the archaic nature of the system, the natural response is that if it is archaic then it should be updated, for example by having the register available online, as happens in so many countries, and so on. As to the effect on third-party buyers, if the current rules are unsatisfactory they should be reformed to give protection to defined classes of buyers, as happens in so many other countries. Even if the "industry" does "put its own house in order" that cannot improve the poor state of the

⁵ Companies Act 2006 s 860(7)(b): "a charge created or evidenced by an instrument which, if executed by an individual, would require registration as a bill of sale". There is nothing equivalent in the Scottish provision (s 878) because there is nothing like the bill of sale in Scotland. (But the omission is nevertheless odd because a Scottish company could presumably grant a bill of sale over goods it had in England.)

⁶ Bills of Sale Act 1878; Bills of Sale Act (1878) Amendment Act 1882; Bills of Sale Act 1890; Bills of Sale Act 1891.

⁷ See the consultation paper *A Better Deal for Consumers: Consultation on proposal to ban the use of Bills of Sale for Consumer Lending* available at <<http://www.bis.gov.uk/consultations/ban-use-of-bills-of-sale-for-consumer-lending>>.

⁸ Page 6.

⁹ The consultation paper reveals that motor vehicles are the chief type of collateral used in bills of sale.

¹⁰ The Government's response is also available at <<http://www.bis.gov.uk/consultations/ban-use-of-bills-of-sale-for-consumer-lending>>. For the quoted words see para 6.

¹¹ "An APR of over 400% is not uncommon." (Page 13).

¹² Indeed, economic theory would suggest that the effect of security is to *reduce* the interest rate. And certainly there is plenty of unsecured consumer lending at rates significantly higher than 500%.

legislation.¹³ Accordingly, whilst not wishing to express a view about law reform within England and Wales, we think that the criticisms levelled at bills of sale are of little weight in relation to the question of whether a registered non-possessory security interest should be introduced to Scots law.¹⁴

Parties

16.11 The general principle of the law of security rights is that there are no restrictions as to who can be the grantor or grantee, subject always to rules about consumer protection. The exception is the floating charge, which can be granted only by specified entities, notably companies. We would propose no such restrictions for the new moveable security (subject always to consumer protection rules), and this would be so equally for corporeal and incorporeal collateral. This point would be of particular significance if the new moveable security is capable of including after-acquired assets,¹⁵ for in that case it would be functionally comparable to the floating charge. So, for example, a sole trader, or an ordinary partnership, would be able to grant the new security. We quote a leading Canadian scholar; "Commercial lawyers old enough to remember the pre-PPSA complexities would include the integration of security interests of incorporated and unincorporated debtors as one of the great accomplishments of the PPS legislation."¹⁶

Asset types

16.12 Any type of corporeal moveable property could be used as collateral under the new moveable security, with three qualifications. (i) The first concerns consumers, and this is discussed below. The second is that ships and aircraft,¹⁷ which have their own special regime for secured transactions, would be excluded. (iii) The third is that if the Cape Town Convention were to be adopted,¹⁸ the asset types covered by that convention would, we think, not be available for use as collateral under the new moveable security.

Registration: introduction

16.13 If Scotland were to introduce non-possessory security, should registration be required? As mentioned above, round the world both approaches – registration and no registration – can be found, though registration is the commoner. One argument against registration is that it adds expense. The expense is not only the registration fee but also the staff time involved in carrying out the registration. Another is that since sale does not require registration, why should a lesser transaction, namely security? In favour of registration is the fact that it helps future potential lenders to know the position, and that the transparency brought about by registration has other benefits too, such as less scope for dispute. Again, in the event of insolvency, registration makes it much easier for the liquidator (trustee in sequestration, etc) to ascertain what rights the various creditors have. All these factors make for economic efficiency. Professor Drobnig, writing on German law, where there is no

¹³ There has long been unanimity in England and Wales that the Bills of Sale legislation is absolutely unacceptable, but nothing has been done.

¹⁴ For more on security over motor vehicles, see Chapter 17.

¹⁵ For this issue, see below.

¹⁶ Jacob Ziegel, "A Canadian Academic's Reactions to the Law Commission's Proposals" in John de Lacy (ed), *The Reform of UK Personal Property Security Law: Comparative Perspectives* (2010), at p 150.

¹⁷ For ships and aircraft, see Chapter 17.

¹⁸ For the Cape Town Convention, see Chapter 17.

registration of securities over corporeal moveables (or incorporeal moveables),¹⁹ notes that "the rate of litigation in cases of the buyers' bankruptcies is very high and as a result at least some of the initial saving of cost and time due to non-registration is later lost in litigating".²⁰ Moreover, as a result of the digital revolution, both registration and searching can be done quickly and cheaply. In New Zealand a registration costs NZ\$3 and a search costs NZ\$1.²¹ It is hardly possible to have a balance sheet, with the respective costs and savings of (a) registration and (b) non-registration, but if costs at or even near the New Zealand level can be achieved, it seems likely that the overall balance, in cost terms, must favour registration.

16.14 Another argument against registration should be mentioned. This is that even if registration is quick, and cheap, and simple, it is a step that some parties will not take because they do not know about it. Obviously this would not be an issue for banks and other financial institutions and so on, whose business it is to be well-informed about the law of credit and security. But less sophisticated parties might suffer. In general we think that there is unlikely to be a substantial problem. Non-possessory security would be something new, so anyone using it would have to have found out about it, and to find out about it would be to find out how to effect it.²²

16.15 However, if our law were to adopt the rule of the UCC and the PPSAs that retention of title, hire purchase, finance leases etc would (in many cases²³) have to be registered, the issue becomes a more significant one. Such a requirement would be likely to meet with some resistance especially if the law south of the border continues to be that such arrangements do not have to be registered. Moreover, since retention of title is commonly used by small and medium-size enterprises in their standard-form sale contracts, and since such enterprises may not be legally sophisticated, the result, at least for a significant period of time, might be to penalise such enterprises, who would find that their protection against the buyer's insolvency had vanished – in practice to the benefit of the buyer's bank.

16.16 The advisory group, while in favour of the possibility of non-possessory security over corporeal moveable property, was divided as to whether such security should be based on registration. Nevertheless, our provisional view is that registration should be required. That is the pre-dominant approach internationally, and we think that the arguments in favour outweigh the arguments against. Moreover, it should not be supposed that everyone would support a new non-possessory security right, the only issue being whether it should be registered or not registered, for there would be those, perhaps not few in number, who would agree to the introduction of a new non-possessory security right *only* if it were to be on the basis of public registration.

16.17 In Chapter 20 we consider how registration might work. The chapter is self-standing, for registration issues potentially arise for (i) outright assignment, (ii) non-possessory security

¹⁹ Subject to some exceptions, such as ships.

²⁰ In John de Lacy (ed), *The Reform of UK Personal Property Security Law: Comparative Perspectives* (2010) p 448.

²¹ See <<http://www.ppsr.govt.nz/cms>>. One NZ dollar = about 50p.

²² A parallel issue arises for assignment. If, however, the new rule for assignment were to be "either registration or intimation" there would be no problem, for parties who carried on using the old system – intimation – would be safe.

²³ The general rule is that registration is needed, but there are important exceptions. Apart from the obvious case where the creditor has possession, the exception worth particular note is "a purchase-money security interest in consumer goods" (UCC § 9-309(1)). Thus if a consumer acquires a washing machine on (to use UK terminology) hire purchase or conditional sale, the UCC does not insist on registration.

over corporeal moveable property and (iii) security over incorporeal moveable property. For present purposes we ask the basic question:

32. If a new non-possessory security is introduced, do consultees agree that it should be on the basis of some type of public registration?

Existing assets or after-acquired assets too?

16.18 One of the pervasive issues of law reform in the area of moveable security is whether it should be possible to grant security over after-acquired assets, significant arguments against such a possibility being that it is too prejudicial to other creditors, and that it leads to excessive over-collateralisation to the prejudice of the debtor.²⁴ UCC-9 allows security over future assets,²⁵ as do the PPSAs,²⁶ the EBRD²⁷ and the DCFR, though generally this is disallowed in consumer cases.²⁸ The Murray Report took a different approach: as far as corporeal moveable property was concerned, only what was owned at the time of the security could be covered. (By contrast, for receivables the moveable security would cover future assets too.)

16.19 Obviously it is not possible today for Jack to grant a real right over something he has not yet acquired. Indeed, it may not even yet exist, because it may not yet have been manufactured or grown. But in principle it would be possible for a juridical act effected today to take real effect tomorrow from the moment when Jack acquires ownership of the property in question. Suppose that Jack grants a security to Jill over all his bicycles present and future. That would create a real right of security in her favour over the two bicycles he owns today. Tomorrow he acquires a third. One *scintilla temporis* after the moment when Jack acquires the real right of ownership in that bicycle, Jill would acquire a subordinate right over it, namely a security right.

16.20 The question of whether non-possessory security should be available for future assets cannot be considered in isolation. It needs to be taken in connection with the question as to whether a security interest over *incorporeal* moveable property should be capable of covering future assets, which itself needs to be considered in connection with the question of whether a reformed system of assignation should be capable of applying to future assets. And all these issues have to be considered with the floating charge in mind. The more the law allows security over future assets (whether corporeal or incorporeal or both) the more that it is functionally duplicating the floating charge. And in terms of insolvency law, there is the vital question of whether the new security interest would be classified as "fixed". These issues will be looked at later.²⁹

²⁴ Over-collateralisation, also called over-security, is where the value of the collateral exceeds the debt. Moderate over-collateralisation is simple prudence. But excessive over-collateralisation harms the debtor, for example by making it harder to borrow from other lenders. It is a criticism of the floating charge that it often has this effect. In German law, over-collateralisation is regarded as unconscionable and renders the entire security void. We are not aware of other systems with a similar rule, though see Article L650-1 of the French *Code de Commerce*, which applies where "*les garanties prises en contrepartie de ces concours sont disproportionnées*".

²⁵ UCC § 9-204.

²⁶ See eg the New Zealand PPSA s 43, the Australian PPSA s 18 and the Saskatchewan PPSA s 13.

²⁷ Article 4.

²⁸ For the consumer dimension, see below.

²⁹ Chapter 22.

16.21 For present purposes, the arguments against allowing the new security are as follows. (i) A creditor who wishes to take security over future assets can take a floating charge. That is what the floating charge was designed to achieve. One limited counterargument here is that sole traders and partnerships cannot grant floating charges. (ii) A floating charge can be trumped by certain classes of creditor.³⁰ A moveable security over future assets would not be so trumped. That would be unfair to those other creditors. (iii) The more that security covers future assets, the harder it becomes for a borrower to seek finance from other sources. If Jack has granted global security to Bank X and he approaches Bank Y, the latter may decline to deal with him because all his assets are encumbered. In principle he could offer a second-ranking security, but that is likely to be unattractive. Again, he could seek to borrow enough from Y to pay off the whole indebtedness to X, so that X's security would be discharged, but that might be unworkable in practice. Of course, these difficulties already exist in relation to the floating charge.

16.22 It remains to add that the idea of a fixed security over future *immoveable* property does not seem to be discussed, here or elsewhere. In both the USA and Germany, for example, future security is limited to moveables, and in neither country does there seem to be any suggestion that the same idea should be extended to immoveables. Perhaps the reasons are (i) that turnover of immoveables is low (in comparison with moveables), so that separate security for each immoveable is not a problem and (ii) that the average value of an immoveable is much higher than the average value of a moveable, so that the transaction costs associated with the creation of a security right are comparatively small.³¹

16.23 If the new moveable security can cover after-acquired property, it begins to look like a floating charge. Floating charges are considered in a separate chapter,³² and it is there that the question is posed whether the new moveable security should be able to cover after-acquired property.

Security for future obligations too?

16.24 In general, security can be granted not only for existing obligations but for future obligations too. For example, if a standard security is granted (as is usually the case) for "all sums due or to become due" then a further loan from the creditor to the debtor some years later will automatically be secured by the standard security. The same is true of floating charges. This possibility of securing future debts is generally regarded as desirable. For example, in the case of a standard security over residential property, the owner might, a few years after the original loan, wish to borrow a further sum to finance an extension to the building. It would be inconvenient, and expensive, if a new standard security had to be granted to secure the new loan. As with standard securities and floating charges, the parties would naturally be free to agree that the security would *not* extend to future obligations. The UCC/PPSA approach is the same,³³ and we think that this should also be the position for the

³⁰ (i) Creditors using "effectually executed diligence". (Companies Act 1985 s 463; Insolvency Act 1986 ss 55 and 60; Bankruptcy and Diligence etc (Scotland) Act 2007 s 45.) (ii) Creditors with preferential claims, eg for arrears of salary (Insolvency Act 1986 s 59). (iii) Creditors participating in the "prescribed portion". (Insolvency Act 1986 s 176A.)

³¹ But in some countries taxes and notarial fees push the cost of immoveable security to levels that from a Scottish standpoint seem remarkably high.

³² Chapter 22.

³³ Two examples: UCC § 9-204(c): "A security agreement may provide that collateral secures... future advances or other value, whether or not the advances or value are given pursuant to commitment." Saskatchewan PPSA s 14(1): "A security agreement ... may provide for future advances."

new moveable security. (And hence in relation to security over incorporeal moveable property as well.)

16.25 Where security can cover future obligations, a possible problem can arise. Suppose that X grants to Y an all-sums standard security. At a time when the property is worth £1,000,000 and the loan is £700,000, X wants to borrow £100,000 from Z, secured *secundo loco* on the same property. Since there is £300,000 free "equity" in the property, it might seem that this deal is unproblematic.³⁴ But since the security held by Y is an all-sums security, if Y makes further advances to X in future, that would eat up the equity and undermine the value of Z's security. The same issue can arise with floating charges. So for both standard securities and floating charges there is a rule whereby in this situation the priority of Y's security can be frozen by means of a notice served on Y.³⁵ Arguably a similar rule would be appropriate for the new moveable security.³⁶ But it is worth noting that there is no equivalent provision in the UCC/PPSAs.³⁷

16.26 The question of whether consumers should be able to grant security over after-acquired property is discussed below.

16.27 We ask the following questions (which consultees should take as being as applicable also to incorporeal collateral):

- 33. Do consultees agree that the new moveable security should be capable of securing future obligations?**
- 34. If so, where there is an all-sums security, should its priority be capable of being frozen by notice, so as to enable a subsequent security to be granted, on lines broadly similar to the rules for floating charges and for standard securities?**

Licence/mandate to deal

16.28 A creditor in the new moveable security would be able to authorise the debtor to deal with the collateral free of the security, on such terms and subject to such conditions as may be agreed. This concept has sometimes attracted the name of "licence", the idea being that the debtor is "licensed" so to act. A better juridical basis would seem to be mandate. A creditor can discharge a security either personally or through a mandatory, and that mandatory can, if the creditor so chooses, be the debtor. Some have queried whether it is consistent with the essential concept of a security right for the debtor to be able to sell free of it, but we do not share that doubt. We think the general law of security already allows it.

³⁴ Though the X/Y contract might, and in practice commonly does, forbid X to grant any other security over the property without Y's consent.

³⁵ Conveyancing and Feudal Reform (Scotland) Act 1970 s 13; Companies Act 1985 s 464(5); Bankruptcy and Diligence etc. (Scotland) Act 2007 s 40(5).

³⁶ If the legislation were to be silent, then such a rule would probably be implied, as being part of the common law of rights in security (though the point might be open to debate). See in particular *National Bank of Scotland Ltd v Union Bank of Scotland Ltd* (1886) 14 R (HL) 1. (This case is sometimes cited with the defender's name, ie Union Bank, given first.)

³⁷ The PPSA rules allow "the first ranking creditor [to] erode the value of the subordinate creditor's security interest" and the only way to ensure this does not happen is for the second secured creditor to enter into a contractual priority arrangement with the first secured party. (Michael Gedye, Ronald C C Cuming and Roderick J Wood, *Personal Property Securities in New Zealand* (2002) para 72.2.)

35. Do consultees agree that there is no reason why a creditor should not be able to mandate the debtor to deal with the collateral free of the security?

16.29 To what extent creditors would wish to adopt such a course would be a matter for them. But they will be mindful that the wellbeing of the debtor's business may require some degree of latitude, and the wellbeing of the debtor's business is something in which the creditor has an interest. Having said that, the more broadly the law protects buyers from debtors, the less need there would be for creditors to grant such "mandates to deal" to their debtors. To this subject we now turn.

Protection for those buying (etc) from the debtor: introduction

16.30 The existence of a security right does not prevent the owner from transferring ownership to someone else, though the grantee will take subject to the security. In accordance with that general common law principle, if Adam owns a bicycle and grants to Ella a possessory pledge, and then he sells it to Siegfried, Siegfried acquires ownership, but subject to Ella's rights. But in such a case there is no need to protect Siegfried, for he must have acted with his eyes open. That is because Ella, the pledgee, has possession. Accordingly our law does not see Siegfried as being in need of protection. For possessory security, other legal systems take the same view of matters. But when it comes to non-possessory security, the position is different. If Adam has the bicycle in his hands, there is nothing to alert Siegfried to the fact that Ella may have a security right over it. There is clearly a case for saying that Siegfried should, at least in some types of case, be protected, ie should acquire the bike free of the security interest. The argument has two strands, one being fairness, and the other being economic efficiency.

16.31 The "fairness" argument is, indeed, not a conclusive one. For *whenever* one buys goods one takes a risk, at least under current Scots law.³⁸ For example, Siegfried runs the risk that the bike that Adam has in his hands might have been stolen. A buyer of land can investigate title and verify the seller's right to sell with an extremely high degree of certainty. That is not possible for corporeal moveables. Given that Siegfried must take a risk in any event, why should he not also run the risk of a security interest? Indeed, assuming that non-possessory security interests must be registered, can one really speak of a risk at all, since Siegfried can eliminate that risk by a simple search,³⁹ whereas the risk that the title is vitiated by a theft cannot be so readily eliminated.

Protection for those buying (etc) from the debtor: some comparators

16.32 Notwithstanding that argument, most systems that allow non-possessory security provide that buyers are, in at least some type of case, protected, so that they take free from the security.⁴⁰ Parties *other* than buyers (such as those taking subsequent security interests, donees, etc) are seldom protected. As a general point, in all systems it appears to be

³⁸ In a few legal systems, such as the Italian, a good faith buyer always takes a perfect title, free of all third party claims whatsoever.

³⁹ Any register would be on-line. In New Zealand a search costs about 50p. Even for a bicycle that is a low figure.

⁴⁰ As mentioned above, the English bill of sale is an exception. No protection exists. "Taking free from the security" does not necessarily mean a good title. Alan steals a bicycle from Beth. He grants a security over it to Charlene. Then he sells it to Donald. Then he vanishes. Beth is still the owner: Charlene loses the money she lent and Donald loses the price he paid. This absence of protection is regarded (see above) as an objection to the entire system of bills of sale.

competent for the original security agreement to authorise the debtor to sell property free of the security interest. To the extent that such a clause is applicable, a buyer is protected anyway, and does not need to rely on special statutory protections. To such special statutory protections we now turn.

16.33 The UCC provides:⁴¹

"(a) Except as otherwise provided in subsection (e),⁴² a buyer in ordinary course of business,⁴³ other than a person buying farm products from a person engaged in farming operations, takes free of a security interest created by the buyer's seller, even if the security interest is perfected and the buyer knows of its existence.

(b) Except as otherwise provided in subsection (e), a buyer of goods from a person who used or bought the goods for use primarily for personal, family, or household purposes takes free of a security interest, even if perfected, if the buyer buys (1) without knowledge of the security interest; (2) for value; (3) primarily for the buyer's personal, family, or household purposes; and (4) before the filing of a financing statement covering the goods."

16.34 The DCFR rule is that a buyer is protected if "the transferor acts in the ordinary course of its business".⁴⁴ This rule is to be found in all the UCC/PPSAs. But it also has a rule that we do not see elsewhere: a buyer is protected if "the entry is filed against a security provider different from the transferor."⁴⁵ An example of the latter would be if W grants a security to X, and later W transfers to Y. At this stage the security is undischarged. The register is not amended to give Y's name. At this stage Y transfers to Z. Z takes free, because any search against the seller (Y) would not disclose the security.

16.35 The EBRD Model Law also has an "ordinary course of business" rule.⁴⁶ It also protects good faith buyers where the price is low, to ensure that no one needs to search the register in such cases. (It leaves individual states to fix the figure.)⁴⁷

16.36 Australia⁴⁸ also has an "ordinary course of business" rule.⁴⁹ It also has this rule which applies to goods other than inventory:⁵⁰

"A buyer or lessee of personal property takes the personal property free of a security interest in the property if:

(a) the regulations provide that personal property of that kind may, or must, be described by serial number in a registration; and

⁴¹UCC § 9-320 (a) and (b).

⁴² Subsection (e) is about possessory security interests. In other words if Jack pledges goods to Jill and then sells them to Tim, Tim does not take free. Of course in such a case Jack has not delivered the goods to Tim, because Jill has them.

⁴³ This formulation is perhaps misleading, for what is meant is a person who buys in the ordinary course of the *seller's* business.

⁴⁴ DCFR IX-6:102. A better-phrased formula than that to be found in the UCC: see above.

⁴⁵ DCFR IX-6:102. And see DCFR IX-5:303(2).

⁴⁶ The detailed rules are complex; see articles 19 to 21.

⁴⁷ EBRD Model Law article 21.2.5.

⁴⁸ See Part 2.5 of the Australian PPSA.

⁴⁹ Australian PPSA s 46.

⁵⁰ Australian PPSA s 44.

(b) searching the register, immediately before the time of the sale or lease, by reference only to the serial number of the property, would not⁵¹ disclose a registration that perfected the security interest."

16.37 For motor vehicles there is a special rule, not dissimilar from the one just quoted. There is also a special rule⁵² for the case where goods are bought in good faith "predominantly for personal, domestic or household purposes" for under a prescribed figure, currently A\$5,000. (About £3,250.)

16.38 Many of the UCC/PPSA systems have a rule whereby defective registrations are invalid, and generally this is an objective test, so that it is not necessary for a third party to prove that the register has been searched in vain. For example the Australian PPSA provides that a defect is fatal to the validity of the registration if "no search of the register ... by reference only to the grantor's details (required to be included in the registered financing statement ...), is capable of disclosing the registration".⁵³

16.39 The Report of the Law Commission of England and Wales recommended "that a transferee (other than a secured party) of collateral that is subject to a registered charge which is a fixed charge should take subject to the charge unless the chargee has authorised the sale or other disposition."⁵⁴ But this was on the basis that stock would never be subject to such a charge.⁵⁵

16.40 The Murray Report recommended that a buyer would take free if the buyer "is not aware that the property is subject to a moveable security or is aware that the property is subject to such a security but is not aware that such agreement⁵⁶ is made without the prior written consent of the holder of the security having been obtained."⁵⁷ This is to be read with the proviso that "for the purposes of this section a third party shall not be held to be aware that property is subject to a moveable security by reason only that" it had been registered.⁵⁸ The overall effect would have been that a moveable security would seldom have affected good faith buyers.

Buyer protection: policy

16.41 All UCC/PPSA systems have a rule protecting buyers in the ordinary course of the seller's business, even if they know of the security. That rule is to ensure that security does not encumber commerce. For example, a motor dealer should be able to sell vehicles to customers without any question arising as to whether they should search the register. We think that Scots law should be the same.

⁵¹ Thus the protection does not require that the buyer did actually search the register.

⁵² Australian PPSA s 47(2).

⁵³ Australian PPSA s 165(b).

⁵⁴ Law Com Report No 296 para 3.218.

⁵⁵ "It is not feasible to create, or at least to maintain, a fixed charge over stock-in-trade, so sales of stock-in-trade will fall under the rules for floating charges discussed below." (Law Com Report No 296 para 3.217; see also paras 3.160 and 3.161). In the preceding Consultative Report (*Company Security Interests: A Consultative Report* (Law Commission Consultation Paper No 176 (2004))), the Commission had proposed the introduction of a new single form of charge the effect of which would be to supersede fixed and floating charges. As part of the scheme they had proposed that under any charge a company would have a right and a power to sell its stock-in-trade free of the charge and pay its employees and trade creditors. But the proposal for a new single form of security was not adopted in the final report.

⁵⁶ This means the contract of sale.

⁵⁷ See Draft Floating Charges and Moveable Securities (Scotland) Bill clause 11(4)(c).

⁵⁸ See Draft Floating Charges and Moveable Securities (Scotland) Bill clause 11(5).

16.42 We also think that a buyer who has searched the register without discovering the security should take free of it. For example, suppose that W grants a security to X and then sells to Y⁵⁹ who later sells to Z. If Z searches the register, the security will not be discovered, since Z will be searching against Y's name.⁶⁰ In that case, Z, if in good faith, should be protected. In this type of case there are a number of different possibilities. Although registration would generally be against the name of the debtor, in some cases (eg motor vehicles) it would also be against the number of the vehicle, and in such cases a buyer would be expected to do a "vehicle search". (Unless, as would often be the case, the seller was a dealer selling in the ordinary course of business.) Another possibility is that a buyer searches against a seller whose name is a common one and who gives an address different from the address in the security. (For instance John Smith of 12 Grimmauld Place grants a security. He then moves to 4 Privet Drive and then sells the collateral.⁶¹) A buyer might be unable to locate the entry in the register. This problem might be solvable by requiring, as does (eg) the New Zealand PPSA, that dates of birth be given.⁶² Again, whilst the legislation would require the entry in the register to specify the collateral, some entries might be vague.

16.43 There is also the question of whether protection should be given only to the person who has *in fact* searched the register, or, more broadly, provide that no entry can adversely affect someone if it would not have been discovered by reasonable diligence.

16.44 Protection to buyers would be more extensive than protection to other parties. For example, the "sale in the ordinary course of business" rule would not apply to creditors taking later security, or to creditors doing diligence.

16.45 There is also the question of whether buyers of lower-value items should be exempted from the need to search the register, on the lines adopted in some PPSAs, such as Australia, where the figure, as mentioned above, is A\$5,000 (= about £3,250). As noted above, the EBRD Model Law has such a rule, though no figure is specified. New Zealand has the same rule but the figure is lower, namely NZ\$2,000 (= about £960).⁶³

16.46 Under sections 24 and 25 of the Sale of Goods Act 1979, a precondition for the protection of the buyer from the seller's lack of title is that the goods should have been delivered to the buyer. That approach is not generally to be found in the UCC/PPSAs. Should it be a requirement in Scots law?

16.47 We would appreciate the views of consultees on these matters. There are numerous possibilities, and combinations of possibilities, and much would depend on how the register was set up. We are aware that the following questions are far from exhaustive. But to test views, we ask:

36. Do consultees agree that buyers in the ordinary course of the seller's business should take free from a registered non-possessory security?

⁵⁹ At this stage the property is still subject to the security.

⁶⁰ The registration system would allow the register to be amended so as to be discoverable by a search against Y's name, but in this example we assume that this has not been done.

⁶¹ This type of issue can arise in the law of inhibitions: see *Atlas Appointments Ltd v Tinsley* 1997 SC 200. For the legislative response to that case, see Bankruptcy and Diligence etc (Scotland) Act 2007 s 159.

⁶² See the New Zealand PPSA s 142(1)(a). For companies, the registration number could be given, since this cannot be changed, unlike name and address.

⁶³ New Zealand PPSA s 54.

37. Do consultees agree that a good faith buyer who has used reasonable diligence in searching the register should take free from entries not thereby revealed?
38. Should the proposal just mentioned also apply to creditors taking security?
39. Should there be a broader rule that entries not discoverable by reasonable diligence should not affect either a buyer or another type of grantee, whether or not the register has actually been searched?
40. Should there be a rule that a good faith buyer should always take free from a registered security where the price paid by the buyer is below a certain limit (to be adjusted from time to time by statutory instrument)? If so, what should that limit be?
41. Would consultees prefer something along the lines of the proposal in the Murray Report, which would mean that good faith buyers would not normally take subject to a registered moveable security?
42. Should delivery be a precondition of protection?

Proceeds

16.48 The UCC/PPSAs generally provide that if the debtor sells collateral, the proceeds of sale (and of insurance policies for fire loss etc) are automatically subjected to the security interest.⁶⁴ The Murray Report rejected this approach.⁶⁵ We also reject it. Assuming that the new moveable security can cover after-acquired assets, it can cover proceeds too, not by virtue of some special rule, but simply by virtue of the scope of the security according to its registered terms. For example, suppose that a security is registered covering all the debtor's stock and receivables. The debtor sells an item of stock on credit. As a result the stock itself disappears from the debtor's patrimony, but is replaced by another asset, the receivable. This is subject to the security, not because it is "proceeds" but because it is a receivable, and the security covers receivables. Examination of the UCC/PPSA statutes suggests to us that a "proceeds" rule adds very considerably to the complexity of the legislation without sufficient countervailing benefits. We propose:

43. **The new moveable security should not have a special "proceeds" rule.**

Fixtures

16.49 The UCC and some of the PPSAs provide for personal property security interests to extend to "fixtures" ie moveables that have become part of immoveable property by annexation (accession). Thus the UCC provides that "a security interest under this article may be created in goods that are fixtures or may continue in goods that become fixtures. A security interest does not exist under this article in ordinary building materials incorporated into an improvement on land."⁶⁶ Some PPSAs, such as New Zealand, have not followed this

⁶⁴ See eg UCC § 9-203(f); DCFR IX-2:306.

⁶⁵ Murray Report para 3.5; Draft Floating Charges and Moveable Securities (Scotland) Bill clause 9(3).

⁶⁶ UCC § 9-334.

approach. We think that the New Zealand approach should be followed in Scotland. Such a provision causes considerable additional complexity, not least because the collateral is, by definition, part of the immoveable property in question, so that it is subject simultaneously to land law and to the moveable property security regime.

44. Do consultees agree that the new security right should not extend to property that has acceded to immoveable (heritable) property?

Priority/ranking

16.50 As a general principle, an owner can grant more than one security right in the same item. That is because security is a subordinate real right, which leaves ownership with the granter. That general principle would apply to non-possessory security over corporeal moveable property, and indeed it would be one of the attractions of the system.

16.51 According to the general law of security, ranking (priority) is by date of real right. That would apply to registered non-possessory security. Thus if Jack grants to Jill a security over his bicycle and another security to Kate, also over his bicycle, priority would depend on date of the real right, and the date of the real right would be the date of registration. If Jill registers on 1 May and Kate on 2 May, Jill has the first-ranking security and Kate the second ranking security. So if Jack defaults and the bike is sold for £500, and both loans are for £300, Jill receives £300 and Kate receives £200. All this is simply the general common law of rights in security. It would not be necessary to enact it, though there might be a case for doing so.

16.52 In this example, the security is over an asset that Jack already has. If the law allows security over after-acquired assets, the position is not quite so simple. Suppose that Jack runs a bookshop and the security is over all his present and future stock. It is registered on 1 May 2020. After a year or two – say 1 May 2022 – there may not be a single book in the shop that was Jack's when he granted the security. For each book acquired by Jack after 1 May 2020, the real right of security comes into existence on the day that he acquires the book. It cannot come into existence on 1 May 2020, when the book in question belonged to the wholesaler, and, quite possibly did not even yet exist. So in such a case one cannot say that the date of the real right of security is the date of registration.⁶⁷

16.53 Suppose that Jack grants a security over present and future stock to Cyril, registered on 1 May 2020, and another to Deirdre, registered on 1 November 2020. And consider the position of a book acquired by Jack from the wholesaler on 1 June 2021. Both Cyril and Deirdre would acquire their real right of security at the same moment. Yet Cyril's security ranks before Deirdre's. (This is a twist in the law of ranking that does not arise in the case of land law.)

16.54 Since the law would continue to allow possessory security, ie pledge, it may be asked how a possessory and a non-possessory security would interact. The answer would be given by general law: *prior tempore potior jure*. Thus suppose that Cosmo grants to

⁶⁷ Though this seems to be the position in many UCC-derived systems. In the DCFR, as in the UCC/PPSAs, registration may precede creation (DCFR IX-3:305(2) and yet DCFR IX-4:101(2)(a) says that the priority point is the date of registration, not the date of creation. The same sort of approach can also be seen in DCFR III-5:114(2). The EBRD Model Law is the same: article 6.8. In our view the path of wisdom is that effects should not precede causes. In other words, for a juridical act to have retroactive effect (effect *ex tunc* as opposed to effect *ex nunc*) is undesirable.

Dugald a non-possessory security over his bicycle, registered on 1 March, and on 15 March pledges the bicycle to Eve, then Eve's security, having been constituted later, ranks after Dugald's.

16.55 The "ranking by date of registration" rule would be subject to one qualification. Suppose that the wholesaler has granted to Harry a non-possessory security over a book before sale to Jack, registered on 15 May 2021, and, for some reason, this is not discharged upon that sale. To say that because Cyril's security ranks from 1 May 2020 it trumps Harry's security, because it was registered earlier, would be wrong. The book was encumbered by Harry's security before it ever entered Jack's patrimony.

- 45. Do consultees agree that ranking should be by date of registration, subject to the qualifications necessary in the case of security over after-acquired property?**

Interaction with the landlord's hypothec

16.56 We can see no reason why a non-possessory security should have priority over the landlord's hypothec.⁶⁸

- 46. Do consultees agree that any new security right should be without prejudice to the landlord's hypothec?**

Interaction with diligence

16.57 The new security right would interact with diligence under the general law, and we incline to think that no special rules would be needed. For example, if X owns a combine harvester, and on 1 June grants a security to Y over it, and on 15 June Z, a creditor of X, attaches it, the diligence would be effective but would rank after the security. Conversely, if Z attaches the machine on 1 June and X grants to Y a security on 15 June, the security would be effective but would rank after the diligence.

Interaction with securities arising by operation of law

16.58 A floating charge ranks behind any "fixed security arising by operation of law".⁶⁹ A UCC security interest ranks after any "possessory lien".⁷⁰ Comparable provisions can be found in some of the PPSAs.⁷¹ Such a rule could be framed in various ways. We ask the general question:

- 47. Should the new moveable security be postponed, in terms of ranking, to security rights arising by operation of law?**

⁶⁸ Cf Law Com Report No 296 para 3.207.

⁶⁹ Companies Act 1985 s 464(2); Bankruptcy and Diligence etc (Scotland) Act 2007 s 40(4). A security arising by operation of law is one that comes into being automatically when certain defined circumstances exist without any actual grant of security by the debtor.

⁷⁰ UCC § 9-333.

⁷¹ For instance the New Zealand PPSA s 92; the Ontario PPSA s 31.

The new security as a species of right in security

16.59 The new security would simply be a new species of a familiar genus, namely the genus of "right in security", and the general law applying to that genus would apply to the new security, except in so far as the legislation otherwise provided.⁷² One difference between Scots law and English law is that Scots law has a generic concept of right in security that is more developed than its English equivalent. In English law there are four security devices, namely mortgage (which comes in two varieties, legal and equitable), charge, pledge and lien, and whilst there has evolved to some extent a generic concept, it is weak. English law has not fully developed the concept of a subordinate real right, with the result that when a mortgage of a house is granted, this has to be done by a lease, with the debtor becoming the lender's landlord for a term of three thousand years.⁷³ In other words, a true right in security (in the civilian sense, of a type of subordinate right) has not yet emerged, though an equitable security does have some likeness to a subordinate right. Scots law is fortunate, we incline to suggest, in having inherited the basic concepts of civilian property law.

16.60 The applicability of the general law would apply both to the common law of security and to statutory rules. Thus the common law of ranking (priority) would apply.⁷⁴ So would, for example, the law of catholic and secondary securities,⁷⁵ the law about transfer subject to security and the common law about unfair preferences and gratuitous alienations. Turning to general statutory rules about security rights, the new security would automatically be subject to, for example, the statutory rules about unfair preferences,⁷⁶ and the moratorium rules in company administration and company voluntary arrangements.⁷⁷

Enforcement⁷⁸

16.61 In this section we discuss enforcement, but rather briefly, because for the most part enforcement involves issues that are rather issues of technique than of fundamental policy. There exist several models for enforcement that could be consulted, such as the UCC, the PPSAs, the DCFR, the EBRD Model Law and the Murray Report, as well as existing schemes within Scots law, such as the rules for enforcing standard securities contained in the Conveyancing and Feudal Reform (Scotland) Act 1970.

16.62 One negative point. One of the curious facts about the floating charge is that enforcement can be done only through one or other of three vehicles: liquidation, administration and receivership. Of course, if a debtor were to be sequestrated, put into liquidation etc, the security would be enforced within the framework of that process.⁷⁹ But in

⁷² These remarks would apply equally to the new security in relation to incorporeal moveable property.

⁷³ Law of Property Act 1925 s 87: "Where the mortgage is a mortgage of an estate in fee simple, a mortgage term for three thousand years ..." Where the grantor has a leasehold, then "a term of years absolute, a sub-term less by one day than the term vested in the mortgagor."

⁷⁴ Though the legislation could, if so desired, spell out the ranking rules.

⁷⁵ In *Forth & Clyde Construction Co Ltd v Trinity Timber & Plywood Co Ltd* 1984 SC 1 it was held that this doctrine does not apply to floating charges. The decision illustrates the lack of connection between the law of floating charges and the general law.

⁷⁶ Bankruptcy (Scotland) Act 1985 s 36; Insolvency Act 1986 s 243.

⁷⁷ Insolvency Act 1986 sch A1 para 12 and sch B1 para 43.

⁷⁸ See generally Eric Dirix, "Remedies of Secured Creditors outside Insolvency" in Horst Eidenmüller and Eva-Maria Kieninger (eds), *The Future of Secured Credit in Europe* (2008).

⁷⁹ See below.

our view the new moveable security should not entail such procedures. That is also the general approach of the UCC/PPSAs.

16.63 Enforcement should be, as far as possible, swift and inexpensive. The slower and more expensive security is to enforce, the less effectively it works. Moreover, debtors themselves suffer, because delay in enforcement is likely to mean more accumulated interest, and above all the expenses of the process will normally fall on the debtor anyway.

16.64 Consumer protection is important, but the new moveable security might not be capable of covering assets exempt from diligence.⁸⁰ That in itself would constitute a broad measure of consumer protection. (See below.) Moreover, also as noted below, the Consumer Credit Act 1974 would apply automatically in so far as consumers were involved.

16.65 In the interests of speed and low costs, it seems desirable that enforcement should in principle be possible without the involvement of the court. Of course, the involvement of the court might prove unavoidable. For example there might be a dispute as to whether the debtor was in fact in default. The debtor might simply refuse to hand over the goods. And so on.

16.66 Evidently the creditor would have to issue some sort of formal notice, and probably this should be registered in the register.⁸¹ The notice would be served on the debtor, but there would need to be rules dispensing with this in the event that service could not be effected.⁸²

16.67 The core idea would be that in the event of default in respect of the secured obligation, the creditor would be entitled to sell the goods, and, to this end, could demand that the debtor deliver the goods.⁸³ Such a demand would confer on the creditor a right to possess, so that if the debtor refused delivery, the creditor would have the remedies generally available to someone who is entitled to, but does not yet have, possession. Presumably it would be impermissible for the creditor, or creditor's agent, to enter premises without the consent of either the occupier,⁸⁴ or of the court, but it is for consideration whether the creditor or agent should be entitled to take possession of other items, such as road vehicles that are parked on the street.

16.68 In Chapter 6 we mention the law about the *pactum commissorium*. Most legal systems, including the UCC/PPSAs, have rules restricting the possibility of the creditor taking ownership of the collateral in satisfaction of the debt, the reason being that experience has shown that such a possibility can easily be abusive in practice.⁸⁵ It may be that legislation about the new moveable security should also have provisions on this subject. Indeed, more generally it is likely that the legislation would need to have a core of non-waivable rules about enforcement.

⁸⁰ See below.

⁸¹ As in EBRD Model Law article 22.

⁸² For example a natural person who had done a runner, or a registered company that had been dissolved.

⁸³ In theory collateral can be sold by a creditor even though the debtor still has possession, leaving the problem of getting possession to the buyer. But in practice buyers will be reluctant to buy, unless the creditor already has possession.

⁸⁴ For the DCFR see IX-7:201.

⁸⁵ As mentioned in Chapter 6, the modern rules derive ultimately from the imperial legislation of AD 326.

16.69 Legislation could set out in detail the procedures involved, including such matters as the method of sale, the duty to obtain the best price reasonably available, and so on. There are models for such an approach.⁸⁶ How much detail would be a matter of judgment. For example, some of the provisions set out in the 1970 Act are in fact already covered by the general common law of security.

16.70 It has been suggested to us that the new moveable security should be enforceable (if so desired by the creditor) by a form of receivership. The Murray Report also supported that option.⁸⁷ We are doubtful. If the debtor becomes insolvent, the security would be enforceable through liquidation or administration, or, as the case may be, sequestration, for the new security would be a security, and the general law of insolvency accords security rights their due ranking. Outwith the context of insolvency, a creditor could appoint an agent to act. It is not clear what more could be reasonably asked for. Floating charge receivership is a problematic concept. For example, the receiver is nominally the debtor's agent, when in substantive reality acting for the creditor. Moreover, floating charge receivership goes beyond a mere mechanism for enforcing security. For example, a receiver has power to hire and fire employees.⁸⁸ As has often been remarked, receivership is in part a concept of insolvency law. It may be noted that the policy of the Enterprise Act 2002 was to move away from receivership except in certain types of case. We think that receivership is probably not appropriate, but that if it were to be adopted it would need to be significantly different from receivership as a means of enforcing a floating charge. Nevertheless we note that some of the PPSAs allow enforcement through receivership.⁸⁹

16.71 Many of the issues about enforcement are the same regardless of whether the collateral is corporeal or incorporeal. We ask the general question:

48. What views do consultees have as to the enforcement of the new moveable security?

Debtor insolvency

16.72 If the debtor were to be sequestrated (or put into liquidation etc), an as-yet unenforced moveable security would be treated like any other as-yet unenforced security. The provisions of the applicable legislation⁹⁰ are in general terms, so it is unlikely that any amendment would be needed.

16.73 But in so far as the new moveable security approximated in functional terms to a floating charge, it would be subject to the priority downgrade that a floating charge may suffer, such as postponement to the preferential creditors, and also the "prescribed part." This issue is considered elsewhere.⁹¹

⁸⁶ For example in the provisions about the enforcement of standard securities contained in the Conveyancing and Feudal Reform (Scotland) Act 1970.

⁸⁷ Murray Report para 3.25 ff.

⁸⁸ Insolvency Act 1986 sch 2 para 11. Another example in the same schedule is para 5: "Power to bring or defend any action ... in the name ... of the company." (Emphasis added.)

⁸⁹ We have not made a full study, but two examples are Ontario PPSA s 60 and Saskatchewan PPSA s 64.

⁹⁰ Bankruptcy (Scotland) Act 1985; Insolvency Act 1986.

⁹¹ Chapter 22.

Consumer protection

16.74 The provisions of the Consumer Credit Act 1974, including sections 105 to 113, would apply automatically to any new moveable security, in so far as consumers were involved. That would be as true for incorporeals as for corporeals.⁹²

16.75 Should there be any restrictions on the power of consumers to grant the new security? The UCC/PPSAs generally do not allow security over after-acquired consumer goods.⁹³ The DCFR does not allow security to be granted by consumers over after-acquired property.⁹⁴ There is a difference here, the one restriction relating to the type of goods and the other to the type of granter. We incline to favour the DCFR formulation. There exists a parallel issue for the assignation of future claims, mentioned in Chapter 14.

16.76 Possibly there should be an additional restriction. The law protects some assets of consumer debtors against diligence. There is evidently a reasonable case for saying that property that would be exempt from diligence should not be capable of being used as collateral under the new security. (Some of the PPSAs have a comparable rule.⁹⁵) It is true that no such restriction exists at present for security by way of pledge. But pledge requires delivery to the lender. That will cause any debtor to think very carefully, and moreover if a debtor can give up possession of something then it may be that that item is not really an essential item. But in the case of a non-possessory security, no yielding of possession would be needed. Moreover enforcement in the event of default might involve intrusion into the debtor's home, something whose acceptability would be open to question. We incline to think, therefore, that any item that would be exempt from diligence should likewise be incapable of being used as collateral for the purposes of the new security.

16.77 This argument is, however, not necessarily conclusive.⁹⁶ Goods that are exempt from diligence can still be subject to hire-purchase etc, and it may be argued that to exclude such goods from the new regime would be merely to encourage the use of hire-purchase, which in itself is an artificial system. The Diamond Report proposed that it should be competent for consumers to grant security to finance the *purchase* of consumer assets.⁹⁷

16.78 We ask:

⁹² The definition of "security" in s 189 of the Consumer Credit Act 1974 is not limited to security over corporeal property.

⁹³ See Chapter 13. The Diamond Report took a similar line: para 18.1.9.

⁹⁴ IX- 2:107.

⁹⁵ For example, in Ontario, property exempted from seizure under a court writ by the Execution Act 1990 s 2 (eg: the debtor's home, clothing, household items, occupational tools and motor vehicle (below a certain value)) is excluded from the creditor's usual right to take possession of the collateral on default (sections 62(1) and (2)). The New Brunswick PPSA has a similar rule at section 58(3) and the Nova Scotia PPSA at s 59(3). The Saskatchewan rules are scattered in various provincial statutes such as the Exemptions Act 1978, the Limitation of Civil Rights Act 1978 and the Distress Act 1978. A summary can be found in Ronald Cuming and Roderick Wood, *Saskatchewan and Manitoba Personal Property Security Acts Handbook* (1994) para 58(2).

⁹⁶ There is valuable discussion of the issue in Part X of Law Com CP No 164. In the final report the Law Commission decided to leave the question of security rights by consumers open, merely recommending that "the Department of Trade and Industry, who are already involved in an extensive review of consumer credit law, should examine the question of replacing the Bills of Sale Acts with a more efficient and effective scheme." See Law Com Report No 296 para 1.53. As of the time of the present discussion paper, the law of bills of sale had not been reformed.

⁹⁷ Diamond Report paras 18.1.1 to 18.1.12.

49. **If a new non-possessory security over corporeal moveable property is introduced, do consultees agree that it should not be capable of being granted by a consumer in relation to future property?**
50. **If a new non-possessory security over corporeal moveable property is introduced, should there be other restrictions in relation to consumer debtors? For example should goods exempt from diligence be excluded? Or should the security be valid only to secure purchase finance?**
51. **If a new non-possessory security over corporeal moveable property is introduced, should the pro-consumer protections in the Consumer Credit Act 1974 be amended so as to extend to it? (Other than those protections that would apply automatically.)**

Hire-purchase etc

16.79 The provisional proposals in this discussion paper would leave existing quasi-security techniques, such as hire-purchase, available for use, though there would always be the possibility of further reform at a future stage. The finance industry would thus have a choice. If someone wishes to buy a car on the basis of secured finance, then that could be done either as it is done at present, or by means of a registered security. It might be that the latter would prove more attractive, though here something depends on the precise details of the new system.

Agricultural charges

16.80 Agricultural charges are discussed in Chapter 6. Since the decision – which we consider to have been unwise – to abolish the need for them to be registered, the number of such charges cannot be known, but our impression is that they are rare. Whether they should continue to exist even under current law may be questioned, especially as they can now be enforced only by bankrupting the debtor, which seems a disproportionate method of enforcement. Moreover, the fact that they are now secret charges makes their existence difficult to defend from the standpoint of public policy.

16.81 In any event, if the proposals put forward in this discussion paper go ahead, we would suggest that there would be no need to maintain the Agricultural Credits (Scotland) Act 1929 in force.

52. **If a new non-possessory security over corporeal moveable property is introduced, the Agricultural Credits (Scotland) Act 1929 should be repealed.**

Name

16.82 "Non-possessory security over corporeal moveable property" may be a precise term but it is not snappy. Moreover, later in this paper we propose the introduction of a new non-notification security right over incorporeal moveable property, and our vision is that of a single security right that could cover both corporeal and incorporeal moveable property. A snappy name would be desirable. The Murray Report used the term "moveable security" to cover both non-possessory security over corporeal moveable property and security, without

intimation, over incorporeal moveable property. It provides a neat match to "heritable security". A drawback to the term is that there are other moveable securities, including pledge, ship mortgage and so on. Legislation could merge pledge with the new security, in which case both could be called moveable security, or, indeed, both could be called pledge. Since "pledge" is a term that traditionally indicated that the creditor has possession, there would be a case for using the term "moveable hypothec" for the new device, "hypothec" meaning non-possessory security. If that opinion were to be adopted, a separate term would be needed for incorporeals, because with incorporeals the possessory/non-possessory issue does not arise. One could have "corporeal moveable security/hypothec" and "incorporeal moveable security/hypothec" as the two sub-types of "moveable security/hypothec." But that might be regarded as inconvenient, and in this discussion paper we treat the possible new security as an essentially unitary security, as did the Murray Report. Moreover, the UCC/PPSAs, the DCFR and the EBRD Model Law all conceptualise the security interest as essentially unitary, albeit requiring some variations according to the particular type of property. Provisionally we use the term "new moveable security" but this is just a holding title. If (and we incline to think) the new security should be a registered security, then "registered moveable security" might be appropriate, albeit low on the snappiness scale.

16.83 Of course, names are not very important. But bad names can be inconvenient. Since we propose that the new security right could cover both corporeal and incorporeal moveable property, the name should be appropriate for both.⁹⁸

53. If a new type of security right over moveable property is introduced, what should it be called?

⁹⁸ For discussion of the issue in the context of the Murray Report, see Andrew J M Steven, "Reform of Security over Moveable Property" 1995 SLT (News) 120.

Chapter 17 Special types of corporeal moveable property: ships, aircraft, motor vehicles, spacecraft, and rolling stock

Ships

17.1 Ships have their own regime for security rights: ship mortgages.¹ In addition, there are the unregistered bonds of bottomry (over the ship itself) and bonds of respondentia (over the cargo), which are obsolete in practice. We do not think that this project should affect shipping law. In the first place, the existence of a mature system of ship mortgages would mean considerable complexity if a new competing type of security were to be added, side by side with the existing law. Moreover, if the law of security over ships is to be reformed, ideally that would be done at the UK level. Our reluctance to interfere, in this project, with shipping law is both positive and negative. That is to say we do not think that the possible new moveable security should be extended to ships, nor do we think that this project should recommend, for instance, the abolition of bonds of bottomry, albeit that a case for such abolition could be made.

17.2 However, any new moveable security would be applicable to any vessels for which ship mortgages are not available.

- 54. Do consultees agree that any new non-possessory security right over corporeal moveable property should not extend to ships over which a ship mortgage can be granted?**

Aircraft

17.3 In this project we do not think it appropriate to undertake a general review of the law about ship mortgages or aircraft mortgages.² Nevertheless, the Mortgaging of Aircraft Order 1972 has some specifically Scottish provisions and it has been represented to us by one of the members of the Advisory Group³ that these are imperfect. In the first place, the 1972 Order prescribes a style deed for Scots law but not for English law. The suggestion is that experience has shown that the Scottish style can be awkward to use, and that if no prescribed style is needed in England, none should be needed in Scotland either. In the second place, whereas the English provisions allow for the use of priority notices, there is

¹ Merchant Shipping Act 1995 sch 1.

² We incline to think that the Mortgaging of Aircraft Order 1972 stands in need of a general review. But, as we say, that lies outwith the scope of this project.

³ Mr Bruce Wood.

doubt whether the same is true for Scotland.⁴ The suggestion is that priority notices are valuable in practice and that they should be available in Scotland. We ask:

55. **Do consultees agree that any new non-possessory security right over corporeal moveable property should not extend to aircraft over which an aircraft mortgage can be granted?**
56. **Should the prescribed style for Scottish aircraft mortgages be deleted from the Mortgaging of Aircraft Order 1972?**
57. **Should the Mortgaging of Aircraft Order 1972 be amended to make it clear that priority notices are competent in Scotland, as in England?**

Motor vehicles

17.4 In some countries the registration of motor vehicles is a system of title registration, and security can happen as part of that register. But in the UK the registration system operated by DVLA belongs to administrative law rather than to private law. It is not a register of private law rights. Hence if a new scheme of non-possessory security is introduced, then such security would not be constituted by registration with DVLA.

17.5 If a new system of non-possessory security were to be introduced, it would, presumptively include motor vehicles. Indeed, in practice motor vehicles might prove a major aspect of any new system, as we understand to be the case in some PPSA systems such as Canada. In Chapters 10 and 16 we refer to recent concern in England and Wales about logbook loans, in which high-interest rate loans are secured over road vehicles by means of bills of sale. As we said there, whilst we share some of those concerns, we think that the problem does not lie in the existence of non-possessory security as such. Non-possessory quasi-security is already very common for road vehicles, in the form of conditional sale and hire-purchase. What is hard to achieve under current law is where a borrower *already* owns a road vehicle and wishes to use it as collateral. Our proposals would make that possible,⁵ as it is in so many other jurisdictions. And, whilst in this discussion paper we do not propose the abolition of hire-purchase,⁶ the new moveable security could be used as an alternative to hire-purchase, and it may be that the automobile finance sector might find the moveable security to be preferable to hire-purchase.

The Cape Town Convention

17.6 The Cape Town Convention on International Interests in Mobile Equipment covers security interests in "(a) airframes, aircraft engines and helicopters; (b) railway rolling stock; and (c) space assets." It is heavily influenced by UCC-9.⁷ It is asset-specific, so that (unlike

⁴ Priority notices are dealt with in article 5, but they are not mentioned in schedule 2, which is about Scotland. W A Wilson, *Scottish Law of Debt* (2nd edn, 1991) para 7.6 says that article 5 applies in Scotland. Any opinion expressed by the late Professor Wilson must carry considerable weight, but the matter is not free from difficulty.

⁵ As noted elsewhere, if the borrower were to sell the vehicle to a finance company, retaining possession on the basis of a hire-purchase contract, there is a danger that the title transfer to the finance company would be held to be invalid because of s 62(4) of the Sale of Goods Act 1979.

⁶ See Chapter 21.

⁷ The standard text is R M Goode, *Official Commentary on the Convention on International Interests in Mobile Equipment* (2nd edn, 2008). See also Appendix A.

the UCC/PPSAs) the possibility of security over generic future assets does not exist.⁸ The UK has signed the Convention, but has not ratified it. Whether ratification might happen in the future is not known. The international registry which it created is based in Dublin.⁹ Article 52 provides: "If a Contracting State has territorial units in which different systems of law are applicable in relation to the matters dealt with in this Convention, it may ... declare that this Convention is to extend to all its territorial units or ... only to one ... of them." Hence the UK Government could ratify or accede in respect of Scotland without doing so for other parts of the UK.

17.7 If the Cape Town Convention were to be adopted, the asset types with which it deals would be excluded from the scope of the new moveable security.

17.8 To test views we ask:

58. Should the UK Government accede to the Cape Town Convention (either for the whole UK or for Scotland only)?

⁸ But the Protocol to the Convention on International Interests in Mobile Equipment on Matters specific to Railway Rolling Stock (2007) says that the description of railway rolling stock can be "a statement that the agreement covers all present and future railway rolling stock" (article V(1)).

⁹ <<https://www.internationalregistry.aero/irWeb/Controller.jspf>>.

Chapter 18 Security over ordinary incorporeal moveable property: reform options

Introduction

18.1 There are different kinds of incorporeal moveable property. The core case is the *claim* – a personal right that typically, but not necessarily, arises out of contract, and is typically a right to be paid money, though in principle personal rights to other types of performance are relevant. A trade receivable is a typical claim. Security over claims is the subject of this chapter of the discussion paper. Other types of incorporeal moveable property are considered in the next chapter.

International private law

18.2 Any reforms that may emerge from this project will affect such transactions as are subject to Scots law. What those transactions are, is for international private law to determine, and in particular the Rome I Regulation.¹

Current law

18.3 Under current law, security is effected by *cessio in securitatem debiti* – assignation in security. That is to say, there is a transfer of the claim. Dorothy owes £20,000 to Chris. He assigns his claim to Alice, to secure a loan by her to him of £12,000.² There is intimation to Dorothy. Alice is now Dorothy's creditor, for the full £20,000. Chris is wholly divested, for the right has passed from his patrimony to Alice's. So he now has no rights against Dorothy. (Though he has rights against Alice.) If Dorothy pays, she must pay Alice. If she paid Chris she would have paid the wrong person. If she wishes to renegotiate the terms of the debt, it is with Alice that she must deal: any re-negotiation of the contract with Chris would have been carried out with the wrong person, because he is no longer her creditor. If Alice is paid £20,000 by Dorothy, she will dock off the £12,000 and pay Chris the balance of £8,000. If, before Dorothy pays, Chris repays the loan of £12,000, Alice is bound to assign the claim against Dorothy back to Chris (with intimation to Dorothy), ie retrocession. If (while Dorothy has not yet paid the debt) Chris wishes to assign his right to the £8,000 to Daniel, the assignation falls to be intimated not to Dorothy but to Alice. Chris and Dorothy have no legal relationship. Chris's legal relationship is with Alice, and it is Alice who is Chris's contingent debtor for the £8,000.³ In other words, assignation in security works as a fiduciary transfer of title – *fiducia cum creditore contracta*.⁴ The underlying logic is comparable to the old *ex facie* absolute disposition in the law of heritable property. There is a transfer. It is, indeed, a

¹ Regulation 593/2008 on the law applicable to contractual obligations.

² Would it not be simpler for Chris to collect the money from Dorothy, rather than to borrow from Alice? In general it would. But there may be reasons why this is not done, the most obvious being that the Dorothy/Chris debt may be unmaturing.

³ *Ayton v Romanes* (1895) 3 SLT 203.

⁴ That is to say, full title transfer for the purpose of security.

transfer for the *purpose* of security. But it is still a transfer: the right against Dorothy is no longer in Chris's patrimony.

Criticism of the current law

18.4 Assignment in security has a number of inconveniences. One is that the creditor – Alice in the example – might become insolvent, with consequent prejudice to Chris. In a security in the narrow or pure sense,⁵ this is not a risk. For example, if Chris owns a house and grants to Alice a standard security over it, he has nothing to fear from her insolvency, for she does not own the house. She merely has a subordinate real right in it.⁶ But in the case of assignment in security, Alice has more than a subordinate right: Chris has been divested. It does not seem that this issue has been litigated, and it might be that a court would hold that Alice holds for herself and Chris as a trustee,⁷ in which case he would be safe.

18.5 Another inconvenience is that there is no direct method whereby Chris can grant a postponed security to another lender. Where a security in the narrow or pure sense is used, such as a standard security, there is normally no problem about granting a second security, or indeed any number of securities. That is because the debtor remains owner, each right granted being merely a *subordinate* real right. But Chris is divested. What he does have is a contingent right *against Alice*. So any security he might wish to grant has to be done by an assignment in security of his rights *against Alice*, intimated to her. That is possible – it is done in practice – but it is undeniably inconvenient.

18.6 Since the law allows partial assignment, some of the inconveniences could be circumvented by a partial assignment, to the value of the debt. Thus in the example, Chris could assign the Dorothy/Chris debt up to the amount of £12,000 only. But this seldom happens in practice. One reason is that the amount owed to the secured creditor can increase (interest, penalties, further advances) so that a partial assignment may prove inadequate as collateral. (And the sum can also go down. In a *proper* security such a reduction automatically increases the debtor's equity, but in a partial assignment that happens only in an indirect and inconvenient manner.) Even if it is done, it does not resolve all difficulties. For example if Alice becomes insolvent there is the unresolved problem of whether Chris will be able to make a full recovery.

18.7 One of the main problems is that once intimation has been made to Dorothy, her obligations are owed to Alice. Thus if she is paying quarterly interest, those interest payments are due to Alice, not to Chris. That may be inconvenient to Chris and even to

⁵ In Latin, the distinction is between *hypotheca* and *pignus* on the one hand (security in the pure sense) and, on the other, *fiducia cum creditor contracta*, in which there is a complete transfer of title to the creditor, albeit for the purpose of security.

⁶ The same is true of pledge, which is a security in the pure sense. It would also be true of any new system of non-possessory security over corporeal moveable property.

⁷ Cf *Purnell v. Shannon* (1894) 22 R 74. Here X owed money to Y and was himself owed money by Z. X assigned to Y the money owed by Z. The assignation said that it was for the purpose of extinguishing the X/Y debt. But when it emerged that the total paid by Z was going to be more than the X/Y debt, X claimed that the assignation had merely been for the purpose of security. It was held that this amounted to an averment of trust and that accordingly (as the law then stood) it could be proved only by "writ or oath". Since the assignee was solvent, and so no creditor was party to the litigation to challenge the pursuer's claim, it is not certain that the case established that in such cases a trust exists in the full sense of the term. Even if an assignment in security does give rise to a trust in the full sense, the debtor still has problems in the event of the creditor's insolvency. Since trust property falls outwith the control of a trustee in sequestration or liquidator, there may be practical difficulties in obtaining a reconveyance.

Alice. In a standard security, neither debtor nor creditor wishes the latter to take possession, assuming that there is no default in the secured obligation. Something similar is the case for security over incorporeal moveable property. Most security providers remain happily solvent and accordingly the security never has to be enforced. Accordingly, in practice when there is an assignation in security the account debtor (here, Dorothy) is sometimes instructed that, notwithstanding the intimated assignation, she is to carry on performing to the cedent (here, Chris) unless subsequently instructed otherwise by the assignee (here, Alice). This once again illustrates the essential artificiality of assignation in security. Furthermore, it is not absolutely certain that such an arrangement works.⁸

18.8 The fundamental problem is that assignation in security gives the grantee *too much*. It is a full title transfer, which is not really what the parties want. Ingenuity has to be expended in trying to undo some of the consequences of that transfer, but the results can never be perfectly satisfactory. And moreover, since assignation in security is merely a form of assignation, it also suffers from the general defects of the law of assignation.

A possible new system

18.9 In theory, security over a claim could be set up as a subordinate right.⁹ In the case of security in the narrow sense, such as a standard security, there are two real rights in the same property. If Jack owns Blackmains and grants to Jill a standard security over it, there are now two real rights in Blackmains: Jack's real right of ownership and Jill's real right of security. The same idea is possible for incorporeals. Chris could still hold the claim against Dorothy, with Alice at the same time having a subordinate right over that claim.¹⁰ Scots law does not at present make use of this possibility, except in one instance. The one instance is arrestment. There is much that is uncertain about the underlying logic of the law of arrestment. But it does appear to be possible for two or more arrestments to affect the same attached claim and to rank *inter se*. This looks very like a subordinate right.

18.10 English law, in relation to incorporeal property, allows both (i) a legal mortgage, which is to say a security by title transfer, corresponding roughly to our assignation in security and (ii) an equitable security, which is to say a non-title-transfer security. Whilst English equity is not a suitable item for import into Scotland, we think that Scots law suffers from the lack of a non-title-transfer security in relation to incorporeal moveable property. In England there is an option. In Scotland there is no option: assignation in security is the only dish on the menu. The recent Supreme Court case of *Farstad Supply A/S v Enviroco Ltd*,¹¹ discussed in the next chapter, is a useful illustration of this fact, at the same time showing how desirable it would be for Scots law to be able to offer a two-dish menu. We would stress that whilst the practical outcome of the new security would be broadly comparable to the equitable security of English law, in that it would be a non-title-transfer security, the internal logic would be different, in that it would not be based on English equity, but would be based on civilian concepts. The reason for this would be simply to ensure its compatibility with the general corpus of Scots private law. We would thus seek to avoid the mistake made when

⁸ See Chapter 11.

⁹ "A standard security over a claim" captures the idea to some extent.

¹⁰ On one view Alice's right would be a subordinate real right. On another view, that would not be so, but rather she would have a subordinate personal right. For this latter view see G L Gretton, "Ownership and its Objects" (2007) 71 *Rechtszeitschrift* 802. The issue is more of theoretical than practical significance. What is of practical significance is the possibility of a subordinate right over a personal right.

¹¹ [2011] UKSC 16.

that remarkable creation of English equity, the floating charge, was introduced to Scots law in 1961.

18.11 If a security in the narrow sense, ie a subordinate right, were to be introduced, here are some of the characteristics it would have. In broad terms, they follow from the simple fact that this would be a true security, rather than *fiducia cum creditore*.

- The same claim could be used as collateral for more than one security, in favour of different lenders. Ranking would be by order of grant. The device could be used for chargebacks, ie arrangements in which Z, who has money on deposit with Y bank, can use that deposit as collateral in favour of Y Bank itself.¹²
- The extinction of a fixed-sum secured claim, whether by payment or otherwise, would mean that the security would *ipso facto* be extinguished, without the need for retrocession.¹³ (The position for all-sums securities would be different, because the fact that the balance ceases to be against the debtor does not mean that the security is discharged; it would be available for future drawings.)
- The insolvency of the secured party could not prejudice the debtor.
- The security provider, being still the holder of the claim, could assign it. The assignee would take it subject to the security.
- Payments by the account debtor, whether of interest or principal, would be made to the security provider, unless and until such time as the secured party took enforcement action.¹⁴ That would, to some extent, mean that the security was a weak one. It would mean that the security would die with the asset.¹⁵ But the picture just painted is slightly misleading. In practice no creditor would take security over an individual claim that was about to be liquidated. In practice where security was taken over a particular claim, it would be over an unmatured claim. Where a creditor took security over claims that were mature or about to mature, it would be on a bulk system, including future claims.

18.12 We propose:

59. The concept of a "proper" security right over incorporeal moveable property should be introduced into Scots law.

Name

18.13 The question of names is mentioned in Chapter 16, in connection with a new non-possessory security over corporeal moveable property. Since we consider the possible new

¹² For security over bank accounts under current law, see Chapter 7.

¹³ The same would be true if the secured obligation were void *ab initio*. Cf the South African case of *Grobler v Oosthuizen* 2009 (5) SA 500, discussed in Appendix B.

¹⁴ In theory one could have a system in which the account party could pay nobody except against the signature of both the creditor and the security holder. But there would be difficulties with such a system, including the fact that when a claim matures the debtor will usually want to be able to pay it off so as to stop interest running. The law should not lock debtors into involuntary interest payments – especially if market interest rates are falling. One could have a further rule entitling the debtor to consign the money on DR, but this would add further complexity.

¹⁵ In theory it would be possible to extend the creditor's right to the proceeds of payment, and this is the general pattern in the UCC/PPSAs. But we do not agree with that approach: see para 16.48 above.

moveable security as being essentially unitary, we think that it should bear a single name, regardless of whether the collateral is corporeal or incorporeal. As mentioned in Chapter 16, we use the term "new moveable security" as a holding title.

Mode of creation

18.14 If a new type of security is introduced – the "new moveable security" –, how should it be created? The three main options are (i) by intimation, (ii) by registration and (iii) by nothing other than the consent of the two parties involved. It would also be possible for the rule to be that creation could be either by intimation or by registration. The issues are closely connected with the parallel issues for outright assignment, discussed above.¹⁶

18.15 As discussed earlier,¹⁷ the publicity principle, which applies most strongly of all to land, and rather less strongly to corporeal moveables, applies most weakly of all to money claims. German law allows security over money claims without either intimation or registration: this is *Sicherungsabtretung*.¹⁸ The arguments against that approach are the same as for security over corporeal moveables without any external act.¹⁹ Ultimately they boil down to the view that that approach is economically inefficient.

18.16 There are three arguments against having a requirement for intimation. The first is that in secured transactions default is rare. Notifying the debtor may be needed if there is default, but to incur that cost in every case, when it can be known in advance that most such intimations will turn out, with hindsight, to have been pointless, is inefficient. Better to have a single registration costing a few pounds than notice to a thousand or ten thousand account debtors. In bulk transfers, intimation may be regarded as impracticable from a commercial perspective. (Of course, this argument does not apply in the case of a security over a single money claim.) In the second place, as with outright assignment, there is the problem that in some cases intimation may be difficult to achieve. Here registration comes into its own. In the third place, intimation may create complications that registration would not. If Jack receives a notice saying that a security has been granted over the debt he owes to Jill, he may not understand it. He may write back asking its meaning, thereby generating costs to himself and the recipient of his letter. He may even think he must now pay the debt to the secured party.

18.17 Our view is that, where intimation is not made, registration should be required. We think that the arguments in its favour are strong and that the costs would not be enough to outweigh the benefits.

60. Do consultees agree that, if a new security right over claims is introduced, it should be created by registration?

61. Do consultees agree that, if a new security right over claims is introduced, it should apply to all types of claim, and not just some types, such as receivables?

¹⁶ Chapter 14.

¹⁷ Chapter 11.

¹⁸ Also known as *Sicherungsabtretung*.

¹⁹ See paras 16.13 to 16.17 above.

Present assets only or future assets too?

18.18 The UCC-9-type systems allow security over future assets as well as present assets. So do the legal systems that follow the German lead. The Murray Report would have allowed security over future receivables. But it would not have allowed security over other future incorporeal moveable property (nor over future corporeal moveable property.)

18.19 As mentioned earlier, there is nothing conceptually impossible about the idea of security over future assets. It is true that today Jack cannot grant a security to Jill over a claim that he does not have. That indeed would be absurd, but that is not the way it would work. The way it would work is that today Jack would grant to Jill a security over (say) "all book debts owed to me now or in the future." If tomorrow Boris buys goods on credit from Jack, then one *scintilla temporis* after the Jack/Boris contract is entered into, Jill would acquire a security over the Jack/Boris claim. It is the same general idea as anticipatory assignment, discussed in Chapters 4 and 14.

18.20 The arguments for and against "future security" have already been touched on earlier in relation to corporeal moveable property.²⁰ As mentioned there,²¹ if the new moveable security can cover future assets it begins to resemble a floating charge. Floating charges are considered in Chapter 22 and the question is asked there whether the new security should be able to cover after acquired property. The parallel issue is also discussed in connection with outright assignment.²²

18.21 If outright assignment by registration is to be capable of covering future assets, the same would presumptively be the case for a security interest, and *vice versa*.

Proceeds

18.22 The question of whether the new moveable security should cover "proceeds" is considered in Chapter 16.

Future obligations

18.23 In Chapter 16 we discussed, in relation to corporeal moveable property, whether the new moveable security should be capable of securing future obligations, and we made provisional proposals. We think it clear that the same rules should apply to the new moveable security as a whole, without distinction between corporeal and incorporeal property, and accordingly we refer consultees back to that chapter.

Construction contracts

18.24 Subcontractors run the risk of the insolvency of the main contractor, happening at a time when money is due to the subcontractor. If the main contractor were willing, in advance, to grant to the subcontractor a moveable security over the sums due from the employer, the subcontractor would be protected. Of course, the main contractor might or might not be willing to do this. But given such willingness, the mechanism would be there.

²⁰ Chapter 16.

²¹ Para 16.23.

²² Chapter 14.

18.25 Nevertheless we think it appropriate to ask consultees:

62. Should there be a special regime for construction contracts?

Protecting buyers etc?

18.26 In Chapter 16 we discussed the protection of certain classes of buyers (of corporeal moveable property) from the effect of the new moveable security right. Should something similar apply for incorporeal moveable property? We incline to think not. The reasons that exist for shielding certain types of buyer do not seem to apply to incorporeal property, or at least do not apply with the same strength. We note that the buyer-protection rules in the UCC/PPSAs are limited to corporeal moveable property. Nevertheless we would welcome the views of consultees on whether there would be a need for buyer-protection rules for incorporeal moveable property. (We would add, however, that there may be a case for protecting a buyer who could not with reasonable diligence have discovered the existence of the security by a search of the register. This issue is discussed in Chapter 20.)

Priority/ranking

18.27 What we have said in the previous chapter of this discussion paper about ranking applies here too, including what we have said about the ranking issues that can arise if security over future assets is allowed.

18.28 Something should be said about priority as between a security and an assignation. For example, Adam owes Belisarius £10,000. The latter grants a security over the claim to Clara, and also assigns it to Dorothea. If the general law were to apply, Clara and Dorothea would rank according to their respective dates of completion of title. So if Clara completed title on 1 June and Dorothea completed title on 15 June, Dorothea would be Adam's creditor, as Belisarius was previously, but, as was the case with Belisarius, the claim would be encumbered by the security in favour of Clara. Reverse the dates, and Dorothea would have an unencumbered right against Adam, and Clara would have nothing. The rules are here just the same as if Belisarius were owner of land, and granted a standard security to Clara and a disposition to Dorothea.

63. Do consultees agree that the issues about priority/ranking are substantially the same as for non-possessory security rights?

Enforcement

18.29 The enforcement of the new moveable security is discussed in Chapter 16 in connection with corporeal moveable property. To some extent the same issues apply to incorporeals, but there are some important points of difference as well, in part because the question of taking possession of the collateral does not arise for incorporeals, and in part where security is over money (a monetary claim), the most straightforward way of enforcing the security may simply be the appropriation of that money.

18.30 Enforcement would be either by sale or by appropriation of the collateral, where that is money, as will almost always be the case.²³ Suppose that X owes Y money, and Y owes money to Z, and Y grants a security to Z over the claim Y has against X. Y defaults on the Y/Z loan contract and Z wishes now to enforce the security. If the debt owed by X does not mature for another two years, Z may wish to enforce by selling the claim (ie the debt owed by X). That approach is likely to be appropriate for cases where maturity is still at some distance and the claim is of a type that is likely to be marketable. The alternative is for Z to appropriate the claim, ie to become X's creditor, and that is more likely to be desired by Z the shorter the maturity period is and the less marketable the claim is. This sale/appropriation choice in such cases is to be found in the DCFR.²⁴

18.31 The Financial Collateral Directive²⁵ has certain rules whereby member states may not impose certain types of restrictions on the way that financial collateral can be realised. As mentioned in Chapter 2, there are questions about the scope of the Directive, but in any event we do not think that any prospective legislation would raise any questions in relation to those rules.

18.32 The details of the enforcement process would need careful consideration, but the broad concepts seem clear enough, and there are several models in existence, such as the EBRD Model Law, DCFR, the UCC/PPSAs etc. Nevertheless we ask:

64. Do consultees have views as to the enforcement of the new moveable security in so far as the collateral consists of personal rights?

The future of the assignation in security

18.33 At present, security over claims is effected by assignation. If a new form of security were to be introduced, assignation in security would presumably no longer be needed. The question would arise as to whether it should continue to exist. As a comparison, when the standard security was introduced, it became unlawful to transfer heritable property for the purpose of security.²⁶ In Dutch law, transfer for the purpose of security of property of any type, corporeal or incorporeal, is unlawful.²⁷ The reasoning behind such provisions is that transactions should fly under their true colours and not pretend to be what they are not.

18.34 A counterargument would be that distinguishing outright assignation from assignation for the purpose of security is notoriously difficult. That is so, but it can also be difficult for other types of property, such as land. (For example, how does one distinguish a legitimate sale-and-leaseback from an illegitimate *ex facie* absolute disposition?) And most systems require the distinction, however challenging, to be drawn for various purposes. For example, Part 25 of the Companies Act 2006 requires the distinction to be drawn. So does the UCC-9, because the UCC says that whilst only some outright assignments are registrable, all security assignments are registrable, so one has to be able to decide whether an assignment is for the purpose of security or not. Moreover the applicability of Part 6 of UCC-9 (enforcement) depends on the answer to the "is this really a security?" question.

²³ Since security could be over personal rights in general, in theory security could be over a non-monetary personal right. As for the enforcement of security over intellectual property rights, see the next chapter.

²⁴ DCFR IX:214(1). See also NZ PPSA Part 9 and UCC-9 Part 6.

²⁵ Financial Collateral Directive (Directive 2002/47/EC as amended by Directive 2009/44/EC).

²⁶ Conveyancing and Feudal Reform (Scotland) Act 1970 s 9.

²⁷ See Appendix B.

18.35 Prohibiting assignation in security, and recharacterising assignation in security as a proper security, are similar in substantive effect. One says "assignation in security is void" and the other says "assignation in security is valid, but takes effect not as an assignation but as a proper security". In both approaches, in the new world there would be no assignations in security, but only proper securities. Nevertheless, we ask here a question about prohibition, and take up the possibility of recharacterisation later.²⁸

18.36 It should be added that assignation in security has to be permitted in respect of financial collateral, so the following question is to be read as not extending to financial collateral.²⁹

65. If a new type of moveable security right is introduced, should assignation in security cease to be competent?

Transferability a condition of security

18.37 The basic principle of the law of rights in security is that something can be used as collateral only if it is transferable. In the context of the present chapter, that would mean that only assignable rights could be used as collateral. Given that the new security right would simply be a new species of the genus "security", and as such would be subject to the general principles of security, it would not, we think, be necessary to spell this out in legislation. (Unless and until the law is codified.) This topic leads to the next.

Consumer protection and alimentary rights

18.38 In so far as consumers were involved, the Consumer Credit Act 1974 would apply automatically.³⁰

18.39 Consumer protection issues can arise for incorporeals as well as for corporeals. For example, the DCFR, in a provision that applies to both corporeals and incorporeals, limits the ability of consumers to grant security over future assets, and also has a rule invalidating security over alimentary rights such as future salary or pension to the extent that such security would trench on the reasonable income needs of the debtor.³¹

"(1) The creation of a security right by a consumer security provider by granting is only valid within the following limits:

- (a) the assets to be encumbered must be identified individually; and
- (b) an asset not yet owned by the consumer ... (apart from the rights to payment covered by paragraph (2)) can only be encumbered as security for a credit to be used for the acquisition of the asset by the consumer.

²⁸ Chapter 21.

²⁹ Directive 2002/47/EC on financial collateral arrangements. See Chapter 2.

³⁰ The definition of "security" in s 189 of the 1974 Act is not limited to security over corporeal property.

³¹ DCFR IX-2:107.

(2) Rights to payment of future salary, pensions or equivalent income cannot be encumbered in so far as they serve the satisfaction of the living expenses of the consumer security provider and his or her family."

18.40 At present, there is a piecemeal approach, with various statutes prohibiting both assignation and security, sometimes couched solely in the language of English law.³² For example, the Pensions Act 1995 says:

"(1) Subject to subsection (5),³³ where a person is entitled to a pension under an occupational pension scheme or has a right to a future pension under such a scheme— (a) the entitlement or right cannot be assigned, commuted or surrendered, (b) the entitlement or right cannot be charged or a lien exercised in respect of it, and (c) no set-off can be exercised in respect of it, and an agreement to effect any of those things is unenforceable."³⁴

18.41 The Social Security Administration Act 1992 says:³⁵

"(1) Subject to the provisions of this Act, every assignment of or charge on—
(a) benefit as defined in section 122 of the Contributions and Benefits Act;
(aa) a jobseeker's allowance;
(ab) state pension credit;
(ac) an employment and support allowance;
(b) any income-related benefit; or
(c) child benefit,

and every agreement to assign or charge such benefit shall be void; and, on the bankruptcy of a beneficiary, such benefit shall not pass to any trustee or other person acting on behalf of his creditors.

(2) In the application of subsection (1) above to Scotland—
(a) the reference to assignment of benefit shall be read as a reference to assignation, 'assign' being construed accordingly;
(b) the reference to a beneficiary's bankruptcy shall be read as a reference to the sequestration of his estate"

³² For these various provisions, see Ross G Anderson, *Assignation* (2008) para 10.30.

³³ Which is about assignation in favour of a family member.

³⁴ Section 91.

³⁵ Section 187.

18.42 There may be a question as to whether these provisions form a sufficient package or whether something further is required. It may be that it should not be open to consumers to grant security over after-acquired rights. We ask:

- 66. Is there a need for restrictions on the ability of consumers to grant security over after-acquired rights?**

Chapter 19 Security over special types of incorporeal moveable property: reform options

Introduction

19.1 As well as personal rights (claims), monetary or otherwise, discussed in the previous chapter of this discussion paper, there are also other types of incorporeal moveable property which can serve as collateral. The main categories are intellectual property rights, company securities (shares and bonds), public sector bonds, intermediated securities and negotiable instruments.

Should the new moveable security extend to special types of property?

19.2 If a new type of moveable security is created, which would be constituted by registration, should it be limited to claims or should it extend to special types of incorporeal moveable property? The answer seems clear, and was supported by our advisory group: the new security should extend to all types of moveable collateral, except where there exists a separate security regime. (Which is the case with ships and aircraft.) The new security right would thus extend to intellectual property rights, company shares, corporate and public sector bonds, intermediated securities and negotiable instruments.

19.3 A basic rule of security rights is that only an asset that can be transferred can be made an object of a security right. So for example, "moral rights", being non-transferable, could not be used as collateral.¹

Corporate shares and bonds as collateral

19.4 Thus, for example, someone who holds shares in a company could grant a security over the shares. The security would be registered in the Register of Moveable Transactions and would be effective without any actual transfer of the shares to the creditor. This would not prevent a security being created as it is under current law, which is to say an actual transfer of the shares to the creditor.

19.5 *Farstad Supply A/S v Enviroco Ltd*² is a Supreme Court decision that both illustrates how the current law works, and also shows why it needs to be reformed. In that case a bank took security over company shares. It did so in the only way that Scots law allows (other than by way of floating charge) namely by an actual transfer, with the result that the debtor ceased to be the shareholder. That fact then had unhappy consequences, in that the company whose shares were being used as collateral thereby ceased, for the time being at least, to be the subsidiary of the debtor company. Had the security been governed by English law, the parties would have had a choice. They could have used a "legal mortgage"

¹ Designs and Patents Act 1988 s 94.

² [2011] UKSC 16.

which would have been similar to what they actually did. Or they could have used an equitable security, which would have left the debtor company as the registered holder of the shares in question. Because Scots law was the applicable law, that choice was not open. If the reforms suggested in this discussion paper were to be adopted, the parties would have had a choice, the choice being similar to the choice available under English law. We say "similar to" rather than "identical with" because there would still be certain differences. A legal mortgage of company shares is not in every respect the same as a transfer of shares in security under Scots law. And an equitable security is not in every respect the same as the proposed new moveable security in Scots law, in part because we are not using the logic of English "equity". But the differences are more of interest and concern to lawyers than to business people.

Marketability of shares and bonds

19.6 It would be unacceptable if the new security right were to cause problems for the free marketability of shares. Clearly there are different types of case. Dealers trading in shares on the London Stock Exchange cannot be expected to check the Register of Moveable Transactions. But if one member of a small private company sells shares in that company to another member, the position would be different, and if the buyer did not check the register then one might reasonably argue that the buyer should take subject to the registered security.

19.7 There would seem to be two main options, with the second having sub-options. The first main option would be that a good faith buyer would always take free from a registered security.³ (The new security right would still be good against transferees other than good faith buyers. It would also still be good against subsequent security rights, and it would still be good in the event of the debtor's insolvency.) The second option would be to protect some good faith buyers but not others. For example, open-market buyers could be protected.

19.8 Similar considerations would apply to corporate and public-sector bonds.

19.9 We ask:

- 67. Should all good faith buyers of company shares, and of corporate and public-sector bonds, take free of registered security rights? Or should the protection be limited to a certain class, such as open-market buyers?**

Intellectual property as collateral⁴

19.10 Although intellectual property can have considerable value, and so in principle can be desirable as a form of collateral, in practice lenders often regard it with some suspicion.⁵ Nevertheless the law should not place obstacles in the way of its use as collateral.

³ In essence, this is the New Zealand rule: PPSA s 97.

⁴ On this subject see David Townend, *Using Intellectual Property as Security* (1996), and Howard P Knopf (ed), *Security Interests in Intellectual Property* (2002). See also the UNCITRAL *Supplement on Security Rights in Intellectual Property*, (2010) available at <http://www.uncitral.org/pdf/english/texts/security-ig/e/10-57126_Ebook_Suppl_SR_IP.pdf>.

19.11 We think that intellectual property rights should be included in the new scheme. A security could be created as happens at present, which is to say by a transfer to the creditor. Or the parties could opt for the new moveable security, which would leave title to the IP right in the debtor. Thus parties would have a choice.

19.12 For unregistered intellectual property, such as copyright, the choice would work as follows. The parties could choose to do what is done at present, which is to say assign the copyright, by way of security, the assignation not being registered (except, in cases where the debtor is a company etc, under the company charges registration scheme). Or they could use the new type of security, which would leave title to the copyright in the hands of the debtor. The security would be registered in the Register of Moveable Transactions. Assuming that a section 893 order were to be made,⁶ separate registration under the company charges registration scheme would not be necessary.

19.13 For registered intellectual property rights, such as patents, the same choice would exist, but there would be a complicating factor. In Chapter 7 we concluded that the intellectual property legislation leaves the question of security rights to general law, thus leaving Scots law free to develop an alternative to assignation in security. But we also concluded that in some cases such a security would, because of the provisions of the legislation in question, be precarious unless registered in the intellectual property register concerned. Thus suppose that X held a patent and wished to grant to Y a security over it, using the new security right. If the rule is that the new security right must be registered in the Register of Moveable Transactions, then Y might wish to ensure that the security would not be precarious by registering it also in the Patents Register. That would be double registration. Such double registration could be criticised as being inconvenient, and adding expense.

19.14 One possibility would be to amend the intellectual property legislation so as to allow registration in the Register of Moveable Transactions to suffice. We do not think that that possibility can be pursued in the context of the present project.⁷ Another possibility would be to provide that if the new security right were to be registered in the relevant intellectual property register, that would suffice. So the security by X to Y could be registered in the Patents Register, and that would be all that would be needed. Neat though that solution would be, it would not be free from difficulty. In the first place, the issue would be a live one only where the security being granted was limited to intellectual property, for if it were not so limited it would be registrable in the Register of Moveable Transactions *anyway*. In the second place, it would arguably place more weight on the intellectual property legislation than that legislation is designed to bear. The provisions about registered intellectual property do not have a coherent set of ranking rules: they have a few specific rules, but no general scheme. Moreover, they presuppose (as we read them) that a security right will exist *before*

⁵ We will not go into details here but merely quote one author: "There are a myriad of ... commercial reasons why relying on intellectual property as security for loans can be more difficult, and more risky, for financiers than dealing with more 'traditional' assets as security." (Jacqueline Lipton, "Security Interests in Intellectual Property", in John de Lacy (ed), *The Reform of UK Personal Property Security Law: Comparative Perspectives* (2010) at p 306.

⁶ Companies Act 2006 s 893. See Chapter 8.

⁷ There is also the practical point that whilst legislation on the law of rights in security is for the Scottish Parliament, legislation on intellectual property rights is for the UK Parliament. There is a certain parallel here with the USA, where legislation on the law of rights in security is for the state legislatures, but legislation on intellectual property rights is for the federal legislature.

any registration, and that would be inconsistent with the policy behind the new security right, which is that it should not come into existence without satisfying the publicity principle.

19.15 It is also to be noted that in English law it is already possible to have a security right (an equitable security) over intellectual property that is not registered in the relevant register, and that is therefore to some extent precarious.

19.16 Given these points, and given that registration in the Register of Moveable Transactions should be fairly easy and inexpensive, we incline to think that no exception should be made, ie that even if a security (of the new type) were being granted solely over intellectual property, it should still be registrable in the Register of Moveable Transactions.

68. In the case of registered intellectual property, we propose that registration of the new security right in the relevant intellectual property register should not displace the requirement for registration in the Register of Moveable Transactions.

Applicability of Scots law

19.17 The question would arise, in such cases, as to whether Scots law was applicable. But that can be an issue under current law anyway, and as observed in Chapter 7 the intellectual property legislation presupposes that security rights are primarily subject to the general law of security as it operates in the relevant jurisdiction. The intellectual property legislation points, so to speak, at the general law of security, and what any legislation that emerges from this project would be doing is simply to modify that general law as far as Scotland is concerned.

19.18 Hence whilst these special property regimes are mainly subject to reserved legislative competence, to include them in the new moveable property security regime would not trench on reserved competence. It would leave the law of company shares, IP rights and so forth untouched.

Negotiable instruments as collateral

19.19 In the case of negotiable instruments there are special rules about protecting "holders in due course."⁸ Such rules are central to the law of negotiable instruments and so should not be in any way impaired by any new legislation on security rights.⁹ In practice that would diminish the effectiveness of the new security in relation to negotiable instruments.

Proposal

19.20 Accordingly we propose:

69. Special types of incorporeal moveable property such as intellectual property rights, company securities (shares and bonds), public sector bonds, intermediated securities and negotiable instruments should be included in any new system of moveable security.

⁸ See s 29 of the Bills of Exchange Act 1882 for those types of negotiable instrument governed by that Act. Some types of negotiable instrument remain subject to common law, but the common law is the same.

⁹ Cf New Zealand PPSA s 96.

Enforcement

19.21 Enforcement is discussed in Chapters 16 and 18. The same general principles would apply to the enforcement of security over intellectual property rights.

Chapter 20 Registration and connected matters

Introduction

20.1 Elsewhere in this discussion paper we suggest that a new register be established, provisionally called the Register of Moveable Transactions. It would be (i) an optional alternative to intimation as a mode of transferring claims and (ii) a mode of setting up the proposed new moveable security. In this chapter we consider how the register might work.¹ But first we formally propose:

- 70. A new public register should be established, provisionally to be called the Register of Moveable Transactions, in which (i) assignments of personal rights and (ii) securities over moveable property (corporeal and incorporeal) could be registered.**

Who would run it?

20.2 The Murray Report² proposed a new "Register of Security Interests". Its role would have been to some extent comparable to what we now propose. The Murray Report proposed that the new register would be administered by the Registrar of Companies for Scotland. The new register would have been divided into two parts, one for floating charges and the other for moveable securities other than floating charges.³ A certain awkwardness would, however, have resulted, because under the Murray Report's proposals, the new moveable security and indeed floating charges themselves would have been available for use by non-companies. When this Commission reported on the registration of floating charges in 2004, we recommended that there should be established a new Register of Floating Charges, and that it should be kept by the Keeper of the Registers of Scotland rather than by the Registrar of Companies for Scotland.⁴ That logic would apply to the new Register of Moveable Transactions with even more force, because the proposed new register would have no particular links with company law. The only qualification is that it might make sense to follow the flexible approach taken for the Register of Community Interests in land, which was that the register was to be kept by the Keeper or by such other person as Ministers may appoint.⁵ We propose:

- 71. The new register would be administered by the Keeper of the Registers of Scotland or by such other person as Ministers may appoint.**

¹ For a transnational overview of this subject see the EBRD publication, *Publicity of Security Rights: Guiding Principles for the Development of a Charges Registry*, (2004) available at <<http://www.ebrd.com/downloads/legal/secured/pubsec.pdf>>.

² See Chapter 10.

³ Murray Report para 3.11.

⁴ Scottish Law Commission, *Report on Registration of Rights in Security by Companies* (Scot Law Com No 197 (2004), para 2.9).

⁵ Land Reform (Scotland) Act 2003 s 36(9).

Merger with the Register of Floating Charges?

20.3 As has just been mentioned, the Murray Report thought that there should be a new register with two parts, one of them for floating charges. Since then, matters have moved on, for the registration of floating charges has been taken from the Registrar of Companies for Scotland and transferred to the Keeper of the Registers of Scotland, albeit that this change has not yet come into force.⁶ The question thus arises as to whether the new register should absorb the Register of Floating Charges, either as a unitary register or as a two-part register as contemplated by the Murray Report. We ask:

72. Should the new register absorb the Register of Floating Charges?

And what about costs?

20.4 A new register should not be a burden on the taxpayer, but should be self-financing, as, for example, the Land Register is self-financing. Any new register involves start-up costs, which can then be recouped from future income generated by the new register, the income consisting chiefly of registration fees and search fees. Experience in jurisdictions round the world operating comparable registers shows that demand is such that overall fee levels can be modest, without support from the taxpayer. The lowest-cost system seems to be that of New Zealand where a registration normally costs NZ\$3 and a search NZ\$1.⁷

20.5 Possibly the reason is that whereas in other jurisdictions the registers were born as paper registers, the New Zealand register was born as a purely electronic system.

"The first project manager for the New Zealand registry, Andrew Bridgman, indicated that the costs to government of introducing the NZ PPSR came to just over US\$1.2 million. Software development costs amounted to US \$846,800, with other costs (dedicated staff, hardware, publicity, travel, internal training and miscellaneous) adding an additional US \$234,000. With quality assurance and consultancy costs, the total was US \$1,180,300. He also indicated that the system paid for itself from fee income in the first few months: total net revenue for the transitional period of 1 May - 31 October 2002 was US \$1.6 million. Mr Bridgman noted that the costs were substantially reduced because: (a) development of the system was built off the back of an existing IT platform; (b) a trusted IT developer was used with low overheads and previous familiarity with government IT development, and (c) the development team used existing staff from high performing units within the Ministry."⁸

20.6 In the USA filing fees vary from state to state but are generally in the range of US\$10 to US\$30. The usual practice in the UCC/PPSA systems is for filing fees to be flat-rate, not *ad valorem*, so that a one-off registration fee of (say) £15 might support financing of many millions of pounds. We are not in a position to predict the costs of a Scottish system, but we think it should be possible for the costs to be low enough to make the system attractive to users. The actual fee levels would be set, as they are for other registers, such as the Land

⁶ Bankruptcy and Diligence etc (Scotland) Act 2007, Part 2. But information will be fed through to the Companies Register by means of an order under s 893 of the Companies Act 2006.

⁷ See <<http://www.ppsr.govt.nz/cms>>. One NZ dollar = about 50p. The system is impressive. An online demo is available.

⁸ Quoted from para 2.9 footnote 11 of Law Com Report No 296.

Register, by statutory instrument. We understand that in Canada, not only does the PPSA registration break even, but it in fact generates profits for the public purse.⁹

Not a title register

20.7 Some registers are registers of title to property. From such registers one can determine, with varying degrees of reliability, to whom something belongs. The new Register of Moveable Transactions would not be such a register. A comparison can be made here between ship mortgages and aircraft mortgages. The former are entered into the Shipping Register which is a register of title. The latter are entered into the Register of Aircraft Mortgages. This is not a register of title. The only entries in it relate to mortgages. From it no definite information can be derived as to title to a particular aircraft. The UCC/PPSA registers are in this respect like the Register of Aircraft Mortgages. They give no information as to title. The fact that there is an entry about a security granted by X to Y is no evidence that the collateral in question belongs to X. Of course in practice it is likely that it does so belong: people do not usually grant security over property that belongs to someone else. But that is a practical fact rather than a legal one. Creditors must satisfy themselves as to title. The same is true if the creditor enforces the security and sells. The fact that a buyer is taking from someone whose security has been duly registered is no guarantee to the buyer that the title is good. Buyers must satisfy themselves as to such matters. The same is true of registration under Part 25 of the Companies Act 2006. The new Register of Moveable Transactions would be the same in this respect.

Registration: notice filing

20.8 The registration system used in the UCC/PPSAs has been described earlier.¹⁰ In UCC-9 there are two documents: the "security agreement" and the "financing statement". It is the latter, and only the latter, that is registered. This duplication of documents is, to that extent, like the system in Part 25 of the Companies Act 2006, whereby the security document itself is not registered, but instead a separate document called the "particulars". But there the likeness ends. There are several differences between Part 25 registration, on the one hand, and UCC/PPSA notice filing, on the other hand. Three will be mentioned here. (i) Part 25 presupposes that the security has already been constituted, whereas the registration of a financing statement does not. A financing statement can be registered either before or after the signing of the security agreement. (ii) Another difference is that under Part 25 both documents are submitted to the Registrar of Companies, who compares them to check that they tally. There is no equivalent in notice filing. The registrar does not check, or even see, the security agreement. (iii) A third difference is that Part 25 applies only where the debtor is a company (or LLP). By contrast, notice filing applies to debtors of every description including natural persons.

20.9 The need for two documents rather than one might be criticised as increasing cost and also as giving rise to a danger of discrepancy between the document that is registered

⁹ See Jacob Ziegel, "A Canadian Academic's Reactions to the Law Commission's Proposals", in John de Lacy (ed), *The Reform of UK Personal Property Security Law: Comparative Perspectives* (2010), at pp 118 to 119. But we would here quote the EBRD's *Publicity of Security Rights: Guiding Principles for the Development of a Charges Registry* at page 16: "fees should enable recovery of costs ... *The fees should not be used as a source of taxation by government.*" (Emphasis added.) The Canadian Government played a major role in the development of the document just quoted.

¹⁰ Chapter 13.

and the document that is not registered, a familiar problem with the Part 25 system.¹¹ But one benefit of the system is that it makes online registration easier, for the registered "document" can be a simple form with drop-down menu options, and no "free text" capacity.¹² (Whether there should be a "free text" capability is a decision that would have to be made.) However, the same result can be achieved simply by a rule whereby what appears in the register is itself the constitutive document. (See below.)

20.10 In Chapter 13¹³ we quote Professor Sigman's exposition of the nature of filing under UCC-9. He mentions the *data certa* function of filing. *Data certa*, though not an expression traditionally used in Scotland, is a familiar concept. It means a date which is certain in the sense that it can be proved that the document existed at that date, thus eliminating the possibility of false ante-dating. In Scotland one of the functions of the Books of Council and Session is to provide a *data certa* service: if a document is registered in the Books of Council and Session on a particular date, that shows that the document must have existed at least by that date. The *data certa* function of notice filing does indeed exist but only to a limited extent. The *data certa* function applies to the financing statement, but not to the security agreement, whose date has no particular link with the financing statement. (In our provisional proposals for Scots law, there would also be a limited *data certa* function. But the position would be rather different from the UCC/PPSAs, because under our proposals the registered document would be the constitutive document.)

20.11 The possibility of filing of the financing statement *before* there is a security is said to be beneficial because of its flexibility. But this may be questioned. In the first place, since a security interest can secure future debt, it could be directly registered in advance of the loan being drawn down. In the second place, it would be possible to have a system of advance notices, as in section 39 of the Bankruptcy and Diligence etc (Scotland) Act 2007. Such a system is flexible and has the advantage that it is time-limited, in the sense that the priority period established by the notice is limited in time.¹⁴ By contrast, a financing statement that in fact secures nothing will clutter the register for up to five years.¹⁵ (And financing statements do not have to be signed by the debtor.¹⁶)

20.12 Notice filing arguably generates costs that other registration systems do not. The less informative the register, the more that third parties¹⁷ will have to carry out their own investigations.¹⁸ In UCC-9 and the PPSAs the registered financing statement is minimal.¹⁹ The PPSAs contain provisions requiring the secured party to provide certain information, but only to interested parties (eg: the debtor, other creditors of the debtor or their personal

¹¹ For the UCC's rules about such discrepancies see UCC § 9-506.

¹² This is the way, for example, that "automated registration of title to land" (ARTL) works in Scotland.

¹³ Para 13.40.

¹⁴ Under the 2007 Act it is 21 days. We have recommended a system of advance notices for the Land Register, in which the period would be 35 days: Scottish Law Commission, *Report on Land Registration* (Scot Law Com No 222 (2010)), Part 14.

¹⁵ Under UCC-9 entries expire after five years, unless renewed: § 9-515.

¹⁶ The debtor must authorise registration but does not sign the registered form: UCC § 9-509. The official reason is that the registration staff cannot check signatures. But we understand that the registration of financing statements that have not in fact been authorised by the debtor has become a problem in the USA. Though signature is a hurdle that the unscrupulous could get over, by resorting to forgery, it is nonetheless a hurdle that will deter many.

¹⁷ But in practice such third parties will often be lenders, and lending on second-ranking security is much less common than lending on first-ranking security.

¹⁸ For instance as to the level of indebtedness, the exact items of collateral secured and terms of repayment.

¹⁹ A standard work calls it the "bikini" of the UCC: James J White and Robert S Summers, *Uniform Commercial Code* (5th edn 2000) para 22-10.

representatives).²⁰ Since the PPSAs restrict who can request this information, the right does not extend to potential creditors who, having searched and found a financing statement, want more information before they decide whether to lend funds. In this case, the prospective creditor will need to ask their prospective debtor to use its status as an interested party to make the request for information and ask (ideally) that it be sent directly to the prospective creditor.²¹ Arguably such information requests create work for three parties (security provider, secured party, third party) and is repeated each time there is a need for information. This involves some inconvenience and expense.²² Moreover, the debtor may be reluctant to ask the creditor (eg its bank) to disclose information to a third party for fear of damaging the relationship, so that the possibilities for new financing are damped down.

20.13 But we incline to think that these difficulties are not really caused by notice filing. For example, in land transactions a standard security will identify the two parties, will identify the collateral, and will give an indication of what the security secures. The latter can be stated in general terms only. There is no need to specify the amount of the loan, or the repayment terms. Hence a standard security does not have to reveal much more than a UCC-9 filing statement reveals. The main difference seems to be that notice filing merely shows that a security may have been, or may hereafter be, granted, whereas the Land Register shows that a standard security has in fact been granted.

20.14 Indeed, it may be that the distinctiveness of the notice filing system may have been rather over-stated by its advocates. For example, McCormack has argued that the benefits of notice filing identified by the Law Commission for England and Wales "could all be realised in a revamped version of the present transaction-based system."²³

Constitutive effect

20.15 One of the foundational principles both of notice filing in the UCC/PPSAs and the company charges registration scheme is that registration documents a right that in itself comes into existence independently. Failure to register impairs the effect of a security, but the security in itself exists, and is created, outwith the register. Thus in the UCC/PPSAs there is the basic distinction between the "security agreement" which is the document that creates the security, and the "financing statement" which is a separate document, and which is the document that appears in the register. The DCFR has the same approach.²⁴

20.16 This approach is different from the Scottish tradition whereby a security right is constituted by the external act, for example the act of registration. We think that the Scottish

²⁰ Ontario PPSA s 18; Saskatchewan PPSA s18; New Zealand PPSA s 177; Australia PPSA s 275.

²¹ See, for example, on the Saskatchewan provisions, Ronald C C Cuming and Roderick J Wood, *Saskatchewan and Manitoba Personal Property Security Acts Handbook* (1994) paras 18(1) and 18(2), and on the New Zealand provisions: Michael Gedye, Ronald C C Cuming and Roderick J Wood, *Personal Property Securities in New Zealand* (2002) paras 177.1 and 177.2.

²² In Canada "secured creditors regard it as a nuisance to be required to answer numerous enquiries..." (Jacob Ziegel, "A Canadian Academic's Reactions to the Law Commission's Proposals", in John de Lacy (ed), *The Reform of UK Personal Property Security Law: Comparative Perspectives* (2010), at p 126.)

²³ Gerard McCormack, "The Law Commission Consultative Report on Company Security Interests: An Irreverent Riposte" (2005) 68 *Modern Law Review* 286 at 292. The reference to the "present system" is a reference to what was then Part XII of the Companies Act 1985 and is now Part 25 of the Companies Act 2006. McCormack has said something similar more recently in his "Pressured by the Paradigm: the Law Commission and Company Security Interests" in John de Lacy (ed), *The Reform of UK Personal Property Security Law* (2010) at p 92ff.

²⁴ See further Chapter 13.

tradition on this issue is preferable.²⁵ A "no security unless and until registration" rule is simpler and more workable, without loss of flexibility. It is obviously better for third parties, who can know that "no entries means no securities", whereas in the UCC/PPSAs a clear search of the register does not mean that there are no securities. The EBRD Model Law, in this respect departing from the UCC/PPSAs, provides that security is created on registration.²⁶ We propose the same approach: the new moveable security should not be capable of coming into existence before registration.²⁷ That does not necessarily mean that [date of creation] = [date of registration], because if security is allowed over after-acquired property, then the security in relation to a given item of after-acquired property would come into existence not on the date of registration but on the later date when the item is acquired by the debtor.²⁸

20.17 In the UCC/PPSAs there are two documents, one of which is the constitutive document, but it is not registered, and the other is the registered document, but it is not constitutive, yet is the key document for priority purposes. In Scots law the registered document would be the constitutive document. Any separate document would be a contractual document, and would not be constitutive of the security interest.

20.18 In the UCC, filing is not normally necessary for consumer goods.²⁹ But the PPSAs generally do not follow the UCC in this respect. In other words, they do not except consumer goods from their registration requirements. Under current law, consumer goods may well be financed by hire-purchase, which is a quasi-security but which does not require registration,³⁰ but that point is of limited significance because it has no necessary connection with consumer goods, for businesses may also have goods on HP or similar arrangements. We incline to think that a sufficient case for excepting consumer goods does not exist and accordingly we incline to follow the PPSAs in this respect rather than the UCC. It should be borne in mind that in the context of Scots law a "no need to register" rule would be a much bigger step than it would be in legal systems based on English property law concepts. For in the latter, security rights can in principle be created by simple agreement between the parties, with no external act. All requirements for an external act are statutory. So in such systems an unregistered non-possessory security interest is merely what the common law provides for anyway. By contrast, in this project we are proposing a new type of non-possessory security, for which the constitutive external act would be registration.

20.19 The following objection might be made to the idea that the registered entry should itself be the constitutive document. Contracts, and especially commercial contracts, are often long documents, and lenders often like to have "charging" provisions in them. The proposal we make here would mean that those "charging" provisions would, in and of themselves, not be effective. We do not think that such an objection bears analysis. In the first place, the same is in effect true of security over immovable/heritable property. Banks and others

²⁵ We think it better in absolute terms. But there is also the point that to move away from it would cause higher "costs" in terms of adjusting to the new rules, because people are familiar with the principle that the creation of a security requires an external act. Indeed, it can probably be said that adjustment has still not taken place to the fact that a floating charge is created without registration. (This unsatisfactory rule will disappear when Part 2 of the Bankruptcy and Diligence etc (Scotland) Act 2007 comes into force.)

²⁶ EBRD Model Law Article 6.7.

²⁷ This issue is touched on in Chapters 13, 16 and 18.

²⁸ And here our approach differs somewhat from that of the EBRD Model Law, because that allows retrospective effect, backdating priority to the date of registration.

²⁹ UCC § 9-309. For exceptions, see § 9-311.

³⁰ Though it would do so if recharacterisation were to be adopted. See Chapter 21.

seem to manage that happily. For example, a "Form B" standard security is used, which is a skeletal security document, identifying the two parties, and the land, and saying that the security secures the obligations set out in the separate contract. The new register would operate in much the same way. In the second place, from the standpoint of managing bits of paper (physical or digital) our scheme would be comparable to the UCC/PPSAs. In the UCC/PPSAs there have to be two documents, the "security agreement" (which may be part of a 100-page commercial contract) and the skeletal "financing statement". In our scheme there would be the skeletal registered entry, and there would also be the contract. Thus there are two documents under the UCC/PPSAs and there would be two documents in our scheme. (But in our scheme the legal effects of the documents would work rather differently from the UCC/PPSAs.)

20.20 We ask:

73. Do consultees agree that the registered document should be the constitutive document?

What information should appear in the Register?³¹

20.21 We begin by noting the requirements of certain other systems. The UCC has the least demanding requirements: (i) name of debtor; (ii) name of secured party or representative; and (iii) an indication of the collateral covered.³² The debtor's address does not seem to be required in the legislation, but it is required in the official forms.³³ There is no requirement for registration number (if a company) or date of birth (if a natural person).³⁴

20.22 The Ontario PPSA leaves the details to subordinate legislation.³⁵ The subordinate legislation³⁶ requires: number of years for the registration period; name of the debtor and, if the person is a natural person, the date of birth of the person; address of the debtor; name and address of the secured party; classification of the collateral as consumer goods, inventory, equipment, accounts or a combination/none of these; if a motor vehicle is included in the collateral, an indication that it is included and, if it is consumer goods, a description of the vehicle including the VIN;³⁷ if a motor vehicle schedule is attached, an indication that it is attached; if all the collateral is classified as consumer goods, the principal amount of the collateral; if all the collateral is classified as consumer goods, the maturity date or, if there is no fixed date of maturity, an indication that there is no fixed maturity date.

20.23 In New Zealand the requirements are:³⁸

"(a) if the debtor is an individual, the debtor's name, address, and date of birth or, if the debtor is an organisation, (i) the name and address of the organisation; and (ii) the name or job title, and contact details, of the person acting on its behalf:

³¹ In this area comparison with the UCC/PPSAs is not straightforward as in those systems there are two documents, the security agreement and the financing statement.

³² UCC § 9-502. Some further detail is given in § 9-503 and § 9-504.

³³ Official form UCC1.

³⁴ In North Dakota and South Dakota, but seemingly nowhere else in the USA, the debtor's tax number or social security number is required.

³⁵ Ontario PPSA s 46.

³⁶ <http://www.ontario.ca/en/services_for_business/access_now/ONT04_020917.html>.

³⁷ Vehicle identification number. This is not the same as the plate number. Plate numbers are not fixed and unchanging. The VIN is fixed and unchanging. VINs are also used in Europe.

³⁸ New Zealand PPSA s 142.

(b) [Repealed]³⁹

(c) if the debtor is an organisation that is incorporated, the unique number assigned to it on its incorporation:

(d) if the secured party is an individual, the secured party's name and address or, if the secured party is an organisation, - (i) the name and address of the organisation; and (ii) the name or job title, and contact details, of the person acting on its behalf:

(e) a description of the collateral, including its serial number if required by this Act or by the regulations:

(f) the date of prior registration, if prior registration law (as defined in section 193) applies in respect of the security interest:

(g) any other data required by this Act or the regulations to be contained in the financing statement."

20.24 The DCFR⁴⁰ requires: name and contact details of security provider; name and contact details of creditor;⁴¹ identity of encumbered assets; category of encumbered assets; consent of the security provider; and declaration by creditor that he or she assumes responsibility to third party/security provider for loss caused by a wrongful registration.

20.25 The Law Commission for England and Wales in its work in this area recommended:⁴²

"(1) the name of the debtor and its registered number (if any); (2) the name and address of the chargee or its agent; (3) a description of the collateral; (4) whether the filing is to continue indefinitely or for a specified period; and (5) such other matters as may be prescribed by the Rules."⁴³

20.26 There should, we think, be four elements in the entry. (i) Identification of the debtor. (ii) Identification of the creditor. (iii) Identification of the collateral. (iv) Identification of the obligation/s secured.⁴⁴ We agree with the New Zealand approach, and that of the Law Commission for England and Wales, that there should be a power to make provision by delegated legislation.

20.27 Information about, say, the amount of the debt would not be necessary. As a comparison, a standard security does not have to state the amount of the loan. The distinction to be kept in view is that matters that concern only the contractual relationship between the parties do not need to be registered. Although we think that there should be a reference to the obligation or obligations secured, that would not necessitate any reference

³⁹ This was, before repeal, a requirement for the debtor's date of birth, but this has now been added to (a), so the repeal seems not to have been a substantive one.

⁴⁰ DCFR IX-3:306 ff.

⁴¹ This requirement appears not in DCFR IX-3:306 but in DCFR IX-3:308.

⁴² Law Com Report No 296 para 3.98.

⁴³ Date of birth is not included, and indeed does not appear to be discussed, whether in Law Com CP No 164, Law Com CP No 176 or Law Com Report No 296. This is perhaps surprising because it is a requirement of the two systems that were focussed on, New Zealand and Saskatchewan. (The Saskatchewan PPSA itself is silent on the point, as is Reg 10 of the Saskatchewan Regulations (<<http://www.qp.gov.sk.ca/documents/English/Regulations/Regulations/P6-2R1.pdf>>) but it is a requirement of the statutory form to be found in Appendix A of the Regulations.)

⁴⁴ The EBRD *Publicity of Security Rights: Guiding Principles for the Development of a Charges Registry* at page 8 says that (i) and (iii) are "necessary" and (page 9) that (ii) and (iv) are not necessary but are "desirable". No other data requirements are recommended.

to contractual details or loan amounts. Once again, a comparison can be made with standard securities. A standard security must indicate the obligation or obligations secured, but can do so in a minimalist manner, which may even be (and in fact commonly is) a simple general reference to all and any debts owed now or hereafter by the debtor to the creditor.

20.28 The need for accurate identification is more important for the debtor than for the creditor, because searches will almost always be against debtor names, not creditor names. The more latitude that is allowed for debtor names, the more inconvenience there is for searchers, and hence the less efficient the system is. Moreover, latitude in identification may lead to externalised costs, as where someone applies for credit and difficulties arise because of an entry that, though about someone else, appears *prima facie* to be relevant.⁴⁵ As well as the nuisance of false positives, there can also be the nuisance of false negatives.⁴⁶ The more detail there is (such as dates of birth in the case of natural persons) the more effective the system is.

20.29 Although precision in identification is more important in relation to the debtor, it seems simpler for the requirements to be the same for both debtor and creditor.

20.30 In the case of companies, the registered number would, we think, be essential.⁴⁷ Companies can readily change names. Two companies can even swap names, and this sometimes happens in practice. That is particularly confusing when (as is typically the case in such swaps) the companies share the same address.⁴⁸ Nothing is fixed and enduring except the registration number. As for individuals, date of birth makes sense, because, unlike name and address, it does not change.⁴⁹

20.31 Privacy considerations are also relevant, and some balancing may be necessary, but the logic of registration is publicity, not privacy. A strong privacy agenda would reduce the value of the system. It would in principle be possible to have (for example) a rule that a search against the name of a given person could not be done without the consent of that person.⁵⁰ But that would detract from the value of the system and would also push up transaction costs. The UNCITRAL Legislative Guide says: "The information provided on the record in the registry is available to the public. A search may be made without the need for the searcher to justify the reasons for the search."⁵¹

20.32 The identification of collateral may be straightforward by reason of its generality, such as all moveable property, corporeal or incorporeal, present or future. An assignation of future

⁴⁵ This is a familiar issue in other sectors, for example the Register of Inhibitions, which is also a name-based register.

⁴⁶ A false negative is where a search in the register draws a blank, but there was in fact a relevant entry. For a false negative problem arising out of the Register of Inhibitions, see *Atlas Appointments Ltd v Tinsley* 1997 SC 200, where one and the same person was sometimes identified as "Stephen John Tinsley" and sometimes as "Steve Tinsley".

⁴⁷ Law Com Report No 296 para 3.100 ff takes the same view, and also suggests that registration software could reject automatically applications where name and number did not tally.

⁴⁸ For an alarming example of a name swap see *F J Neale (Glasgow) Ltd v Vickery* 1973 SLT (Sh Ct) 88.

⁴⁹ Date of birth is also mentioned in the Diamond Report (para 11.6.4) and by the EBRD *Publicity of Security Rights: Guiding Principles for the Development of a Charges Registry* page 4. It is also mentioned at para 59 of the UNCITRAL Legislative Guide. Diamond, at the same paragraph, also mentions VAT numbers and social security numbers as possibilities. Our views about identity are the same here as for land registration, for which see Scottish Law Commission, *Report on Land Registration* (Scot Law Com No 222 (2010)), Part 4.

⁵⁰ Many variant rules could be devised. For instance one could make "legitimate interest" a requirement. German law has this approach for the Land Register: see § 12 of the *Grundbuchordnung* (the land registration statute).

⁵¹ UNCITRAL Legislative Guide para 55.

receivables could simply say "all future receivables". An assignation of all debts present or future owed to the cedent by a named account party should also be straightforward, provided the account party is identified suitably. An assignation of a single claim, such as a debt of £10,000, would identify the account party and give some details of the debtor, such as the date of the loan contract. It would always be for the facts and circumstances of the case whether the right assigned, or the collateral, was or was not sufficiently identified. In the jurisdictions that have adopted the UCC/PPSA approach, the problems do not seem to be excessive.

20.33 In the case of motor vehicles, the PPSAs generally require the VIN (vehicle identification number), and that seems reasonable.

20.34 As well as the identifications of the two parties, the identification of the collateral, and an indication of the obligation/s secured, a fifth element, and an absolutely crucial one, would be date of registration. This would appear on the face of the register, but it would not be part of the data provided by the applicant.

20.35 We think that the issues are mainly technical, and would, as such, require further detailed work, in co-operation with the Department of the Registers, but nevertheless ask:

74. What views do consultees have about the information to be contained in the entry in the register?

Errors

20.36 In practice there will sometimes be errors. For example, a debtor's name might be mis-spelt. We understand that in the UCC/PPSAs errors are common.⁵² The rule adopted in many PPSAs is that an error invalidates an entry if, but only if, it would have misled a person searching the register with ordinary diligence.⁵³ The test is thus not whether anyone actually did search: it is an objective test, which might be dubbed "reasonable findability". For example, in Ontario the rule is expressed thus: "A financing statement or financing change statement is not invalidated nor is its effect impaired by reason only of an error or omission therein or in its execution or registration unless a reasonable person is likely to be misled materially by the error or omission."⁵⁴ We note that an objective test promotes simplicity; an entry is either good or bad.

20.37 But there may be a case for a tougher approach. It might be argued that it is the task of the creditor to ensure that the entry is correct, and that since the requirements would not be particularly onerous, there would really be no excuse for mistakes, especially given that the vast majority of creditors would be professional moneylenders. So one could have a tough rule, whereby validity would depend on accuracy, and near misses would fail, just as a key that is *almost* correctly cut will not open the lock. Such an approach could be argued for

⁵² "The Canadian experience is that errors in identifying correctly both corporate and non-corporate debtors' names ... are quite common and provide a fruitful source of contention that the secured party does not have a properly perfected security interest." Jacob Ziegel, "A Canadian Academic's Reactions to the Law Commission's Proposals" in John de Lacy (ed), *The Reform of UK Personal Property Security Law: Comparative Perspectives* (2010), at p 125.

⁵³ The same test is adopted in the UNCITRAL Legislative Guide para 64.

⁵⁴ Ontario PPSA s 46(4).

in utilitarian terms: occasional unfairness to particular creditors would be justified by benefits to the system as a whole, by incentivising creditors to fill in the forms correctly.

20.38 We ask:

- 75. Should errors be subject to a "reasonable findability" test? (In other words, errors that did not prejudice "reasonable findability" would not matter. Errors that did prejudice "reasonable findability" would be fatal to the validity of the entry, whether or not anyone had in fact been misled.) Or should the validity of an entry depend on its being error-free?**

Paper or online or both?

20.39 The register itself should be online, and searchable online. We think that to be uncontroversial. But that still leaves open the question of whether registration applications should be in paper form, or online, or both. Online is simpler and quicker and cheaper. But online applications would require fairly high-level digital signatures, and few debtors, and not all creditors, would have such signatures. We think, therefore, that both paper and digital applications should be possible. The former would have to be handled by staff at the register, and so would no doubt attract a higher registration fee.⁵⁵ The possibility of paper applications would not mean that the Register would not in itself be wholly electronic. What would happen for paper applications is that staff would enter the data into the digital system, so that it would assume electronic form.

20.40 Since few debtors would have appropriate digital signatures, online registrations would presumably have to be signed only by the creditor. Indeed, that is already the position even for *paper* registrations in the UCC.⁵⁶ Such a system has to provide some reasonable assurance that the debtor has in fact consented. There would be more than one possibility here. One might be that the creditor would, as part of the application, have to transmit a scanned copy of a signed paper document in which the debtor consented to the registration. Something here depends on what is technically practicable.

20.41 Depending on the final details of the registration process, it may be that, following registration, the debtor should be notified of the registration.⁵⁷ Such a notice would be sent by the Keeper, not the creditor.

Searchability

20.42 Searching is important, and the UCC/PPSAs generally have detailed provisions as to how the register can be searched.⁵⁸ For example, the NZ PPSA says:⁵⁹

"The register may be searched only by reference to the following criteria:

⁵⁵ This is the current position for the Land Register, where paper applications attract a higher registration charge than electronic applications.

⁵⁶ But a filing does require that the debtor has consented, albeit that this consent is not something that appears on the application, nor is it checked by the registry officials.

⁵⁷ This is to be found in the PPSAs, where it is generally called a "verification statement". See eg New Zealand PPSA s 145; Ontario PPSA s 46(6).

⁵⁸ For example, sections 171 to 175 of the New Zealand PPSA are headed "Searches of register."

⁵⁹ NZ PPSA s 172.

- (a) the name of the debtor:
- (b) the name and address of the debtor or, if the debtor is an organisation, the name and address of the organisation and the name or job title, and contact details, of the person acting on its behalf:
- (c) the name and date of birth of the debtor:
- (d) if the debtor is a company, the unique number assigned to the company by the Registrar of Companies on the registration of the company under the Companies Act 1993:
- (e) if collateral is required by this Act or by the regulations to be described by serial number in a financing statement, the serial number of the collateral:
- (f) the registration number assigned to the registration under section 144:
- (g) any other criteria specified in the regulations."

20.43 Land registers are generally searchable by both property and name. But with moveable property, searchability is generally limited to name, because of the difficulties of uniquely identifying moveable property. But some property, notably motor vehicles, can be identified uniquely. But that possibility does not necessarily mean that a registered security document concerning motor vehicles should adopt such unique identification. There is a difference here between a security over a single motor vehicle, on the one hand, and a security granted by a motor dealer over its vehicle stock, present and future. In the latter case one cannot require data on vehicle identification numbers. So what is the difference in practice between the two cases? The answer is that if the vehicle (or other item) is in fact uniquely identified in the register, then that gives added protection to the creditor. Take this case. W owns a car and grants a registered security over it to X. W then sells the car to Y. The security still subsists. (Unless one of the rules protecting buyers applies.⁶⁰) Y then sells to Z. Z searches the register before buying. If Z carries out a name search against Y, a blank will be drawn,⁶¹ assuming that the security did not identify the vehicle by number. In that situation the rule should presumptively be that Z takes a title free of the security. But if the entry did identify it by number, then Z could have discovered it, and so will not take free of the security (unless some other protective rule applies in Z's favour).

20.44 New Zealand has introduced a system whereby the register can be searched by text message from a mobile phone. The service is called TXTB4UBUY. We quote from the Personal Property Securities Register website: "Before you buy a second hand vehicle, text us to check if money could be owing on the vehicle. There are three basic steps to completing a TXTB4UBUY search. First you send us an SMS text. Next you will receive a reply containing information that you then use to complete your search online. It costs NZ\$1 per submitted search (the fee is charged to your mobile phone)... You should receive an SMS reply from 3463 (FIND) within minutes."⁶²

⁶⁰ On this, see Chapter 16.

⁶¹ Unless the register was amended after the sale by W to Y, so as to put Y's name on the register.

⁶² See <<http://www.ppsr.govt.nz/cms/searching-the-ppsr/txtb4ubuy>>.

Questions

20.45 We ask:

- 76. What views do consultees have about the form of the Register of Moveable Transactions, about the way entries would be made, and the manner in which it should be searchable?**

Part 25 of the Companies Act 2006

20.46 Part 25 of the Companies Act 2006 requires certain charges granted by companies to be registered in the Companies Register within 21 days of their creation.

20.47 In our *Report on the Registration of Rights in Security by Companies* in 2004 we recommended that "there should no longer be any requirement to register particulars of a security granted by a company with the Registrar of Companies."⁶³ That view did not prove persuasive, the Companies Act 2006 preserving the current system. Our view nevertheless remains unchanged. Accordingly, if a new type of moveable security is introduced, in our view Part 25 of the 2006 Act should not be amended so as to make it a registrable charge. However, if, once again, our view does not prove persuasive, we would wish, at a minimum, that section 893 of the 2006 Act be activated. Without a section 893 order, the registration requirements of Part 25 are *additional* to the general requirements of the law relating to that security. So, for example, when a standard security is granted by a company it has to be registered twice, first in the Land Register and then in the Companies Register. Section 893 – an innovation in the 2006 Act – allows some relief from this, by enabling the Secretary of State to make an order whereby the first registration triggers an information shunt to the Companies Register. No such order under section 893 has yet been made. If it is ever made for standard securities, the effect will be that when a standard security granted by a company is registered in the Land Register, the Keeper will send a message to the Registrar of Companies enabling the latter to make an entry in the Companies Register. Once a section 893 order has been made, the need for the parties to carry out the second registration disappears. If (i) a new moveable security right is introduced and (ii) it is created by registration in the Register of Moveable Transaction, then (iii) in our view a section 893 order should be made. Of course, the issue does not arise for debtors other than companies.⁶⁴

20.48 We ask:

- 77. Do consultees agree that if a new moveable security is introduced which is created by registration a section 893 order should be made so as to avoid a double registration requirement?**

20.49 The discussion above was about incorporeal moveable property, because the company registration scheme does not cover security over corporeal moveable property, as far as Scottish companies are concerned. The provision for England and Wales includes in the list of registrable charges "a charge created or evidenced by an instrument which, if

⁶³ Scottish Law Commission, *Report on Registration of Rights in Security by Companies* (Scot Law Com No 197 (2004), para 3.25).

⁶⁴ Or certain other entities such as LLPs.

executed by an individual, would require registration as a bill of sale."⁶⁵ That means a non-possessory security over choses in possession (corporeal moveables). There is no corresponding provision in the Scottish provision.⁶⁶ The reason is that Scots law has no equivalent to the English bill of sale, though the logic is imperfect, because a Scottish company could presumably grant a non-possessory charge over a chose in possession situated in England.⁶⁷ It is possible that the company charges registration scheme will be amended so as to bring in security over corporeal moveable property granted by Scottish companies.⁶⁸ If that were to happen then clearly a section 893 order would be necessary in respect of the new moveable security in so far as it would relate to corporeal, as well as incorporeal, moveable property.

Amendments

20.50 Amendments would be a feature of the registration scheme, as in the UCC/PPSAs. One type of amendment worth noting is where title to the collateral passes from the debtor to someone else. In that case there has to be a facility to amend the register so that a search against the name of the transferee will show up the security.

Discharges and decluttering

20.51 It would of course be competent for discharges to be granted and registered. There would be a rule whereby a creditor could be obliged to grant a discharge, no doubt on the basis of reasonable expenses being met.

20.52 Experience shows that in the case of securities registered in a land register, a discharge will almost always be registered,⁶⁹ but that in other cases discharges are often neglected. This is a problem for the Companies Register, for example. It is an even greater problem for the Bills of Sale Register.⁷⁰ UCC-9 has a rule whereby after a defined period (five years) a financing statement lapses, unless it has been renewed.⁷¹ The position in the PPSAs is not quite the same, the position generally being that the registration can be for such period as is chosen by the applicant, with higher fees for longer periods.⁷² We incline to prefer the UCC approach, on the basis that the inconvenience to lenders of having to renew a registration every five years is outweighed by the inconvenience of a register choked with dead entries. But the issue is an open one.

20.53 In some legal systems a security right can have a shadowy existence even though unregistered. That would not be the case in our scheme, and so the effect of an entry in the register being cleared off by a decluttering rule would be that the security, if in fact still live by

⁶⁵ Companies Act 2006 s 860(7)(b).

⁶⁶ Companies Act 2006 s 878.

⁶⁷ Perhaps in that case English law would require it to be registered in the Bills of Sale Register.

⁶⁸ For the DBIS review of the company charges registration scheme see Chapter 10.

⁶⁹ Only "almost always". Every conveyancer has come across cases of securities that are several decades old but which have not been discharged even though there can be little doubt that the debts secured have long ago been paid off. Possibly there should be a decluttering rule for the Land Register, but that question is outwith the scope of this project.

⁷⁰ "Fewer than 20 memorandums of satisfaction were issued in 2007 or 2008, despite almost 80,000 bills of sale being registered." *A Better Deal for Consumers: Consultation on proposal to ban the use of Bills of Sale for Consumer Lending* available at <<http://www.bis.gov.uk/consultations/ban-use-of-bills-of-sale-for-consumer-lending>> at p 34.

⁷¹ UCC § 9-515.

⁷² For the approach of the Law Commission for England and Wales see Law Com Report No 296 paras 3.110 to 3.111.

that time, would be extinguished. For example, suppose that the law allows security over after-acquired assets. X is a motor dealer. On 1 May 2020 a security is registered in favour of a bank, Y, covering all X's vehicle stock, present and future. On 1 April 2025 X acquires a vehicle. The asset becomes, on that date, subject to the security. Y does not renew the registration. The security over the vehicle exists only for one month, after which it is extinguished.

20.54 Superseded data may still be important for one reason or another. The EBRD Model Law recommends that it be archived,⁷³ and we would agree.

78. Should entries lapse after a certain period, unless renewed? If so, should that period be five years, or some other period?

79. Do consultees agree that superseded data should be archived?

⁷³ *Publicity of Security Rights: Guiding Principles for the Development of a Charges Registry* p 12.

Chapter 21 Recharacterisation and registrability

Introduction

21.1 "Recharacterisation" means treating an arrangement that is not – as far as the expressed intentions of the parties are concerned – a secured transaction, as if it were one, on the ground that from a functional standpoint the arrangement's real economic purpose is to secure a debt.¹ Another way of looking at it is that certain arrangements are prohibited, in the sense that if anyone tries to use them, they will be unsuccessful. But such a prohibited transaction is not void: it is regarded in law as being a secured transaction. The justification for recharacterisation is that a transaction that is functionally a secured transaction should be treated as a secured transaction. Party autonomy is overridden in the wider interests of a coherent legal system. Recharacterisation is generally regarded as a matter for corporeal property. But something is said at the end of this chapter about recharacterisation in relation to incorporeal property.

21.2 If an arrangement is recharacterised as a security right, then it become subject to whatever requirements of law that may exist for security rights, including, where applicable, rules about registration. Thus under the UCC/PPSAs, if goods are sold subject to retention of title until payment, the seller's right is recharacterised as a security interest, and that will in most cases bring with it a requirement for registration. But the law can also adopt what by way of shorthand can be called a halfway house, which is to require registration – to satisfy the publicity principle – without going so far as to recharacterise the right itself. Thus there are some legal systems that require registration for retention of title, without turning it into a security interest.² These are the two themes of this chapter: in the first place full recharacterisation, and, in the second place, the halfway house. As will be seen, we incline to think that Scots law should not adopt full recharacterisation at the present time, though the possibility of adopting that approach may be one to be considered at some time in the future. But we think that the case for adopting the halfway house may be stronger.

21.3 German law has a very limited degree of recharacterisation, especially as a result of the modern German insolvency legislation.³ But it is the UCC-9 and the systems that follow it that have gone the furthest. Anything that is in functional terms a security interest *is* a security interest. If Jack sells to Jill, retaining title until payment, the law regards the arrangement as if it were an immediate transfer of title, coupled with a grant back, by Jill to Jack, of a security interest over the goods sold. That is a fairly strong interference with the intentions of the parties. Jack's intention is not to part with ownership. But that intention is overridden. Jill's intention is not to acquire ownership; that intention is overridden. The

¹ For discussion of the concept, see Roger McCormick, *Legal Risk in the Financial Markets* (2nd edn 2010).

² For example, Italy, Quebec, Spain and Switzerland. See below and also Appendix B.

³ *Insolvenzordnung*. See § 50 read with § 51.

general law of property is that for ownership to pass, there has to be intention on both sides.⁴ But the general law of property is ousted by recharacterisation.

If there is recharacterisation, where does ownership lie?

21.4 What has just been said is in fact an oversimplification, as far as UCC-9 itself is concerned, and most of the UCC-9-type systems.⁵ UCC-9 says that in fact Jack remains the owner, but for virtually all purposes Jill is regarded as owner. One could say that ownership is divided between Jack and Jill, with Jack still having 1% ownership and Jill having 99%. UCC § 1-201 says:

"The retention or reservation of title by a seller of goods notwithstanding shipment or delivery to the buyer under Section 2-401 is limited in effect to a reservation of a 'security interest'."

21.5 And UCC § 9-202 says:

"Except as otherwise provided with respect to consignments or sales of accounts, chattel paper, payment intangibles, or promissory notes, the provisions of this article with regard to rights and obligations apply whether title to collateral is in the secured party or the debtor."

21.6 Article 2 of the UCC allows the parties to agree when ownership is to pass.⁶ But UCC § 1-201 means that Jack's retained ownership is treated as a mere security interest for the purposes of Article 9. There are few circumstances in which Jack's reserved ownership could have any real consequences, or, to put it the other way round, there are few circumstances in which Jill is not treated as owner.

21.7 In the USA ownership, or title, to goods is generally regarded as unimportant, and the UCC indeed is constructed to give effect to that outlook.⁷ Scots law has a different outlook, as indeed do most European systems. We think that the deliberately cavalier attitude of the UCC towards the location of ownership would not fit in with Scots law. The complexity of the UCC approach, with its divided ownership, may be unimportant from a US standpoint, but would not be unimportant here. The same view was taken by the EBRD Model Law, based on UCC-9, for use on the European continent. The Model Law, though based in broad terms on UCC-9, provides that the recharacterisation of retention of title should be absolute and complete:

"9.1 Where at or before the time of transfer of title by way of sale of a movable thing there is written agreement between the vendor and the purchaser that the vendor retains title or obtains a security right in the thing until payment of the purchase price

9.1.1 title to the thing is not retained by the vendor but is transferred to the purchaser as if such agreement does not exist; and

⁴ The *animus transferendi dominii* on one side and the *animus acquirendi dominii* on the other.

⁵ The main exception is the EBRD Model Law.

⁶ UCC § 2-401.

⁷ Thus UCC § 2-401 says: "Each provision of this Article with regard to the rights, obligations and remedies of the seller, the buyer, purchasers or other third parties applies irrespective of title to the goods...."

9.1.2 the vendor simultaneously receives a charge over the thing unless the parties otherwise agree without any requirement for a charging instrument or registration."

21.8 This is, in comparison with the UCC, clear and straightforward, and is capable of being slotted into a civilian system of property law without friction. If Scots law were to adopt recharacterisation, we think that it would be important to do so in the EBRD way rather than in the UCC-9 way. The policy result is essentially the same. But technical issues matter too.

Recharacterisation in the UCC-9 type systems

21.9 In UCC-9 recharacterisation applies to retention of title, to hire-purchase and to finance leasing. Three examples will illustrate.

(i) Jack sells to Jill, reserving ownership until payment. Jill is treated as owner, and Jack is treated as the holder of a mere security interest.

(ii) Alpha is a dealer in goods and wants to sell to Beta, who, however, does not have enough money to buy. Alpha sells the goods to Gamma, who enters a hire-purchase agreement with Beta. Alpha is treated as the seller, Beta as the buyer and Gamma as the grantee of a security interest.

(iii) Serafina grants to Harry a lease of a computer, the term of the lease being the computer's expected lifespan. Harry is regarded as the owner and as having granted to Serafina a security interest.⁸

Consequences of recharacterisation

21.10 There are two consequences of recharacterisation. The first is that the arrangement, in order to be "perfected", must comply with the perfection rules that apply to security interests. Assuming that the creditor⁹ is not in possession, that generally means registration. In some cases, however, perfection does not need registration. In retention of title cases, registration is needed in business transactions but not in consumer transactions. In the EBRD Model Law the rule for retention of title is rather different. Registration is required in all transactions, not just business transactions, but, on the other hand, there is a grace period of six months in which there is temporary perfection without registration.¹⁰ Given the short life cycle of many types of goods, this means that failure to register would, under the EBRD Model Law, often not matter much.

21.11 If the required perfection does not take place, the result is that the debtor in effect has the unencumbered ownership of the goods. So if in the USA Jack sells to Jill, subject to retention of title, and nothing is registered, Jack has nothing but an unsecured claim for the price.¹¹

⁸ For the distinction between operating leases, which are not subject to UCC-9, and finance leases, which are, see UCC § 1-203.

⁹ In the examples above, Jack, Gamma and Serafina are all creditors. In current Scots law they would all be owners.

¹⁰ Article 9.

¹¹ The complexities of UCC-9 mean that this statement is an over-simplification. First, Jack is still the owner for certain very minimal purposes. Secondly, Jack still has an attached security interest. For the (complex) distinction between attachment and perfection, see paras 13.20 to 13.29.

21.12 The second consequence of recharacterisation is that the right of the creditor is treated, as a matter of substantive law, as merely a security interest, while the debtor becomes owner. Thus, for example, if there is default, and the creditor wishes to enforce against the goods, the enforcement can only take the form of the enforcement of a security interest. By contrast, under Scots law the "creditor" could simply rescind the contract and demand the return of the goods.¹²

Recharacterisation and the purchase money security interest

21.13 Recharacterisation creates the following problem. First, take a case under Scots law. Suppose that X Ltd grants to Y a floating charge. Later X Ltd buys goods from Z Ltd, subject to retention of title. Z's right trumps that of Y, because although Y's security right extends to future property, the effect of the reservation of ownership is that the goods are not yet X's property, and will not become X's property unless and until paid for. Turn now to the UCC/PPSAs. Z's right is a mere security interest. It has arisen later than Y's, and so in principle is postponed to it. This was thought unjust to Z, and accordingly there is a special rule to protect "purchase money security interests" (PMSIs),¹³ by giving them priority over earlier floating liens. The detailed rules are complex.¹⁴ There is a distinction between different types of goods. For example, for inventory Z has to send to Y an advance notice,¹⁵ a requirement that seriously derogates from the principle.¹⁶

Criticism of recharacterisation¹⁷

21.14 Recharacterisation is criticised as being a one-size-fits-all approach.¹⁸ In particular it is criticised as an interference in the freedom of parties to design their own deals.¹⁹ This approach was also one of the motives for the passing of the Financial Collateral Directive,²⁰ which forbids member states to recharacterise repos²¹ as secured transactions.

21.15 Another criticism concerns the assumption that transactions can be divided into those that are, whatever their outward form, secured transactions, and those that are not: this is the essence of the "functional" approach. In reality the distinction is often fuzzy. Any contractual right of rescission by X if Y breaches the contract could be regarded as a security right, because it is a security against breach by Y. Indeed, logically if X sells to Y, any retention of title is a "security" *even before delivery*. Likewise, any lease of goods by X to Y is a "security" because breach by Y can lead to rescission by X. UCC-9-type systems seek to draw a distinction between finance leases which are to be regarded as involving security and operating (or "true") leases which are not. But any distinction in this area is hard to draw.

¹² In the case of transactions regulated by the Consumer Credit Act 1974, the "creditor's" right to do this is subject to certain controls.

¹³ For the definition of PMSI see UCC § 9-103.

¹⁴ UCC § 9-324.

¹⁵ UCC § 9-324 (b).

¹⁶ UCC § 9-324.

¹⁷ A noteworthy critique is Michael Bridge, Roderick A Macdonald, Ralph L Simmonds and Catherine Walsh, "Formalism, Functionalism, and Understanding the Law of Secured Transactions" (1999) 44 McGill Law Journal 567.

¹⁸ For example see Iwan Davies, "Reform of English Personal Property Security Law: Functionalism and Article 9 of the Uniform Commercial Code" (2004) 24 Legal Studies 295.

¹⁹ This is for example the view of Professor Dalhuisen. See J H Dalhuisen, *Dalhuisen on Transnational and Comparative Commercial, Financial and Trade Law* (4th edn 2010) vol III sections 1.1.7, 2.1.1 and 2.1.2.

²⁰ For this Directive, see Chapter 2.

²¹ A "repo" is a transaction involving financial instruments as collateral.

It may be possible: UCC § 1-203 has about 550 words on how the sheep and the goats are to be separated as far as leases are concerned. The UCC is less forthcoming for retention of title in sale: its approach may be that once the contract has been entered into then the interest of the seller is always a mere security interest.

21.16 Another criticism is that recharacterisation is only partial: for some purposes the debtor is treated as the owner but for other purposes the creditor is treated as the owner.²² The result is complexity.²³ However, whilst this criticism is applicable to the UCC and to the PSSAs themselves, it is possible to avoid it, and the EBRD Model Law does so.²⁴

The English project

21.17 In both its initial consultation paper,²⁵ and its subsequent "consultative report",²⁶ the Law Commission for England and Wales proposed that recharacterisation should be introduced to English law. But it then concluded that insufficient support existed and in its final report²⁷ it dropped the proposal.

A halfway house: registrability without full recharacterisation²⁸

21.18 It would be possible to adopt the first consequence (publicity required, ie registration) and not the second (creditor's right compulsorily converted into a security interest). The logic would be that the main problem with quasi-securities is that they derogate from the publicity principle, and accordingly it is that problem that needs to be fixed. That approach might perhaps be regarded as artificial. But at least three European jurisdictions have that approach, Spain,²⁹ Switzerland³⁰ and, to a limited extent, Italy.³¹ If Jack sells to Jill subject to retention of title, there must be registration, failing which Jill will be the owner. But if there is registration, then the result is not (as in the UCC-9-type systems) that Jack is treated as the holder of a mere security interest. Jack is treated as the owner. The Canadian PPSAs have taken a similar approach, not with retention of title and hire purchase, but with finance leases.³² Quebec's approach is comparable to that of Spain and Switzerland.³³

²² See above and also Chapter 13.

²³ See eg R C C Cuming, "Internationalizing Secured Financing Law" in Ross Cranston (ed), *Making Commercial Law* (1997) at p 523.

²⁴ EBRD Model Law Art 9.1. See para 21.7 above.

²⁵ Law Com CP No 164.

²⁶ Law Com CP No 176.

²⁷ Law Com Report No 296.

²⁸ As well as (i) recharacterisation with a registration requirement and (ii) a registration requirement without recharacterisation, there is logically a third possibility, namely (iii) recharacterisation with no registration requirement. The EBRD Model Law has something like (iii) in relation to retention of title clauses.

²⁹ Ley 28/1998, de 13 de julio, de Venta a Plazos de Bienes Muebles, article 15(1): "*Para que sean oponibles frente a terceros las reservas de dominio o las prohibiciones de disponer que se inserten en los contratos sujetos a la presente Ley, será necesaria su inscripción en el Registro a que se refiere el párrafo siguiente.*" Registration is in the *Registro de Bienes Muebles*.

³⁰ Article 715 of the Swiss Civil Code: "*Der Vorbehalt des Eigentums an einer dem Erwerber übertragenen beweglichen Sache ist nur dann wirksam, wenn er an dessen jeweiligem Wohnort in einem vom Betreibungsbeamten zu führenden öffentlichen Register eingetragen ist.*"

³¹ Article 1524 of the Italian Civil Code, applicable only to machinery, and also necessary only for effect as against voluntary grantees from the buyer. Retention of title is effective against creditors of the buyer even without registration. (See Anna Veneziano in Harry Sigman and Eva-Maria Kieninger, *Cross-Border Security over Tangibles* (2007) p 169.)

³² For example, the Saskatchewan PPSA states at s 3(1) that it applies to "every transaction that in substance creates a security interest, without regard to its form and without regard to the person who has title to the collateral" - for an explanation as to how this "substance test" includes financing leases, see Ronald C C Cuming

21.19 Such an approach could be applied to all cases. Or there could be exceptions, for instance (as in UCC-9) for sales to consumers. There could be a grace period (as in the DCFR). And so on.

21.20 It is possible to attempt to use the trust as a quasi-security, ie as an arrangement intended to secure the performance of an obligation. If full recharacterisation were to be adopted, such trusts would be recharacterised as security rights. But the halfway house would also be available, ie no attempt would be made at recharacterisation, but the trust, to be anything more than an agreement between the parties, would have to be registered. This would be a straightforward application of the publicity principle. We raise this issue only in relation to moveable property, corporeal and incorporeal, and not heritable property, since the latter falls generally outwith the scope of this paper. From a practical point of view it would probably be easier to introduce the halfway house for trusts than for other quasi-securities, because such a measure would be likely to affect fewer, but higher-value, transactions than, for example, requiring registration for hire-purchase transactions.

The UK dimension³⁴

21.21 Some of the possible reforms canvassed in this discussion paper would have only a relatively limited impact at the UK level. The reform of the law of outright assignation would be an example. The introduction of a registered non-possessory security interest would be another. A third would be the introduction of a security interest over personal rights such as trade receivables. But recharacterisation would be different. The types of "title finance" that are familiar to the commercial world would suddenly cease to work in their accustomed manner north of the border. How big the change would be would depend on whether the full recharacterisation option were to be taken up, ie the UCC-9 type of approach, or whether the halfway house option were to be taken up. But even the halfway house option would be a significant change.

The EU dimension

21.22 Article 4 of Directive 2000/35/EC³⁵ says: "Member States shall provide in conformity with the applicable national provisions designated by private international law that the seller retains title to goods until they are fully paid for if a retention of title clause has been expressly agreed between the buyer and the seller before the delivery of the goods." Article 2 defines "retention of title" as meaning "the contractual agreement according to which the seller retains title to the goods in question until the price has been paid in full." Article 4 has been criticised by academic commentators as verging on the meaningless.³⁶ But the cautious view must be to assume that it does have at least some meaning. In that case, its ostensible effect is to exclude recharacterisation. As against that, if Article 4 is interpreted teleologically rather than literally, recharacterisation would not be excluded. Whilst it is

and Roderick J Wood, *Saskatchewan and Manitoba Personal Property Security Acts Handbook* (1994) para 3(2). See also the Ontario PPSA s 2; the New Zealand PPSA s 17 and the Australian PPSA ss 12 and 13.

³³ Quebec Civil Code Article 1750.

³⁴ On these issues see also Chapter 1.

³⁵ On combating late payment in commercial transactions.

³⁶ See for example: Gerard McCormack, "Retention of Title and the EC Late Payment Directive" (2001) 1 *Journal of Corporate Law Studies* 501; Eva-Maria Kieninger at pp 23 – 24 of Eva-Maria Kieninger (ed), *Security Rights in Movable Property in European Private Law* (2004); J M Milo, "Combating Late Payment in Business Transactions: How a New European Directive Has Failed to Set a Substantial Minimum Standard Regarding National Provisions on Retention of Title" (2003) 11 *European Review of Private Law* 379.

certainly possible that the European Court of Justice might construe Article 4 in a purpose-orientated manner, unless and until there is such a decision we consider that the working assumption can only be that recharacterisation is excluded.³⁷ Article 4 of Directive 2000/35/EC affects one strand of recharacterisation, namely retention of title in the sale of goods. It does not appear to affect finance leasing or hire purchase.

One step at a time?

21.23 One possible position would be that it would be better to begin by introducing a system of security by means of registration, and letting that bed down first. The possibility of recharacterisation could then be considered at a future stage, by which time registered security interests in moveable property would already be familiar and any teething problems would have been addressed. But this of course assumes that recharacterisation is permitted by EU law, which we regard as doubtful.

Recharacterisation and incorporeal property

21.24 The UCC and the PPSAs recharacterise assignments in security of receivables. The same could be done in Scots law. In theory it could also be done for assignations in security of intellectual property rights, but this would give rise to difficulties. Suppose that X holds a patent and assigns it to Y, and Y is then registered in the Patents Register as the new holder of the patent. If the X/Y assignation is truly in security of a loan, and if the law recharacterises the assignation by saying that X is still the patent holder, and that Y has merely a limited right, that would cause problems for the system of registering patents and their holders. We think therefore that, at least in the context of the present project, the issue can sensibly be raised only for ordinary personal rights.

21.25 Recharacterisation would be virtually the same as prohibiting assignations in security. That would be a radical step. We do not think it should be taken at least at the present time. As with recharacterisation for corporeals collateral, we think that, even if recharacterisation is eventually regarded as desirable, time should be allowed for the new system proposed in this discussion paper to bed down.

Options

21.26 On balance we think that even if the problem of EU law mentioned above does not prove an obstacle, recharacterisation should not be adopted, at least for the time being. Nevertheless, to test views we ask:

- 80. (a) Do consultees agree that, even if the issue of Article 4 of Directive 2000/35/EC is not an obstacle, Scots law should not, at least at the present time, introduce a system of recharacterisation of quasi-securities?**

- (b) If consultees agree with the previous proposal, do they think that Scots law should introduce the "halfway house" in relation to quasi-**

³⁷ As far as we are aware, this issue has not been discussed, except briefly by Gerard McCormack, "Quasi-securities and the Law Commission Consultation Paper on Security Interests: A Brave New World" (2003) Lloyd's Maritime and Commercial Law Quarterly 80 at 90 to 91. The two consultation papers and final report by the Law Commission of England and Wales do not discuss the issue.

securities, ie registrability without full recharacterisation? If so, should it apply to certain cases only (such as trusts) or to all cases?

(c) If either full recharacterisation is adopted, or the halfway house, should there be categories (eg sales to consumers) where registration should not be required? Should there be grace periods?

Chapter 22 Floating liens and floating charges

Introduction

22.1 The floating charge is a security over moveable property, corporeal and incorporeal. It can cover immoveable property too, but its main significance is for moveables. It was the perceived need for a new type of security over moveable property that led to the introduction of the floating charge in 1961.¹ The equivalents of the floating charge in other legal systems are generally limited to moveables. This is true of both the Germanic family and the US family. In German law, and systems based on it, the combination of *Sicherungsübereignung* (for corporeals) and *Sicherungsabtretung* (for incorporeals) achieves an effect broadly comparable to that of the floating charge.² But only moveables can be dealt with in this way. There is no equivalent for immoveable property. In UCC-9 it is competent to grant a security interest over future assets, corporeal and incorporeal. Such a security interest is called a floating lien.³ But as in German law, it is limited to moveables.⁴

22.2 We include floating charges in the present exercise for two reasons. One is the reason already given, that moveables lie at the heart of the floating charge. The second is that if a new type of security interest is introduced, capable of covering corporeal and incorporeal moveables, and if that security is capable of covering not only present assets but future assets as well, the result is something very like the floating lien of the UCC.⁵ And at that point a sort of collision with the floating charge takes place. To a considerable extent they would overlap.

The floating lien and the floating charge: similarities and differences

22.3 The floating lien and the floating charge have much in common but they also have their differences. We proceed to discuss these, but it must of course be borne in mind that legislation can create new concepts, so that if the floating lien were to be introduced, it would not necessarily have to be the same as the UCC-9 floating lien.

22.4 The floating lien and the floating charge coincide in that the moveable property of the debtor, present and future, is subject to the security. (Subject always to any agreed

¹ Companies (Floating Charges) (Scotland) Act 1961, implementing the Eighth Report of the Law Reform Committee for Scotland, Cmnd 1017 (1960).

² The German system is, however, rather nearer to the floating lien than it is to the floating charge. Like them, it does not cover immoveable property, and, like them, it does not employ the concept of crystallisation. The great difference between the German system on the one hand and, on the other, the floating charge and the floating lien is that the latter require registration.

³ This term is not used in the UCC. It does not have to be used, because – unlike the floating charge – it is not a separate institution. It is merely a UCC-9 security interest that is granted to the maximum extent allowed by law.

⁴ For a qualification to this statement see UCC § 9-334.

⁵ For which see Chapter 13. Although we use the American expression "floating lien" for the purposes of discussion, we would repeat the point made in Chapter 13, that the word "lien" in that expression does not match the Scottish meaning of "lien".

exclusions. Thus a "limited asset" floating charge is competent, limited, for example, to the debtor's receivables.) But there are differences too, and to these we now turn.

22.5 Their inner logic is different. A floating lien is, in the terminology of English law, a "fixed" security right.⁶ In civilian terminology, it is a real right. By contrast, the nature of the floating charge before crystallisation⁷ is obscure both in England⁸ and in Scotland.⁹ Probably before crystallisation it is not a real right.¹⁰ The obscure conceptual nature of the floating charge is in itself a weighty argument for replacing it by the floating lien.

22.6 The floating charge can be trumped, to some extent, by unsecured claims. In the first place, the "effectually executed diligence" of another creditor will trump an uncrystallised floating charge.¹¹ In the second place, a floating charge is trumped by the preferential creditors such as employees in respect of arrears of salary.¹² In the third place, assets that would otherwise be available to meet the claim of the floating chargeholder are subject to the "prescribed part" in favour of the unsecured creditors.¹³ And, fourthly, a floating charge, unlike other charges, is subject to the expenses of an administration.¹⁴ Collectively these rules detract to a significant extent from the effectiveness of a floating charge. These rules do not apply to ordinary "fixed" security rights, such as a standard security. The logic of a floating lien is that it is an ordinary fixed security. If it were to be introduced, therefore, it would presumptively not be subject to these rules. Indeed, one of the themes of the English law of rights in security for many years has been the attempt to expand the scope of fixed security, so as to defeat these rules.¹⁵ In Scotland there has been some envy (from the standpoint of secured creditors) at the success that has been achieved south of the border. Had the Murray Report been enacted, Scots law would have attained something like parity with English law in this respect. A major development since then has been the decision of the House of Lords in the *Spectrum Plus* case,¹⁶ the effect of which was that some security rights that had previously been thought to be fixed were in fact floating.¹⁷ Nevertheless it is still the case that in English law it is easier to grant fixed security than it is in Scotland.

22.7 Anyone can grant a UCC-9 security interest. But most UCC-9-type systems limited the power of non-business debtors to grant security over *future* assets, thus barring the creation of a floating lien in such cases. Since a floating charge cannot be granted by a

⁶ This may seem a paradox: to float and to be fixed are antithetical. But that is true only in the English tradition.

⁷ The term used in the Scottish legislation is not "crystallise" but "attach". But the word "attach" has so many different meanings that we will for convenience use the English term.

⁸ See the references in Appendix B para 10.

⁹ See Chapter 9.

¹⁰ *National Commercial Bank of Scotland Ltd v Liquidators of Telford Grier Mackay & Co* 1969 SC 181. Scott Styles suggests that it is a "conditional real right". In a broad sense that is no doubt the case. See Scott Styles, "The Two Types of Floating Charge: The English and the Scots" (1999) 4 *Scottish Law and Practice Quarterly* 235 at 240. English law also finds the nature of the pre-crystallised floating charge problematic: see Appendix B.

¹¹ See below.

¹² Insolvency Act 1986 s 59.

¹³ Insolvency Act 1986 s 176A.

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

¹⁵ "By the 1970s, however, the banks had become disillusioned with the floating charge. The growth in the extent and amount of the preferential debts, due in part to increases in taxation and in part to higher wages and general financial obligations to employees, led banks to explore ways of extending the scope of their fixed charges." *Re Brumark Investments Ltd* [2001] 2 AC 710 *per* Lord Millett at para 17. This was a New Zealand case before the Privy Council but the remarks seem to be as much about the position in England as in New Zealand.

¹⁶ *National Westminster Bank plc v Spectrum Plus Ltd* [2005] UKHL 41, [2005] 2 AC 680. See also *Re Brumark Investments Ltd* [2001] 2 AC 710.

¹⁷ In Scots law it is almost always perfectly clear whether a security is a floating charge. But in English law the "fixed or floating" question can be difficult to answer.

consumer, the practical results are comparable. But whereas a floating charge can be granted only by companies (and certain other entities), a floating lien can be granted by any non-consumer, such as a sole trader or a partnership. (The Murray Report recommended that the power to grant floating charges should be extended to sole traders and partnerships.¹⁸)

22.8 A floating charge can, and usually does, cover the debtor's immoveable property. A floating lien, by contrast, does not touch immoveable property.¹⁹

22.9 The holder of a floating charge can appoint an administrator.²⁰ There is no equivalent for the floating lien. It would, however, be possible for the law to so provide.²¹ The Murray Report recommended that the new "moveable security" that it proposed should be enforceable by receivership.²²

22.10 A floating charge covers, or at least can cover, all the debtor's moveable property. A floating lien may, however, be subject to qualifications as to asset types. In general it does not cover moveable assets that have their own registration system, such as intellectual property, ships and aircraft.²³

22.11 A floating charge has, or purports to have, extraterritorial effect.²⁴ A floating lien is not necessarily the same, the position varying as between different systems.

Main options

22.12 In principle there are four main options, dividing into two groups. The first group involves the introduction of the floating lien.

22.13 (i)(a) The floating lien would be introduced and the floating charge would be abolished. Thus the floating charge would be replaced by the floating lien. (i)(b) The floating lien would be introduced but the floating charge would not be abolished. The red squirrel and the grey squirrel would thus co-exist, though over time one might drive out the other.

22.14 The second group of options involves the rejection of the floating lien. (ii)(a) The floating lien would not be introduced, and the floating charge would be kept. In other words, no change, though the new system of security rights would still apply, though not to after-acquired property. Security over after-acquired property would continue to be handled, as now, through the floating charge. (ii)(b) The floating lien would not be introduced, and the floating charge would be abolished.

¹⁸ See clause 1 of the draft bill appended to the Report.

¹⁹ As mentioned above, UCC § 9-334 is a limited exception. And under the EBRD Model Law it seems that immoveable property can be included.

²⁰ For the appointment of an administrator by a floating chargeholder see the Insolvency Act sch B1 para 14. The power to appoint a receiver has now been abolished for floating charges created after the Enterprise Act 2002 came into force (September 2003), subject, however, to certain exceptions. See Insolvency Act 1986 s 72A – H.

²¹ Assuming at any rate that any heritable property was also secured to the lender. See Insolvency Act 1986 sch B1 para 14. The EBRD Model Law has "charge managers" and "enterprise administrators".

²² Para 3.25 and sch 1 para 1(2) of the draft bill appended to the Report.

²³ The fact that the floating charge is subject to no restrictions as to asset type has been a cause of difficulty, especially as to its interaction with land law.

²⁴ For the extraterritorial operation of English law see Chapter 9.

22.15 Before putting the question as to which of these options should be adopted, various issues need to be looked at, so as to put these options into context.

The floating lien within insolvency law

22.16 The floating charge is a security that can, as we have noted, be trumped by certain other creditors. Would the same be true of the floating lien? In one sense that is a matter for policy decision. And no doubt there would be a desire from financial institutions that the floating lien would differ from the floating charge in this respect. Indeed, from the standpoint of financial institutions there might not be much point in introducing the floating lien unless it was stronger, in terms of priority, than the floating charge.

22.17 But the issue is essentially one of insolvency law, and the substantive reform of insolvency law is not part of this project. It is true that one might be able to construct the floating lien in such a way that it might escape the definition of "floating" as laid down in *Spectrum Plus*.²⁵ But that would be a back-door route. Given that the policy of insolvency law is that security rights of a certain general type should have a postponed ranking in insolvency, and given that the substantive reform of insolvency law is not part of this project, it must be accepted that if the floating lien is introduced it would have to be treated, in the insolvency of the debtor, in broadly the same way as a floating charge.²⁶

22.18 One specific issue concerns the law of unfair preferences. With one exception, the law applies to all types of security rights, and is the same in personal and corporate insolvency.²⁷ The exception is section 245 of the Insolvency Act 1986, which has a special "unfair preference" rule applicable solely to floating charges. If the proposed new security right is introduced, and if it is capable of extending to after-acquired property, ie is capable of being a floating lien, the question would arise as to whether section 245 should also apply to it, to the extent that the collateral in question had been acquired by the debtor after the registration of the security.

22.19 We ask:

- 81. Do consultees agree that if the floating lien is introduced, it would have to be treated, for the purposes of insolvency law, in substantially the same way as the floating charge?**
- 82. Specifically, should the special rule in section 245 of the Insolvency Act 1986 apply to the new security, to the extent that the collateral in question had been acquired by the debtor after the registration of the security?**

²⁵ *National Westminster Bank plc v Spectrum Plus Ltd* [2005] UKHL 41, [2005] 2 AC 680.

²⁶ The rules in the insolvency legislation about the ranking of floating charges are incoherent, and if the suggestion in the text were to be adopted, that incoherence would apply also to floating liens. For example, a floating charge may rank above a fixed security. But a fixed security ranks above the preferential claims while the preferential claims rank above floating charges. Thus there is a priority circle. Whilst we regard this incoherence – which has existed for decades without being addressed – as unacceptable, it is something that belongs to insolvency law and the present project has to leave insolvency law essentially as it finds it.

²⁷ Insolvency Act 1986 s 243, which adopts, for corporate insolvency, the same rules as apply in sequestration: Bankruptcy (Scotland) Act 1985 s 36. There is also a common law of unfair preferences, and this too applies equally to all security rights.

Floating liens and "effectually executed diligence"

22.20 An issue that is, by contrast, a live issue in terms of policy formation is the issue of whether the floating lien would be subject to the "effectually executed diligence" of other creditors. The floating charge is so subject.²⁸ This is not a matter of insolvency law. The policy reason for the rule is that without it the floating charge would be too strong.²⁹ The Murray Report considered the point important. The reason the committee rejected UCC-9 (under which there is no equivalent to the "effectually executed diligence" rule) was, among other reasons, the following:³⁰

"Given that it was likely that most businesses would have been required (at least by their most important creditors) to grant the new security over all their moveable property, that could have meant that in practice the moveable property of most businesses would no longer have been available for effective diligence by other creditors. At least with the current law on floating charges, there is the possibility of diligence being carried out before the floating charge attaches."

22.21 No doubt banking interests would not support the application of the "effectually executed diligence" rule to the floating lien. But others may take a different view. We ask:

83. If the floating lien is introduced, should it be subject to the "effectually executed diligence" rule?

Case for introducing the floating lien

22.22 Why the floating lien? Does the floating charge not do the job? The answer should be apparent from what has been said elsewhere in this discussion paper, but it may be worth summarising the main points here. (i) It must be borne in mind that the proposed legislation would not introduce or establish a new type of security interest, the "floating lien." If there is to be a new security interest over moveable property, the floating lien would come into being automatically, unless the new security right were to be restricted to existing assets. As has been made clear elsewhere, the floating lien would not be, as the floating charge most definitely is, a separate type of security right. The floating lien does not have to be bought separately: it is a case of "buy one, get one free". (ii) The floating charge can be granted only by certain entities. The floating lien could be granted by any person, natural or juristic. (iii) The floating lien would have a superior inner logic. Fifty years after the introduction of the floating charge its inner logic remains absolutely obscure. On balance we think that the floating lien should be introduced, or, to put the point more correctly, we think that the new security right that we propose should not be limited to present assets. We ask:

84. Do consultees agree that the new moveable security right should not be limited to present assets (other than in consumer cases)?

²⁸ This topic is mentioned again below in relation to possible reform of the law of floating charges.

²⁹ But whether, as a matter of history, that is why the rule exists is unclear. Scots law took it from English law when the floating charge was introduced by the Companies (Floating Charges) (Scotland) Act 1961. No thought seems to have been given to the issue at that time. It is not clear to us to what extent the English rule was developed as a matter of thought-out policy.

³⁰ Murray Report para 2.4.

Who could grant the floating lien?

22.23 Only certain entities can grant a floating charge. Those not on the list cannot grant such a charge. With the floating lien it would be the other way round. Any person, natural or juristic, could grant the new moveable security right, except to the extent that the legislation otherwise provided. Our provisional view is that consumers should be disabled from granting floating liens.³¹ The result would be that the floating lien would be more widely available for use than the floating charge. In particular, sole traders and ordinary partnerships, which cannot grant floating charges, would be able to grant floating liens.

85. Do consultees agree that the new moveable security right should be capable of being granted by any person, juristic or natural?

Ranking of floating liens in relation to other examples of the new security right

22.24 If the new security covers after-acquired assets, how would that security rank in relation to such an asset where there is another security over it? For example, suppose that a debtor, a motor dealer, grants a floating lien to X on 1 January and to Y on 1 March, in each case the security being over its vehicle stock. Suppose that on 1 June it acquires a given vehicle. That is the date when the vehicle becomes subject to each security. Although the two security rights, in relation to that vehicle, would come into existence at the same time, as between themselves the ranking of the two securities would follow the order of registration.

Ranking of floating liens in relation to retention of title etc

22.25 Under current law, if X has granted a floating charge to Y, and thereafter acquires goods from Z, subject to a clause of retention of title, Z's right trumps Y's, because the goods still belong to Z. In the UCC/PPSAs the position is different, because Z's right is recharacterised as a mere security interest, and Z's right will trump Y's only if the PMSI rules are engaged. Under our proposed new scheme, the current law would continue. In other words, a supplier of goods, subject to a valid retention of title clause, would prevail as against a creditor who held a floating lien over X's assets.

Abolition of the floating charge?

22.26 There are those who would favour the abolition of the floating charge, without at the same time introducing the floating lien. As a practical matter, that seems not to be a real policy option, at least at the present time. The practical question is whether, if the floating lien is introduced, the floating charge should be abolished. (Any such abolition would apply only prospectively. Existing floating charges would not be invalidated.)

22.27 The floating charge does not survive in those jurisdictions that have adopted the floating lien.³² An exception is Quebec, where something very like the floating lien has been

³¹ This issue is discussed in Chapters 16 and 18.

³² In the USA the floating charge never established itself: *Benedict v Ratner* 268 US 353 (1925). In the PPSA jurisdictions it did, but because it was non-statutory it did not have to be got rid of by legislation. With the enactment of the PPSAs the fixed/floating distinction disappeared and any purported floating charge now takes effect as a floating lien. See Chapter 13 for further discussion.

adopted, but the floating charge remains in existence.³³ But in Quebec it appears to have become virtually a dead letter.

22.28 With the introduction of the floating lien there would clearly be a strong case for abolishing (prospectively) the floating charge.³⁴ As against that, there might well be opposition to the idea that the floating charge would disappear in one part of the UK. Financial institutions tend to be conservative organisations when it comes to law reform. It is true that to have *both* the floating lien *and* the floating charge would be untidy. But it would be workable, and it may be that the floating charge would fade away in practice, and might be abolished in a future phase of law reform. We ask:

86. Do consultees agree that the floating charge should not be abolished, at least for the time being?

Floating charges: the land issue

22.29 In Chapter 9 we noted that there is a case for providing that floating charges granted in future should not cover immovable/heritable property, and we noted that the Murray Report had put this question to consultees.³⁵ We think that the question needs to be put again.³⁶ Of course, if there were to be any change in the law, it would be prospective only, so that the rights of existing floating charge holders would be unimpaired. We ask:

87. If floating charges are to continue to be competent, should they continue to be capable of covering immovable/heritable property?

The ranking of floating charges

22.30 The ranking of floating charges is a complex subject. (One of the attractions of the floating lien is that its ranking rules are simpler.) One difference between Scotland and England, noted elsewhere,³⁷ is that in England a floating charge will normally rank *after* subsequent fixed securities, and perhaps floating too. The floating charge comes above ordinary unsecured creditors but, apart from that, it is generally the security *ultimo loco*. By contrast, in Scots law a floating charge normally ranks ahead of subsequent security rights, other than security rights arising by operation of law.³⁸ It is for consideration whether

³³ There is a certain irony in the fact that in Canada, the common law provinces do not have the floating charge, having abandoned it on the introduction of the PPSAs, and the only province to retain it is the civil law province of Quebec.

³⁴ Those in England who support the introduction of a UCC/PPSA-type system generally wish to see the disappearance of the floating charge. For example, Sir Roy Goode calls the floating charge an "anachronism": see his paper "The Exodus of the Floating Charge" in David Feldman and Frank Meisel (eds), *Corporate and Commercial Law: Modern Developments* (1996) at p 201.

³⁵ The Murray Report was in fact only a consultation paper. No final report was issued and we do not know what respondents said on this issue.

³⁶ The question is only about the floating charge – assuming that it continues to exist. The new security right could affect only moveable property.

³⁷ Appendix B.

³⁸ Under current law (Companies Act 1985 s 464) this happens where the floating charge contains a negative pledge clause, which is in practice usually the case. When Part 2 of the Bankruptcy and Diligence etc (Scotland) Act 2007 comes into force, the same result will be the default position.

something like this should not also be the position in Scotland. It is not clear that the current Scottish position is the result of anything more than a misunderstanding of English law.³⁹

22.31 However, if the current proposals, mentioned in Chapter 10, to amend Part 25 of the Companies Act 2006, are implemented, the result would be that in English law negative pledges in floating charges would be registrable, and the consequence of their being registrable would, we think, be that the English doctrine of constructive notice would be engaged, and if that doctrine were to be engaged the result would perhaps be that negative pledge clauses in floating charges in England would have an effect similar to their effect in Scotland. But this is to speculate.

22.32 If the new security right, capable of applying to after-acquired assets, were to be introduced in Scots law, the need for a floating charge with a ranking prior to that of subsequent security rights would largely disappear. Moreover, if the floating charge became an *ultimo loco* security right that would avoid certain ranking problems. We ask:

- 88. If floating charges are to continue to be competent, and if the floating lien is introduced, should the current ranking rules of English law, in relation to subsequent security rights, be followed more closely?**

Floating charges and "effectually executed diligence"

22.33 A floating charge is trumped by "effectually executed diligence".⁴⁰ but there is uncertainty as to what that means. In *Lord Advocate v Royal Bank of Scotland*⁴¹ it was held that where the sequence was (i) floating charge constituted; (ii) another creditor arrested; (iii) the charge crystallised without an action of furthcoming having been raised, the arrestment was not "effectually executed". This decision has been widely criticised, as having been based on mistakes about the law of arrestment, and also as to the policy of the floating charges legislation. Subsequent research confirmed from Hansard that the intention of Parliament had been that in such a case the arrestment was to prevail.⁴²

22.34 Whatever view may be taken of the interaction of diligence with the floating lien, if that is introduced, we think that for floating charges the position should be returned to what Parliament intended it to be. We propose:

- 89. The statutory provisions about the interaction of floating charges with "effectually executed diligence" should be amended so as to ensure that the original intention of the legislation is given effect to.**

³⁹ The point is that an English negative pledge clause seldom affects subsequent chargees, but a Scottish negative pledge clause almost always does.

⁴⁰ Companies Act 1985 s 463; Insolvency Act 1986 ss 55 and 60; Bankruptcy and Diligence etc (Scotland) Act 2007 s 45.

⁴¹ 1977 SC 155, interpreting the pre-1985 Act legislation, the Companies (Floating Charges and Receivers) (Scotland) Act 1972, which was in similar terms.

⁴² See generally Scott Wortley, "Squaring the Circle: Revisiting the Receiver and 'Effectually Executed Diligence'" 2000 Juridical Review 325.

Floating charges, sole traders and companies

22.35 The Murray Report recommended that sole traders and ordinary partnerships should be able to grant floating charges, but only over their moveable assets.⁴³ There is an undoubted logic behind this, for it is difficult to see any reason why some trading entities should be able to grant floating charges and others not. But we are now proposing a new moveable security that could be granted by (among others) sole traders and ordinary partnerships. This proposal would satisfy the policy behind the Murray Report's recommendation. Accordingly we think that the recommendation should not now be taken forward. But to test views we propose:

- 90. The recommendation of the Murray Report that sole traders and ordinary partnerships should be able to grant floating charges should not now be taken forward.**

⁴³ Murray Report para 3.3.

Chapter 23 Summary of questions and proposals

1. Are there issues in the field of moveable transactions that stand in need of reform that are not addressed in this discussion paper?

(Para 1.42)
2. Would a new scheme on the general lines sketched in this chapter be appropriate?

(Para 3.45)
3. Should non-accessory moveable security be competent?

(Para 5.29)
4. Do consultees agree that Scots law should not adopt the attachment/perfection distinction in any of its various forms?

(Para 13.29)
5. The main options as to completion of title are as follows. Which should be preferred?
 - (a) Keep the current law, which requires intimation, albeit with certain revisions.
 - (b) Abandon the need for intimation. Transfer should happen solely by the mutual consent of the cedent and the assignee. (But with protections for the account debtor who acts in good faith.)
 - (c) Adopt something like the UCC approach: abolish the requirement of intimation, and introduce registration for some cases; for other cases transfer would happen solely by the mutual consent of the cedent and the assignee. (But with protections for the account debtor who acts in good faith.)
 - (d) Maintain the requirement of an external act in all cases, but give the parties the choice of registration or intimation. We provisionally incline towards to this option.

(Para 14.27)
6. Should there be legislative clarification of the effect of a suspensive condition in an assignation?

(Para 14.28)

7. Do consultees agree that priority should continue to be determined simply by date of completion of title?
(Para 14.32)
8. Should notification, to be effectual, be in such a form as to bring home its meaning to a reasonable account party?
(Para 14.41)
9. Should there be information duties on the assignee?
(Para 14.41)
10. If so, what should they be, and what should be the consequences of failure to perform them?
(Para 14.41)
11. (a) Do consultees agree that agreements to assign should not be subject to any requirement of form?
(b) Should assignments have to be in writing? If so should they have to be signed by the granter only, or by both parties? (Writing and signature in this case could be electronic as well as paper-and-ink.)
(Para 14.47)
12. Do consultees agree that:
(a) The rule that a mandate can operate as an assignation should be abrogated?
(b) The rule whereby an assignee can sue in the name of the cedent should be abrogated?
(Para 14.51)
13. (a) If a contract between X and Y contains an anti-assignation clause, and nevertheless there is a purported assignation by X of a right arising from the contract, should the effect of the clause be (as under current law) that the assignation of that right is invalid, or should the only consequence be that there has been a breach of contract by X?
(b) Should the rule vary according to the type of case? (For example, that the rule should apply to receivables but not other claims.) If so, which rule should apply to which type of case?
(Para 14.57)

14. Do consultees think that the law about assignability, and the effect on assignability of contract terms conferring powers on the creditor, stand in need of reform? If so, how?
- (Para 14.59)
15. Should the law allow a future claim to be assigned (subject to the right in due course coming into being and being identifiable as the claim to which the assignation relates)?
- (Para 14.68)
16. If so, do consultees agree that the transfer of the claim should not be deemed to take place before the claim comes into being?
- (Para 14.68)
17. Should the power of consumers to assign after-acquired rights be restricted?
- (Para 14.68)
18. Do consultees agree that the Policies of Assurance Act 1867 should be amended to confirm that it does not apply in Scotland?
- (Para 14.69)
19. Do consultees agree that the DCFR rule on partial assignation should be adopted?
- (Para 14.72)
20. Is there a need for legislation about the rule commonly known as *assignatus utitur jure auctoris*?
- (Para 14.73)
21. Should there be legislative clarification as to the effect of a waiver-of-defence clause? If so, what should the law provide about such clauses?
- (Para 14.74)
22. Do consultees agree that there is no need for legislative intervention to deal with the transfer of entire contracts?
- (Para 14.76)
23. Should it be provided that unless otherwise agreed, assignation of a claim carries with it a right to acquire any security that exists for the assigned claim, and that if any further act is needed to vest the security in the assignee, the cedent will perform that act?
- (Para 14.77)

24. Should it be provided that where an assignation is registered in the relevant register (eg the Land Register in the case of a standard security), that registration should suffice to complete the title of the assignee, even though the general requirements for completed assignation of claims have not been met? (Any such rule would be accompanied by protection to the debtor who acts in good faith.)
- (Para 14.79)
25. Should the codification of the law of assignation be an objective of the present project?
- (Para 14.80)
26. Should "intimate/intimation" be replaced by "notify/notification"?
- (Para 14.81)
27. (a) Should legislation bring Scots law into line with English law (as settled in *Sewell v Burdick*) by providing that the pledge of a bill of lading (or of a delivery order) is true pledge?
- (b) Should legislation make it clear that the redelivery of pledged goods (or pledged bill of lading) extinguishes the pledge (but without prejudice to any new system allowing for non-possessory security)?
- (Para 15.6)
28. (a) We propose that where, under the pawnbroking provisions of the Consumer Credit Act 1974, ownership of the pledged item is lost because the loan is below the prescribed figure (currently £75), the debt (if more than the value of the item) should be reduced by the value of the item.
- (b) We propose that where, under the pawnbroking provisions of the Consumer Credit Act 1974, ownership of the pledged item is lost because the loan is below the prescribed figure (currently £75), but the value of the item exceeds the loan, the loan should be discharged, and the pawnbroker should be obliged to pay the customer the surplus value (subject always to compensation for administrative expenses etc).
- (Para 15.8)
29. Is the common law about a pledgee's power of sale satisfactory? If not, what changes are needed?
- (Para 15.9)
30. Do consultees agree that, in cases outwith the Consumer Credit Act 1974, there should be a provision dealing with forfeiture clauses along the lines proposed in the DCFR?
- (Para 15.11)

31. Should the law of pledge be codified?
(Para 15.12)
32. If a new non-possessory security is introduced, do consultees agree that it should be on the basis of some type of public registration?
(Para 16.17)
33. Do consultees agree that the new moveable security should be capable of securing future obligations?
(Para 16.27)
34. If so, where there is an all-sums security, should its priority be capable of being frozen by notice, so as to enable a subsequent security to be granted, on lines broadly similar to the rules for floating charges and for standard securities?
(Para 16.27)
35. Do consultees agree that there is no reason why a creditor should not be able to mandate the debtor to deal with the collateral free of the security?
(Para 16.28)
36. Do consultees agree that buyers in the ordinary course of the seller's business should take free from a registered non-possessory security?
(Para 16.47)
37. Do consultees agree that a good faith buyer who has used reasonable diligence in searching the register should take free from entries not thereby revealed?
(Para 16.47)
38. Should the proposal just mentioned also apply to creditors taking security?
(Para 16.47)
39. Should there be a broader rule that entries not discoverable by reasonable diligence should not affect either a buyer or another type of grantee, whether or not the register has actually been searched?
(Para 16.47)
40. Should there be a rule that a good faith buyer should always take free from a registered security where the price paid by the buyer is below a certain limit (to be adjusted from time to time by statutory instrument)? If so, what should that limit be?
(Para 16.47)

41. Would consultees prefer something along the lines of the proposal in the Murray Report, which would mean that good faith buyers would not normally take subject to a registered moveable security?
(Para 16.47)
42. Should delivery be a precondition of protection?
(Para 16.47)
43. The new moveable security should not have a special "proceeds" rule.
(Para 16.48)
44. Do consultees agree that the new security right should not extend to property that has acceded to immovable (heritable) property?
(Para 16.49)
45. Do consultees agree that ranking should be by date of registration, subject to the qualifications necessary in the case of security over after-acquired property?
(Para 16.55)
46. Do consultees agree that any new security right should be without prejudice to the landlord's hypothec?
(Para 16.56)
47. Should the new moveable security be postponed, in terms of ranking, to security rights arising by operation of law?
(Para 16.58)
48. What views do consultees have as to the enforcement of the new moveable security?
(Para 16.71)
49. If a new non-possessory security over corporeal moveable property is introduced, do consultees agree that it should not be capable of being granted by a consumer in relation to future property?
(Para 16.78)
50. If a new non-possessory security over corporeal moveable property is introduced, should there be other restrictions in relation to consumer debtors? For example should goods exempt from diligence be excluded? Or should the security be valid only to secure purchase finance?
(Para 16.78)

51. If a new non-possessory security over corporeal moveable property is introduced, should the pro-consumer protections in the Consumer Credit Act 1974 be amended so as to extend to it? (Other than those protections that would apply automatically.)
(Para 16.78)
52. If a new non-possessory security over corporeal moveable property is introduced, the Agricultural Credits (Scotland) Act 1929 should be repealed.
(Para 16.81)
53. If a new type of security right over moveable property is introduced, what should it be called?
(Para 16.83)
54. Do consultees agree that any new non-possessory security right over corporeal moveable property should not extend to ships over which a ship mortgage can be granted?
(Para 17.2)
55. Do consultees agree that any new non-possessory security right over corporeal moveable property should not extend to aircraft over which an aircraft mortgage can be granted?
(Para 17.3)
56. Should the prescribed style for Scottish aircraft mortgages be deleted from the Mortgaging of Aircraft Order 1972?
(Para 17.3)
57. Should the Mortgaging of Aircraft Order 1972 be amended to make it clear that priority notices are competent in Scotland, as in England?
(Para 17.3)
58. Should the UK Government accede to the Cape Town Convention (either for the whole UK or for Scotland only)?
(Para 17.8)
59. The concept of a "proper" security right over incorporeal moveable property should be introduced into Scots law.
(Para 18.12)

60. Do consultees agree that, if a new security right over claims is introduced, it should be created by registration?
(Para 18.17)
61. Do consultees agree that, if a new security right over claims is introduced, it should apply to all types of claim, and not just some types, such as receivables?
(Para 18.17)
62. Should there be a special regime for construction contracts?
(Para 18.25)
63. Do consultees agree that the issues about priority/ranking are substantially the same as for non-possessory security rights?
(Para 18.28)
64. Do consultees have views as to the enforcement of the new moveable security in so far as the collateral consists of personal rights?
(Para 18.32)
65. If a new type of moveable security right is introduced, should assignation in security cease to be competent?
(Para 18.36)
66. Is there a need for restrictions on the ability of consumers to grant security over after-acquired rights?
(Para 18.42)
67. Should all good faith buyers of company shares, and of corporate and public-sector bonds, take free of registered security rights? Or should the protection be limited to a certain class, such as open-market buyers?
(Para 19.9)
68. In the case of registered intellectual property, we propose that registration of the new security right in the relevant intellectual property register should not displace the requirement for registration in the Register of Moveable Transactions.
(Para 19.16)
69. Special types of incorporeal moveable property such as intellectual property rights, company securities (shares and bonds), public sector bonds, intermediated securities and negotiable instruments should be included in any new system of moveable security.
(Para 19.20)

70. A new public register should be established, provisionally to be called the Register of Moveable Transactions, in which (i) assignments of personal rights and (ii) securities over moveable property (corporeal and incorporeal) could be registered.
- (Para 20.1)
71. The new register would be administered by the Keeper of the Registers of Scotland or by such other person as Ministers may appoint.
- (Para 20.2)
72. Should the new register absorb the Register of Floating Charges?
- (Para 20.3)
73. Do consultees agree that the registered document should be the constitutive document?
- (Para 20.20)
74. What views do consultees have about the information to be contained in the entry in the register?
- (Para 20.35)
75. Should errors be subject to a "reasonable findability" test? (In other words, errors that did not prejudice "reasonable findability" would not matter. Errors that did prejudice "reasonable findability" would be fatal to the validity of the entry, whether or not anyone had in fact been misled.) Or should the validity of an entry depend on its being error-free?
- (Para 20.38)
76. What views do consultees have about the form of the Register of Moveable Transactions, about the way entries would be made, and the manner in which it should be searchable?
- (Para 20.45)
77. Do consultees agree that if a new moveable security is introduced which is created by registration a section 893 order should be made so as to avoid a double registration requirement?
- (Para 20.48)
78. Should entries lapse after a certain period unless renewed? If so, should that period be five years, or some other period?
- (Para 20.54)

79. Do consultees agree that superseded data should be archived?
(Para 20.54)
80. (a) Do consultees agree that, even if the issue of Article 4 of Directive 2000/35/EC is not an obstacle, Scots law should not, at least at the present time, introduce a system of recharacterisation of quasi-securities?
- (b) If consultees agree with the previous proposal, do they think that Scots law should introduce the "halfway house" in relation to quasi-securities, ie registrability without full recharacterisation? If so, should it apply to certain cases only (such as trusts) or to all cases?
- (c) If either full recharacterisation is adopted, or the halfway house, should there be categories (eg sales to consumers) where registration should not be required? Should there be grace periods?
(Para 21.26)
81. Do consultees agree that if the floating lien is introduced, it would have to be treated, for the purposes of insolvency law, in substantially the same way as the floating charge?
(Para 22.19)
82. Specifically, should the special rule in section 245 of the Insolvency Act 1986 apply to the new security, to the extent that the collateral in question had been acquired by the debtor after the registration of the security?
(Para 22.19)
83. If the floating lien is introduced, should it be subject to the "effectually executed diligence" rule?
(Para 22.21)
84. Do consultees agree that the new moveable security right should not be limited to present assets (other than in consumer cases)?
(Para 22.22)
85. Do consultees agree that the new moveable security right should be capable of being granted by any person, juristic or natural?
(Para 22.23)
86. Do consultees agree that the floating charge should not be abolished, at least for the time being?
(Para 22.28)

87. If floating charges are to continue to be competent, should they continue to be capable of covering immoveable/heritable property?

(Para 22.29)

88. If floating charges are to continue to be competent, and if the floating lien is introduced, should the current ranking rules of English law, in relation to subsequent security rights, be followed more closely?

(Para 22.32)

89. The statutory provisions about the interaction of floating charges with "effectually executed diligence" should be amended so as to ensure that the original intention of the legislation is given effect to.

(Para 22.34)

90. The recommendation of the Murray Report that sole traders and ordinary partnerships should be able to grant floating charges should not now be taken forward.

(Para 22.35)

Appendix A

Some transnational instruments

Introduction

1. There are in existence a number of international conventions, model laws etc bearing on moveable transactions, and a very brief account of them is given in this appendix.¹ None is binding in the UK.

UNIDROIT Convention on International Factoring

2. The UNIDROIT² Convention on International Factoring dates to 1988. It has not been adopted by the UK and indeed few states have adopted it.³ Its scope is narrow. It applies only to the factoring of claims arising out of transnational contracts for the sale of goods. It is also rather brief.

UNCITRAL Convention on the Assignment of Receivables in International Trade

3. The UNCITRAL Convention on the Assignment of Receivables in International Trade dates to 2001.⁴ It has not been adopted by the UK. Whilst thus far no state has adopted it,⁵ the fact that it is still fairly new means that adoptions are not impossible. Its scope is slightly wider than the UNIDROIT Convention in that it is not limited to receivables arising out of the sale of goods, though there still are several scope restrictions.⁶ The assignment of future receivables is allowed,⁷ and (like the UNIDROIT Convention) it provides that an assignment is competent notwithstanding that it breaches an anti-assignment clause.⁸ The Convention does not directly address the question of when a receivable passes from the cedent's patrimony to the assignee's. Instead it has a set of situation-specific rules to operate between the cedent, the assignee and the account party,⁹ and then, in relation to other parties, says that "with the exception of matters that are settled elsewhere in this Convention and subject to articles 23 and 24, the law of the State in which the assignor is located governs the priority of the right of an assignee in the assigned receivable over the right of a competing claimant."¹⁰

¹ For a study of these instruments see N Orkun Akseli, *International Secured Transactions Law* (2011).

² The International Institute for the Unification of Private Law.

³ So far only France, Germany, Hungary, Italy, Latvia, Nigeria and the Ukraine.

⁴ Available at <http://www.uncitral.org/uncitral/en/uncitral_texts/payments/2001Convention_receivables.html>.

⁵ Only Liberia has ratified it and even then it is not yet in force - <http://www.uncitral.org/uncitral/en/uncitral_texts/payments/2001Convention_receivables_status.html>.

⁶ Article 3 (transnational transactions only); Article 4 (other scope restrictions).

⁷ Article 8.

⁸ Article 9.

⁹ Articles 14, 16 etc.

¹⁰ Article 22.

4. However, the Annex to the Convention provides for the establishment of a registration system, under which registration generally establishes priority.

5. As to the *assignatus utitur* principle, the Convention has a provision of a type to be found, with minor variations, almost everywhere: "In a claim by the assignee against the debtor for payment of the assigned receivable, the debtor may raise against the assignee all defences and rights of set-off arising from the original contract, or any other contract that was part of the same transaction, of which the debtor could avail itself as if the assignment had not been made and such claim were made by the assignor. The debtor may raise against the assignee any other right of set-off, provided that it was available to the debtor at the time notification of the assignment was received by the debtor."¹¹

EBRD Model Law on Secured Transactions

6. The European Bank for Reconstruction and Development *Model Law on Secured Transactions* dates to 1994.¹² It was designed as a model law for the former Soviet-block states which were emerging with little commercial legislation. Though it has not been adopted as such, it has influenced legislation in a number of such countries.¹³ "The Model law has been criticised, mainly by American scholars, on the basis of not having similar concepts to those of the UCC Article 9".¹⁴ Since it is in fact very much based on UCC-9 (for example it recharacterises title retention as a security interest) and the PPSAs these criticisms may say as much about the critics as about the Model Law. It deviates from UCC-9 in its achievement of simplicity and clarity: a newcomer to the subject of secured transactions can read and understand the EBRD Model Law, something that no one would say of UCC-9 or the PPSAs. There are also some deviations in detailed rules. One policy objective of the EBRD Model Law was to set out a system which, while drawing on the experience of the common law systems and especially the UCC/PPSAs, would be compatible with civil law systems.¹⁵ There are also two associated EBRD publications, *Core Principles for a Secured Transactions Law*¹⁶ and *Publicity of Security Rights: Guiding Principles for the Development of a Charges Registry*.¹⁷

7. After the publication of the model law, the EBRD published "ten core principles for a secured transactions law":¹⁸

"1. Security should reduce the risk of giving credit leading to an increased availability of credit on improved terms.

2. The law should enable the quick, cheap and simple creation of a proprietary security right without depriving the person giving the security of the use of his assets.

¹¹ Article 18.

¹² Available at <<http://www.ebrd.com/pages/research/publications/guides/model.shtml>>.

¹³ See generally the EBRD journal *Law in Transition* which over the years has monitored the influence of the model law. And see the EBRD webpage <<http://www.ebrd.com/pages/sector/legal/secured.shtml>>.

¹⁴ N Orkun Akseli, *International Secured Transactions Law* (2011) p 11 to 12. Akseli gives references.

¹⁵ The former Soviet-bloc countries all had civilian systems, many of them influenced by the German tradition. These systems, however mangled and marginalised, survived and re-emerged on the ending of the Soviet hegemony.

¹⁶ Available at <http://www.ebrd.com/pages/sector/legal/concessions/core_principles.shtml>.

¹⁷ Available at <<http://www.ebrd.com/downloads/legal/secured/pubsec.pdf>>.

¹⁸ <<http://www.ebrd.com/pages/sector/legal/secured/core/coreprinciples.shtml>>. We quote only the principles themselves and not the commentary on them.

3. If the secured debt is not paid the holder of security should be able to have the charged assets realised and to have the proceeds applied towards satisfaction of his claim prior to other creditors.
4. Enforcement procedures should enable prompt realisation at market value of the assets given as security.
5. The security right should continue to be effective and enforceable after the bankruptcy or insolvency of the person who has given it.
6. The costs of taking, maintaining and enforcing security should be low.
7. Security should be available (a) over all types of assets (b) to secure all types of debts and (c) between all types of person.
8. There should be an effective means of publicising the existence of security rights.
9. The law should establish rules governing competing rights of persons holding security and other persons claiming rights in the assets given as security.
10. As far as possible the parties should be able to adapt security to the needs of their particular transaction."

Cape Town Convention

8. The UNIDROIT Convention on International Interests in Mobile Equipment, commonly known as the Cape Town Convention, dates to 2001.¹⁹ It applies to "(a) airframes, aircraft engines²⁰ and helicopters; (b) railway rolling stock; and (c) space assets."²¹ Although these categories are narrow the international commercial value is immense. The convention has been successful, with 42 ratifications so far. The UK has signed but has not ratified.²² The convention itself is a framework convention, which works in unity with its protocols. Two protocols so far exist, for aircraft²³ and for railway rolling stock.²⁴ The third protocol, for "space assets", is in preparation.²⁵ There are international registries for each of the three categories.²⁶ There has evidently been some UCC-9 influence.

UNCITRAL Legislative Guide on Secured Transactions

9. The UNCITRAL Legislative Guide on Secured Transactions dates to 2007.²⁷ In substance it is a model law plus commentary. The accompanying UN General Assembly Resolution "recommends that all States give favourable consideration to the Legislative

¹⁹ See generally: Roy M Goode, *Convention on International Interests in Mobile Equipment and Protocol thereto on Matters Specific to Aircraft Equipment: Official Commentary* (2nd edn, 2008).

²⁰ The international *lex mercatoria* regards aircraft engines as separate from the rest of the aircraft. Thus an engine and an airframe do not "accede" to each other, and accordingly one person may own the airframe and another the engine, and likewise there can be separate security interests over the airframe and over the engine. While there appears to be no express authority on this point in Scotland, we assume that Scots law would follow the international consensus.

²¹ Article 2.

²² This is not the place to discuss UK practice in relation to international commercial conventions and model laws.

²³ <<http://www.unidroit.org/english/conventions/mobile-equipment/aircraftprotocol.pdf>>.

²⁴ <<http://www.unidroit.info/program.cfm?menu=instrument&file=instrument&pid=33&lang=en&do=fulltext>>.

²⁵ <<http://www.unidroit.org/english/workprogramme/study072/spaceprotocol/main.htm>>.

²⁶ See Article 16. For the aircraft registry, which is located in Dublin, see <https://www.internationalregistry.aero/irWeb/Controller.jpf>.

²⁷ Available at <http://www.uncitral.org/uncitral/en/uncitral_texts/payments/Guide_securedtrans.html>.

Guide when revising or adopting legislation relevant to secured transactions, and invites States that have used the Legislative Guide to advise the Commission accordingly".

10. The Guide is based on the UCC/PPSAs. It was followed in 2010 by a Supplement on Security Rights in Intellectual Property.²⁸ One difference from the UCC-9 and the PPSAs is that it allows a choice between full recharacterisation, which it calls the "unitary approach", and the "non-unitary approach" which does not involve recharacterisation. Thus in the latter case if X sells and delivers goods to Y with ownership retained until payment, X remains the owner (as in Scots law). But the way the Guide makes provision for the "non-unitary" approach, the difference between the two "approaches" seems rather slight.²⁹

11. The Guide contains the following "key objectives of an effective and efficient secured transactions law":

- "(a) To promote low-cost credit by enhancing the availability of secured credit;
- (b) To allow debtors to use the full value inherent in their assets to support credit;
- (c) To enable parties to obtain security rights in a simple and efficient manner;
- (d) To provide for equal treatment of diverse sources of credit and of diverse forms of secured transactions;
- (e) To validate non-possessory security rights in all types of asset;
- (f) To enhance certainty and transparency by providing for registration of a notice of a security right in a general security rights registry;
- (g) To establish clear and predictable priority rules;
- (h) To facilitate efficient enforcement of a secured creditor's rights;
- (i) To allow parties maximum flexibility to negotiate the terms of their security agreement;
- (j) To balance the interests of all affected persons; and
- (k) To harmonize secured transactions laws, including conflict-of-laws rules."

DCFR

12. Book III of the DCFR covers assignment.³⁰ As in the UCC-9 and the PPSAs, assignment in security is subject to the general regime about secured transactions.³¹ For outright assignments intimation is not required, in the sense of a condition of transfer.³² As in all legal systems that have that rule, an account party who pays in good faith to the original

²⁸ Available at <http://www.uncitral.org/pdf/english/texts/security-ig/e/10-57126_final_jan_2011.pdf>.

²⁹ See in particular Recommendation 187.

³⁰ For a valuable account, see Eric Clive, "The Assignment Provisions of the Draft Common Frame of Reference" 2010 *Juridical Review* 275. For a study of assignment under the DCFR's predecessor, the *Principles of European Contract Law* (PECL), see Gerhard Lubbe, "Assignment", in Hector MacQueen and Reinhard Zimmermann (eds), *European Contract Law* (2006).

³¹ III-5:103: "In relation to assignments for purposes of security, the provisions of Book IX apply and have priority over the provision of this chapter." Secured transactions are in Book IX of the DCFR.

³² III-5:114.

creditor is discharged, and the time when the account party's *assignatus utitur* rights are fixed is the date of intimation. If there are competing assignments, the first assignee to intimate prevails, assuming good faith. For example W owes money to X. On 1 June X assigns to Y. On 3 June X assigns to Z. On 5 June Z intimates to W. On 7 June Y intimates to W. Y and Z are in good faith. On 1 June the claim passes from X to Y. On 5 June the claim passes from Y to Z.³³ This rule may be compared with sections 24 and 25 of the Sale of Goods Act 1979. The approach is similar in practical terms to that of English law, though of course the law/equity distinction is not used. It is also similar to Italian law.³⁴ The overall practical results are indeed not dissimilar to Scots law. For although the DCFR says "title passes without intimation" the special rules just mentioned take away much of the substance of that approach, so that in many and perhaps most respects the DCFR treats the cedent as if undivested until intimation. Scots law reaches that result by a more direct route. Another way of putting it is this: the main difference between the DCFR and Scots law concerns the question: "whose creditor can attach the claim in the period between the act of assignment and intimation?" In Scots law the answer is "the cedent's creditors" and in the DCFR it is "the assignee's creditors".

13. One or two more points may be noted. It is competent to have assignment subject to a suspensive condition.³⁵ Anti-assignment clauses do not prevent assignment.³⁶ There is an express provision that accessory rights pass with the assigned right.³⁷ There are some interesting provisions³⁸ conferring informational rights on the account party. In brief, the account party cannot be required to pay the assignee without being given satisfactory evidence of the assignment. Simple notice by the person who claims to be the assignee does not constitute sufficient evidence.

14. Book IX of the DCFR deals with security rights in moveable property, corporeal and incorporeal. In substance it follows UCC/PPSAs. Thus, for example, the recharacterisation doctrine is adopted. So is the attachment/perfection distinction, and the general principle that perfection requires either control or registration.

15. An assignment in security will thus be subject to Book IX (as it is subject to Article 9 in the UCC) and so will generally have to be registered to be effective against other parties.³⁹ Book IX speaks of effect against "third persons"⁴⁰ which is a term that does not work well with assignments, in which a "third person" (the account party) is already involved so that presumably "third persons" are, for assignments in security, fourth persons. Presumably the assignment is effective against the account party in accordance with the rules of Book III. Thus an unregistered assignment in security would, it seems, be effective as between cedent and assignee, and, if known to the account party, between cedent and account party, and between account party and assignee. There would then be three more legal relations, namely between any of those three parties on the one hand and a fourth party on the other,

³³ III-5:121.

³⁴ And to some extent to German law, but German law does not have the "priorities reversed by intimation" possibility, albeit it does of course protect account debtors who act in good faith. For English, Italian and German law see Appendix B.

³⁵ III-5:114(1).

³⁶ III-5:108.

³⁷ III-5:115.

³⁸ III-5:120.

³⁹ III-5:103: "In relation to assignments for purposes of security, the provisions of Book IX apply and have priority over the provision of this chapter."

⁴⁰ Eg IX-3:101.

and the result of Book IX would be that lack of registration would mean that the fourth parties could treat the assignation as if it were ineffective, as against some or all of the first three parties. There are difficulties here, which can also arise in the UCC/PPSA systems. No doubt solutions are available. It may be added that since the DCFR says that a security right is a "limited proprietary right",⁴¹ it would seem that an assignation in security is a limited proprietary right. If that is so then if W owes money to X, and X assigns the claim by way of security to Y, X remains W's creditor while Y obtains a limited proprietary right. It is not clear to us that the DCFR works out the implications. A parallel issue may arise for the UCC/PPSAs but their background in the common law means that the issue arises in a different way or perhaps even not at all.

16. The European Commission is preparing an official Common Frame of Reference, based on the DCFR, but more limited in scope. We understand that it will not cover assignation or security rights.

⁴¹ VIII-1:204.

Appendix B

Some comparative law

Introduction

1. This appendix looks at English law, French law, German law, Dutch law, Italian law, US law, Quebec law, and South African law. Only the general rules are considered, and only briefly.¹ For example, most legal systems have a regime for registered security over ships, but such matters are not considered here.

English law: (i) assignment²

2. Assignment can be done without notice to the account debtor: this is equitable assignment. An account debtor who acts in ignorance of the assignment, for example by paying the old creditor, is protected. Equitable assignment can cover future choses in action,³ the assignment taking effect when the chose is acquired by the assigner. Priority is by date of assignment. But priority can be subject to defeasance, for notice gives the priority to the first to notify: this is the "rule in *Dearle v Hall*".⁴ Thus if X assigns first to Y and then to Z, Y has priority, but if Z gives notice to the account debtor before Y does, then Z prevails over Y. Another way of putting it is that the chose in action passes first (consensually) from X to Y and then (non-consensually) from Y to Z.

3. Where a legal chose in action is equitably assigned, it is generally thought that both assignor (A) and assignee (B) must join in any action against the account debtor (C). The case law, however, is not consistent and there is now some authority to suggest that "that rule will not be insisted upon where there is no need, in particular if there is no risk of a separate claim by the assignor".⁵ In the case of an equitable assignment of an equitable chose in action, "equity permits the assignee to sue in his own name without joining the assignor. This is because - provided the whole interest has been assigned - the assignee is the sole owner and no interest remains in the assignor."⁶

¹ For modern comparative studies in this area, see Michael Bridge and Robert Stevens (eds), *Cross-border Security and Insolvency* (2001), Eva-Maria Kieninger (ed), *Security Rights in Movable Property in European Private Law* (2004), Philip R Wood, *Comparative Law of Security Interests and Title Finance* (2nd edn 2007), Harry Sigman and Eva-Maria Kieninger (eds), *Cross-Border Security over Tangibles* (2007), and Harry Sigman and Eva-Maria Kieninger (eds), *Cross-Border Security over Receivables* (2009).

² See generally Gregory Tolhurst, *The Assignment of Contractual Rights* (2006) and Marcus Smith, *The Law of Assignment: The Creation and Transfer of Choses in Action* (2007).

³ This term corresponds fairly closely to incorporeal moveable property.

⁴ (1828) 3 Russ 1. On the rule see John de Lacy, "Reflections on the Ambit of the Rule in *Dearle v Hall*" (1999) 28 *Anglo-American Law Journal* 87 and 197.

⁵ *Raiffeisen Zentralbank Österreich AG v Five Star Trading LLC* [2001] QB 825 at 850. For more detailed discussion, see Marcus Smith, *The Law of Assignment: The Creation and Transfer of Choses in Action* (2007) paras 6.06 to 6.32.

⁶ Marcus Smith, *The Law of Assignment: The Creation and Transfer of Choses in Action* (2007) para 6.04.

4. There is also statutory assignment, under the Law of Property Act 1925.⁷ This requires notice to the account debtor. It is competent only if it is "absolute", is of the whole debt rather than just a part, and is the assignment of a "debt or other legal thing in action."⁸ The assignee can enforce without joining the assignor. An invalid statutory assignment may still be – indeed, commonly is – a valid equitable assignment.

5. Registration is not required, subject to two qualifications. An assignment of trade receivables, being an assignment intended to be for the purpose of security, is registrable if the assignor is a company or LLP.⁹ The other qualification is that, where the assignor is not a company or LLP, but is nevertheless "engaged in any business", registration is required of any "general assignment" of receivables, whether or not for the purpose of security.¹⁰

English law: (ii) moveable security¹¹

6. Possessory pledge over corporeal moveables ("choses in possession") exists in English law, as it does in virtually every legal system. Non-possessory security over choses in possession is also competent by means of bill of sale. If the debtor is a company, registration is in the Companies Register.¹² For individuals, registration is in the Bills of Sale Register.¹³ Neither registration system covers quasi-securities.

7. Non-notification security over choses in action is also competent, by means of equitable security, but the creditor's position is stronger if there is notification.¹⁴ As for registration, that is required in some cases but not others.¹⁵ Whilst legal security is possible only in relation to assets in existence at the time of creation, equitable security can secure after-acquired assets as well. In English law it is not only the floating charge that can secure after-acquired (future) assets. *Fixed* charges over *future* assets are also competent – but only in equity.¹⁶ At law they are incompetent.

8. Floating charges are less attractive to lenders than are fixed charges. The position here is essentially the same as in Scotland.¹⁷ One significant point of difference between English and Scottish floating charges concerns ranking (priority). The Scottish rules are complex, but in practice they usually boil down to the principle that a floating charge ranks

⁷ Section 136.

⁸ "Thing in action" is the term generally used in statutes to mean what English lawyers commonly call a chose in action. "Legal" is an adjective that contrasts with "equitable".

⁹ Companies Act 2006 Part 25. Here as elsewhere in Part 25, and for Scotland as well as England, what matters is the identity of the debtor. The identity of the creditor is irrelevant.

¹⁰ Insolvency Act 1986 s 344. Registration is in the Bills of Sale Register.

¹¹ The literature is extensive. See for example Louise Gullifer (ed), *Goode on Legal Problems of Credit and Security* (4th edn 2008); Hugh Beale, Michael Bridge, Louise Gullifer and Eva Lomnicka, *The Law of Personal Property Security* (2007). For the Anglo-American comparison see Gerard McCormack, *Secured Credit under English and American Law* (2004).

¹² Companies Act 2006 Part 25.

¹³ Bills of Sale Act 1878; the Bills of Sale Act (1878) Amendment Act 1882; the Bills of Sale Act 1890 and the Bills of Sale Act 1891. There was initially uncertainty as to whether the bills of sale legislation applied to company debtors. In *Re Standard Manufacturing Co Ltd* [1891] 1 Ch 627 the point was settled: companies are outwith the bills of sale registration system. For the recent review of bills of sale, see Chapter 10.

¹⁴ The "rule in *Dearle v Hall*". See above.

¹⁵ If the debtor is a company (or LLP), registration is required under Part 25 of the Companies Act 2006 for charges over book debts and some other types of intangible assets. The list is arbitrary. In non-company cases, any "general assignment" of "book debts" by a person "engaged in business" must be registered in the Bills of Sale Register: Insolvency Act 1986 s 344.

¹⁶ The floating charge is itself an equitable, not a legal, security. Crystallisation does not affect its equitable status. A floating charge that ceases to float does not cease to be equitable.

¹⁷ For which see Chapter 9. "Fixed charge" is however not a Scottish term.

according to the date of its creation. On this point the Scottish floating charge diverges from the English charge, which is generally postponed to later security rights, with the possible exception of later floating charges. Given these drawbacks, and given that English law allows (in equity though not at law) *non-floating* charges over after-acquired as well as current assets, it may be asked why floating charges are used at all. The answer is that fixed charges over circulating assets such as receivables and stock (inventory) would cause immediate paralysis of the debtor's business. A debtor company needs to be able to deal with such assets without reference to the lender.

9. Lenders have, not surprisingly, sought to have their cake and eat it too by crafting charges that are fixed but which at the same time allow the debtor company to deal with its circulating assets. But in *Re Spectrum Plus Ltd*¹⁸ the House of Lords held that any charge in which the debtor has power to deal with the charged assets in such a way as to remove them from the ambit of the charge is a floating charge.

10. The conceptual nature of the floating charge remains unclear. Of course, some points are settled, such as that on crystallisation it is not converted into a legal security, but remains equitable. But much else is obscure.¹⁹ Scots law has inherited the conceptual obscurity of the floating charge, though the problems are greater here because we cannot invoke the concepts of equitable proprietary interests.

Differences between English and Scots law: some observations

11. The differences in this area between English and Scots law are extensive, not least because Scots law does not have anything matching the English distinction between legal proprietary interests and equitable proprietary interests. Nevertheless, the differences between English and Scots law have been much less since the introduction of the floating charge in 1961,²⁰ whereby non-possessory security over corporeals and non-intimation security over incorporeals is competent, albeit only where the debtor is a company (or LLP).

12. Three particular points of difference may be worth noting. The first is that, except by means of the floating charge, registered non-possessory security over corporeal moveable property is not possible in Scotland.²¹ The second is that the assignation of incorporeals requires intimation. Though in England this is also true at law, in equity non-notification assignment is competent. But this difference is not so great as might appear, because in Scotland the trust has been pressed into use to function as an equitable assignment.²² The third is that the Scottish floating charge is in one important respect stronger than the English floating charge.²³ In English law a floating charge ranks after later fixed (and possibly also floating) charges – a reversal of the normal *prior tempore potior jure* principle. To protect lenders against this, floating charges usually contain "negative pledge" clauses, ie clauses

¹⁸ *National Westminster Bank plc v Spectrum Plus Ltd* [2005] UKHL 41, [2005] 2 AC 680.

¹⁹ For discussion of the nature of the floating charge, see eg Robert Pennington, "The Genesis of the Floating Charge" (1960) 23 *Modern Law Review* 630; Elis Ferran, "Floating Charges - The Nature of the Security" 1988 *Cambridge Law Journal* 213; Sarah Worthington, "Floating Charges - An Alternative Theory" (1994) 53 *Cambridge Law Journal* 81; Richard Nolan, "Property in a Fund" (2004) 120 *Law Quarterly Review* 108; Sarah Worthington, "Floating Charges: The Use and Abuse of Doctrinal Analysis", in Joshua Getzler and Jennifer Payne (eds), *Company Charges* (2006); Louise Gullifer (ed), *Goode on the Legal Problems of Credit and Security* (4th edn 2008).

²⁰ Companies (Floating Charges) (Scotland) Act 1961.

²¹ Except for ships and aircraft.

²² See para 11.11.

²³ The difference was almost certainly unintended.

that say the debtor is not to grant other charges except with the lender's consent. But such clauses affect only such third parties as are actually aware of them, in practice they usually fail to affect third parties.²⁴ In Scotland, the current legislation²⁵ also has a rule that is the opposite of the *prior tempore potior jure* principle. But it allows negative pledge clauses to be registered and it has become the accepted view that a registered negative pledge clause affects third parties.²⁶ In practice most floating charges contain such a clause. When Part 2 of the Bankruptcy and Diligence etc (Scotland) Act 2007 comes into force the *prior tempore potior jure* principle will be expressly applied to floating charges.²⁷

French law: (i) assignation

13. Assignation (*cession*) requires intimation (*signification*), so that the position is broadly similar to Scots law.²⁸ French law is, however, more rigid than Scots law as to the mode of intimation, which has to be done by a *huissier*. But this basic rule is subject to a large modern exception, the *loi Dailly*,²⁹ which provides that if the creditor is a financial institution, and the account debtor is a body corporate or anyone engaged in commerce, a claim can be assigned without intimation. There is also legislation on securitization (*titrisation*) which is similar to the *loi Dailly*. As well as these modern statutory exceptions, the requirement for formal intimation can sometimes be circumvented by means of acceptance by the account party, or by the doctrine of subrogation.

French law: (ii) security³⁰

14. First, corporeal moveables. As well as possessory pledge, there is also the registered non-possessory pledge.³¹ This can cover after-acquired as well as existing assets.³² There are special rules for motor vehicles.³³ And there is the *nantissement du fonds de commerce*.³⁴ This can be granted only by businesses. It must be registered. It can cover

²⁴ But if the proposals to make such clauses registrable under Part 25 of the Companies Act 2006 are implemented (see Chapter 10), the position could change, for it may be that all parties would be regarded as having constructive notice of the clause.

²⁵ Companies Act 1985 s 464. This is still in force, until it is superseded by Part 2 of the Bankruptcy and Diligence etc (Scotland) Act 2007.

²⁶ *AIB Finance plc v Bank of Scotland* 1993 SC 588. In England such clauses cannot be registered.

²⁷ Bankruptcy and Diligence etc (Scotland) Act 2007 s 40.

²⁸ Some French sources say that the transfer is complete simply by agreement between the cedent and assignee, though ineffectual against (*inopposable à*) the account party (*débiteur cédé*) until intimation. For example, none other than Carbonnier wrote that "*la créance est transmise par le seul échange des consentements*" citing article 1583 of the civil code. (Jean Carbonnier, *Droit Civil* (1955, re-issued 2004) p 2451.) But other sources say that until intimation the claim remains in the cedent's patrimony, this position being based on Article 1690 of the Civil Code. It is not for us to pronounce upon controversies in French law, but the latter approach is confirmed by the facts (i) that in a competition between assignees, the first to intimate prevails and (ii), even more importantly, that until intimation the claim remains available to the diligence (*saisie*) of the cedent's creditors.

²⁹ *Loi Dailly du 2 janvier 1981*. The law has since been consolidated into the Code monétaire et financier Articles L. 313-23 ff and R. 313-15 ff.

³⁰ French law has been subject to several very recent reforms.

³¹ *Code civil* Articles 2333 ff.

³² "*Les créances garanties peuvent être présentes ou futures; dans ce dernier cas, elles doivent être déterminables.*"

³³ *Code Civil* Articles 2351 to 2353.

³⁴ *Loi du 17 mars 1909* and Art R. 313-15 ff *Code monétaire et financier*. (The latter sets out the form of the notices for assignation or pledge, under *Loi Dailly* cessions and *nantissements* as the case may be, to prevent payment being made to cedent: "*L'établissement de crédit [le cessionnaire] peut, à tout moment, interdire au débiteur de la créance cédée ou nantie de payer entre les mains du signataire du bordereau [le cédant].*" After which the debtor cessus may pay only to the assignee: "*A compter de cette notification, dont les formes sont fixées par le décret en Conseil d'Etat prévu à l'article L. 313-35, le débiteur ne se libère valablement qu'après de l'établissement de crédit.*")

both corporeal and incorporeal property. In the event of insolvency its ranking is postponed to the claims of certain preferred creditors. It is thus comparable to the floating charge, though there are important points of difference. For instance, it cannot cover immoveable property.³⁵

15. For incorporeal moveables, there is the *nantissement du fonds de commerce*, already mentioned. There is also a form of assignation in security (*nantissement de meubles incorporels*), which requires neither intimation nor registration.³⁶ It can cover after-acquired as well as existing assets.³⁷

16. The new institution of *fiducie*, which has something in common with the trust, can be used for the purposes of security. The idea is that the debtor transfers the asset to the creditor, in trust.³⁸ But the French "trust" differs considerably from the English or Scottish trust.

17. How the use of the *nantissement du fonds de commerce* will be affected by the new "fixed" securities over existing and after-acquired assets remains to be seen. A parallel issue will arise in Scotland if both (a) the floating charge is retained and (b) new "fixed" securities are introduced capable of covering after-acquired assets.

18. On the question of registration, current French law occupies a half way house, requiring registration for non-possessory security over corporeal moveables (and for the *nantissement du fonds de commerce*) but not requiring it for incorporeal moveables.

German law: (i) assignation

19. German law, like English law, says that assignment (*Abtretung*) is effective without intimation. Like English law, it protects the account debtor who acts unaware of the assignment. Notification is thus a wise precaution. Whilst German law does not have the English law/equity distinction, the net result is that the English and German law of assignation, though on the surface very different, in practical terms have much in common. One point of difference is that the system of defeasible priority created by *Dearle v Hall*³⁹ does not exist in German law.

German law: (ii) security

20. The German Civil Code provides for security over corporeal moveable property to be constituted by delivery,⁴⁰ and for security over claims to be constituted by notification to the account party.⁴¹ But these provisions are of relatively minor importance in practice compared with two institutions (*Sicherungsübereignung* and *Sicherungsabtretung*) that have developed

³⁵ This is a typical feature of floating security in most jurisdictions. The fact that the English floating charge covers immoveables is unusual.

³⁶ *Code civil* Articles 2355 ff. But the pledgee *may* intimate to prevent the account party from paying the cedent: see Art L 313-28 *Code monétaire et financier* (above).

³⁷ Whereas the matching provision for corporeal moveables has the proviso "*elles doivent être déterminables*", there is no such proviso in the provisions about incorporeals. Whether this omission was deliberate we do not know.

³⁸ *Code civil* Articles 2372-1 ff.

³⁹ (1828) 3 Russ 1.

⁴⁰ German Civil Code § 1205.

⁴¹ German Civil Code §1273 ff.

on the basis of caselaw: non-possessory security over corporeal moveable property and non-notification security over claims.

21. Security can be granted over corporeal moveables without any external act, ie without delivery and without registration. (*Sicherungsübereignung*.) After-acquired as well as existing goods can be covered in this way. The agreement between lender and borrower will usually provide that the latter can sell the goods in the ordinary course of business. (Even without such a provision, a buyer would usually obtain good title anyway, because in German law a good faith buyer of corporeal moveable property usually takes free of third party rights.⁴²)

22. Security can be granted over incorporeal moveables without any external act, ie without intimation and without registration. (*Sicherungsabtretung/Sicherungszeession*.) The security can be granted over after-acquired assets.

23. A combination of *Sicherungsübereignung* and *Sicherungsabtretung/Sicherungszeession* thus comes, in functional terms, fairly close to the floating lien of the USA,⁴³ and also (though not so closely) to the floating charge. In three respects the combination just mentioned is nearer to the US law⁴⁴ than to the English law: (i) there is no role for any concept of crystallisation; (ii) the security can be granted by any debtor, not just by companies and LLPs; (iii) it does not extend to land. (Indeed, numerous legal systems round the world admit floating security, but virtually all of them exclude land.⁴⁵) In one respect English and US law are at one, with German law being the odd one out: registration.

Dutch law (i) assignation

24. In Dutch law the assignee's title can be completed either by notification or by a form of registration. The register is kept by the tax authorities and is not open to the general public, so that the only function of the rule is to prevent fraudulent antedating. If a notarial deed is used, neither notification nor registration is necessary.

Dutch law (ii) security

25. Dutch law does not in general allow improper security, ie *fiducia cum creditore*.⁴⁶ Security over corporeal moveables can be created either by delivery (*vuistpand*) or by registration. The same is true of security over claims: the security is constituted either by notification or by registration. In both cases the registration is of the limited type just

⁴² §932 ff of the German Civil Code.

⁴³ For which see Chapter 13 and Chapter 22.

⁴⁴ And to the law of Australia, Canada (with the partial exception of Quebec) and New Zealand, all of which have adopted legislation derived from the US legislation.

⁴⁵ To take an example at random: the Swedish *företagshypotek*, a floating registered security that covers corporeal moveable property and some types of incorporeal moveable property, but not immoveable property. Our knowledge of the Roman floating charge, the *hypotheca generalis*, is slight, but it seems to have covered only corporeal moveable property. At least there appears to be no evidence that other types of property could be covered. See Dig 20, 1, 6; 20, 1, 15 and 20, 1, 34. The French *nantissement du fonds de commerce* excludes immoveable property in general but does include leases.

⁴⁶ This is known as the *fiducia-verbod*, ie the forbidding of *fiducia cum creditore*. See the Dutch Civil Code (Burgerlijk Wetboek), Book 3, article 84(3): "*Een rechtshandeling die ten doel heeft een goed over te dragen tot zekerheid ... is geen geldige titel van overdracht van dat goed.*" ("A juridical act that is intended to transfer property for the purpose of security ... does not constitute a valid title for the transfer of that property.") The position was at one time different. Since the introduction of the *fiducia-verbod* caselaw has to some extent eroded the principle: see in particular *Keereweer qq Sogelease BV* (HR 19-05-1995, NJ 1996).

mentioned. Security that is not constituted by delivery (corporeals) or notification (incorporeals) but by registration is called "silent" security (*stille pand*).

26. Security over future claims is possible provided that the claims arise out of an existing relationship. So a company can grant to a bank security over future sums owed by existing customers, but not future sums owed by future customers. We understand that in practice a bank will require frequent re-grants of the security deed, with re-registration with the tax authorities.

Italian law: (i) assignation

27. In Italian law, assignation (*cessione*) happens by simple agreement between cedent and assignee, no external act being necessary. An account debtor who pays in good faith to the old creditor is protected. But if there are competing assignees, the first to notify the account party prevails.⁴⁷ This rule is similar to the rule in the DCFR and indeed to English law.

Italian law: (ii) security

28. As to corporeal moveable property, the civil code contemplates only possessory security, but special statutes have provided miscellaneous forms of non-possessory security, some of them very specific, such as non-possessory security over ham.⁴⁸ One of these special types of non-possessory security can be granted only in favour of banks.⁴⁹ It requires registration. As for security over claims, that is done by assignation for the purpose of security. There does not seem to be anything equivalent to the floating charge.

29. A special rule about retention of title is worth noting. If the property is machinery, a clause of retention is ineffective against sub-buyers unless there has been registration.⁵⁰

USA, Canada, New Zealand, Australia

30. In the USA the law is contained in Article 9 of the UCC. This has been the basis of legislation in all the Canadian provinces, except Quebec,⁵¹ where, however, the legislation has been much influenced by Article 9, New Zealand and, most recently, Australia. In these countries the legislation is generally not contained as part of a commercial code but is self-standing legislation, called the Personal Property Security Act or the Personal Property Securities Act. The approach taken in UCC-9 and the PPSAs is discussed in Chapter 13.

Quebec

31. Quebec differs somewhat from the other Canadian provinces. It does not have a PPSA as such. The law of secured transactions is to be found in the Quebec Civil Code. It is heavily influenced by the PPSAs but has some points of difference.

⁴⁷ Italian Civil Code Article 1265.

⁴⁸ *Pegno non-possessorio sui prosciutti*, under the law of 24 July 1985. See Anna Veneziano in Harry Sigman and Eva-Maria Kieninger (eds), *Cross-Border Security over Tangibles* (2007) p 169.

⁴⁹ Law of 1 September 1993.

⁵⁰ See Anna Veneziano in Harry Sigman and Eva-Maria Kieninger (eds), *Cross-Border Security over Tangibles* (2007) p 169.

⁵¹ For Quebec, see below.

32. Assignment requires notification to the account party, so that the law is comparable to Scots law, especially in that Quebec law requires the notification to include a copy of the assignment.⁵² Bulk transfers can be effected by registration in a register called the *Registre des Droits Personnels et Réels Mobiliers*.⁵³ This is similar to the PPSA registers in the other provinces. And it is comparable to the Register of Moveable Transactions that we provisionally propose for Scots law.

33. The law of moveable security is comparable to that in the PPSAs. Two differences may be noted. One is that Quebec law takes a half-way-house approach to quasi-security devices, requiring them to be registered, but not recharacterising them as security rights.⁵⁴ The other is that the floating charge (which in Quebec, as in Scotland, is statutory) remains in existence as a distinct institution. But we understand that, since the introduction into the civil code of PPSA-like provisions, the floating charge has largely ceased to be used in practice. Here again there is a parallel between Quebec law and what we provisionally propose for Scots law.

South Africa (i) assignment

34. The basic rule for assignment (cession) is the same as in German law: notification is not a constitutive requirement.⁵⁵ An account debtor who pays in good faith to the old creditor is protected. Assignment in security (generally known as *cessio in securitatem debiti*) is competent and common. Whether it should be conceptualised as a complete transfer, with a contractual right to a retrocession,⁵⁶ or whether it should be conceptualised as conferring a mere limited right on the assignee, has been a matter of prolonged debate. The second view seems now to be predominant.⁵⁷

South Africa (i) security⁵⁸

35. For corporeal moveables, it seems to be uncertain whether security can be created by *fiducia cum creditore*. Non-possessory security can be created by a registered notarial

⁵² Quebec Civil Code Article 1641: "*La cession est opposable au débiteur et aux tiers, dès que le débiteur y a acquiescé ou qu'il a reçu une copie ou un extrait pertinent de l'acte de cession ou, encore, une autre preuve de la cession qui soit opposable au cédant.*"

⁵³ <<http://www.rdprm.gouv.qc.ca/>>. For the statutory instrument that governs it see <<http://www2.publicationsduquebec.gouv.qc.ca/dynamicSearch/telecharge.php?type=3&file=/CCQ/CCQR5.HTM>>.

⁵⁴ Quebec Civil Code Article 1745. It should be noted that Article 1263 expressly recognises the use of trusts for the purpose of security.

⁵⁵ See generally Petrus Nienaber, "Cession", in Willem Joubert (ed), *The Law of South Africa* (2nd edn, Vol 2, Part 2 (2003)). For a comparison between South Africa and Scotland, see Petrus Nienaber and George Gretton, "Assignment/Cession" in Reinhard Zimmermann, Kenneth Reid, and Daniel Visser (eds), *Mixed Legal Systems in Comparative Perspective: Property and Obligations in Scotland and South Africa* (2005).

⁵⁶ The Scottish approach.

⁵⁷ See Nienaber (above) for discussion. In *Grobler v Oosthuizen* 2009 (5) SA 500, the Supreme Court of Appeal of South Africa held that where the secured obligation is void, no retrocession is needed. In Scots law retrocession would be needed.

⁵⁸ For the South African law of security see generally Gerhard Lubbe, "Mortgage and Pledge", in Willem Joubert (ed), *The Law of South Africa* (2nd edn, Vol 17, Part 2 (2008)), and Pieter Badenhorst, Juanita Pienaar and Hanri Mostert (eds) *Silberberg and Schoeman's The Law of Property* (5th edn 2006). For a comparison between South Africa and Scotland, see Gerrit Pienaar and Andrew J M Steven, "Rights in Security" in Reinhard Zimmermann, Daniel Visser and Kenneth Reid (eds), *Mixed Legal Systems in Comparative Perspective: Property and Obligations in Scotland and South Africa* (2005).

bond. But such a bond seems to be limited to existing assets.⁵⁹ A notarial bond can also include incorporeal moveable property.

⁵⁹ *Contract Forwarding (Pty) Ltd v Chesterfin (Pty) Ltd* 2003 (2) SA 253; *Ikea Trading and Design AG v BOE Bank Ltd* 2005 (2) SA 7.

Appendix C

Economic impact assessment

1. The value of moveable property which may be the subject of an assignation or a security transaction falling within the scope of this project is significant.
2. In 2010 the volume of securitisations (of mortgage portfolios, credit cards or car loans etc), in the UK was €47.2 billion.¹ For the month of January 2011 the Royal Bank of Scotland Group plc was ranked fourth in the European securitisation league table, participating in €711 million of deals, while Lloyds Banking Group plc (which includes Lloyds TSB Scotland plc and Bank of Scotland plc) were in joint sixth, participating in €601 million of deals.² (Separate figures for Scotland are not available.)
3. Receivables represent about one third of the assets of an average UK company's assets.³ As potential collateral, therefore, they are of great importance. The Asset Based Finance Association (ABFA)⁴ estimated that in 2006 about 1600 Scottish businesses were using factoring and that the total value of assigned invoices in Scotland in that year was £5.2 billion.⁵ The Association's members in the UK and Ireland "provide financing to over 48,000 businesses (serving primarily the manufacturing, distribution, transport, service, retail and construction sectors) and transact around £173 billion of clients' invoices each year. In 2008, the industry [which they represent] advanced in excess of £17 billion against invoices and

¹ Association for Financial Markets in Europe, *Securitisation Data Report Q3: 2010* page 4 - <http://www.afme.eu/AFME/Markets_and_Business/Securitisation/2010-Q3AFMEESFFINAL.pdf>. The Association for Financial Markets in Europe (AFME) was formed as a merger between the London Investment Banking Association and the European branch of the Securities Industries and Financial Markets Association. Its website states that it "promotes fair, orderly, and efficient European wholesale capital markets and provides leadership in advancing the interests of all market participants." Its Board comprises senior members of many leading financial institutions, such as Citibank, HSBC, Credit Suisse, Barclays, Goldman Sachs, Morgan Stanley, Lloyds and the Royal Bank of Scotland.

² Both figures are taken from Structured Credit Investor, <<http://www.structuredcreditinvestor.com/story.asp?PublD=250&ISS=22395&SID=29028&article=Full-year%20securitisation%20league%20tables%20released>>. The information relates to asset backed securities, collateralised loan obligations, residential mortgage backed securities, commercial mortgage backed securities, and collateralised debt obligations.

³ Bank of England, *Finance for Small Firms: Seventh Report (2000)* para 3.35.

⁴ ABFA is a UK based trade association whose members include the major UK banks or their subsidiaries, foreign banks, and major global industrial companies as well as smaller finance companies. Their members provide factoring services (including invoice discounting) and asset based lending to businesses. See their website at <<http://www.abfa.org.uk>>.

⁵ Scottish Government Scottish Procurement Directorate, *Scottish Procurement Policy Note SPPN 7/2007 31 October 2007* para 5 - <<http://www.scotland.gov.uk/Resource/Doc/1265/0053921.pdf>>. The purpose of the SPPN "was to: announce a change to the Scottish Government's standard terms and conditions of contract to permit assignation of debts arising under the contract; and to provide guidance on the removal of the standard ban on assignation of debts in wider public sector procurement in Scotland" (para 1). This recognises that book debts are now considered to be an acceptable and valuable source of funding for businesses.

other assets such as stock, property, plant and machinery".⁶ Their members alone had 41,511 factoring clients in the UK as a whole in December 2010.⁷

4. The value of intellectual property (IP) rights in Scotland is also considerable. We have not managed to obtain precise figures but inferences can be drawn from information in the public domain. For example, research and development (R&D) spending is an indication of how much is being invested in new products and new products may form the basis of IP rights. According to the Scottish Government, Scottish Business Enterprise R&D (BERD) expenditure in 2009 amounted to £644 million.⁸ The creative sector⁹ is also a major source of IP rights. In 2007, 60,000 people in Scotland were employed in the creative sector, with a £5.2 billion turnover.¹⁰ The Scottish publishing industry had an annual turnover of £180 million in 2008.¹¹ Scottish Universities have created over 170 spin-out businesses to exploit their IP rights over the period 2000 – 2010, of which 125 are still active.¹²

5. Finally there is the motor industry. According to the Finance and Leasing Association (representing motor financing bodies in the UK), in 2010 their members funded £18.4 billion in motor finance in the UK which included around half of all new car registrations.¹³ Again although we have not found separate figures it is not unreasonable to conclude that the figure for Scotland is significant.

6. It is important, therefore, when considering possible changes to the present regime, to have regard to the likely economic impact of any proposed reforms. The main question that arises is whether the facilitation of moveable security has economic benefits – to put it another way, is secured debt efficient in economic terms? We have considered this difficult question in Chapter 12. At various other points in the text we have also considered the particular economic impact of certain proposals.

The main proposals for reform

7. The project has three strands (i) outright transfer (assignment) of incorporeal moveable property¹⁴; (ii) security over incorporeal moveable property;¹⁵ and (iii) security over corporeal moveable property.

⁶ See their leaflet "ABFA Promoting and Representing the interests of Members" <<http://www.abfa.org.uk/public/ABFABrochureSept10.pdf>>.

⁷ ABFA Quarterly Statistics to December 2010, <[http://www.abfa.org.uk/statistics/ABFAStatsQ42010\(Republic%20of%20Ireland\).pdf](http://www.abfa.org.uk/statistics/ABFAStatsQ42010(Republic%20of%20Ireland).pdf)>.

⁸ Scottish Government, "R&D Business Expenditure High Level Summary of Statistics" <<http://www.scotland.gov.uk/Topics/Statistics/Browse/Business/TrendRandDBusiness>>.

⁹ Which can be defined as: advertising, architecture, the art and antiques market, crafts, design, designer fashion, film, interactive leisure software, music, the performing arts, publishing, software and computer services, television and radio – Department for Culture, Media and Sport; Department for Business, Enterprise and Regulatory Reform and Department for Innovation, Universities and Skills, *Creative Britain: New Talents for the New Economy* (2008) Executive Summary <<http://webarchive.nationalarchives.gov.uk/+http://www.culture.gov.uk/images/publications/CEPFeb2008.pdf>>.

¹⁰ Scottish Enterprise, Creative Industries Key Facts <<http://www.scottish-enterprise.com/your-sector/creative-industries/overview/creative-industries-key-facts.aspx>>.

¹¹ Scottish Enterprise, Creative Industries Key Facts <<http://www.scottish-enterprise.com/your-sector/creative-industries/overview/creative-industries-key-facts.aspx>>.

¹² <<http://www.bbc.co.uk/news/uk-scotland-scotland-business-13147563>>.

¹³ <<http://www.fla.org.uk/motor>>.

¹⁴ But not transfers of various types of intellectual property, negotiable instruments or investment securities which have their own special rules of transfer.

¹⁵ Including securities over various types of intellectual property, negotiable instruments and investment securities.

8. It is worth repeating that the law on assignation of incorporeal property and the law on security over incorporeal property are closely linked as an outright transfer and a security are in terms of property law carried out in the same way – by assignation. The general law of assignation therefore applies to an assignation in security.¹⁶ Any problems with the law of assignation also affect assignations in security.

9. The main proposals are brought together in Chapter 3 in the shape of a possible scheme.¹⁷ In brief the principal features of the scheme are as follows:

A new moveable security

- The introduction of a new (proper) security over both corporeal and incorporeal moveable property.¹⁸ For corporeal moveable property it would be a non-possessory security, and for receivables there would be no requirement (as far as the constitution of the security is concerned) for account party notification.
- All moveable property could be used as collateral, except ships and aircraft, which have their own security regime in separate legislation. Thus corporeal moveable property, receivables, intellectual property rights, company securities (shares and bonds), public sector bonds, intermediated securities, bank accounts, and negotiable instruments could all be used as collateral.
- The security could include after-acquired property in the case of a business debtor.
- The security could be granted by anyone, not just by companies and LLPs (which is the current position for floating charges).
- For the right to be constituted the security would require to be registered in a new Register of Moveable Transactions administered by the Keeper of the Registers of Scotland.¹⁹ Registrations could be done online. The register would be public. It would be searchable online. It would be self-financing.
- There would be protection for defined categories of third parties.

Assignation and assignations in security²⁰

- Title to an assignation or an assignation in security could be completed by registration in the Register of Moveable Transactions, as an alternative to completion of title by intimation. Assignees would thus have either possibility open to them. In practice registration would be the attractive option for bulk transfers.

¹⁶ See para 7.6.

¹⁷ The options for reform are discussed in more detail in Chapter 14 (Outright assignation), Chapter 15 (Possessory security over corporeal moveable property), Chapter 16 (Non-possessory security over corporeal moveable property), Chapter 17 (Special types of corporeal moveable property: ships, aircraft, motor vehicles, spacecraft, and rolling stock), Chapter 18 (Security over ordinary incorporeal moveable property), Chapter 19 (Security over special types of incorporeal moveable property), Chapter 20 (Registration and connected matters), Chapter 21 (Recharacterisation and registrability), and Chapter 22 (Floating liens and floating charges).

¹⁸ On the new security see paras 3.21 to 3.36.

¹⁹ On the new register see paras 3.2 to 3.8.

²⁰ See paras 3.9 to 3.20 .

- There would be protection for an account debtor who paid the original creditor in good faith.
- A registered assignation of after acquired rights would be effective subject to a possible exception for consumer grantors.
- The rules about intimation would be clarified.

Pledge²¹

- Pledge of a bill of lading (or of a delivery order) should be regarded as a true pledge.
- Redelivery of pledged goods or a pledged bill of lading should extinguish the pledge.
- Under the Consumer Credit Act 1974 where, in respect of a loan below £75, a pledged item is forfeited but the value of the item is more than the loan, the surplus value should go to the pledger.

Floating charges²²

- The floating charge should not be abolished but it is for consideration whether the scope of a charge should be restricted to moveable property and whether the rules about ranking for floating charges should be modified so that they would be postponed to subsequent security rights other than floating charges.²³

Current difficulties with the existing law

10. This project is principally about commercial transactions, where one or both parties are a commercial or financial enterprise.²⁴ There may also be non-commercial transactions or semi-commercial transactions but the typical case will be a commercial one.²⁵ Of course any problems with the current law impact on all transactions but arguably the impact is likely to be more severe where for example a substantial portfolio of loans is concerned. And, as we have mentioned earlier, the value of property which may be the subject of a transaction falling within the scope of the project is huge.²⁶ If therefore there are problems with the current law then the impact is likely to be significant in economic terms. For example there were thought to be over 300,000 business enterprises in Scotland in 2009, many of whom may wish to use their book debts to fund their operations.²⁷ That figure presumably includes

²¹ See para 3.41.

²² See paras 3.37 to 3.40.

²³ To a certain extent the questions put to consultees about floating charges assume the introduction of a new moveable security covering after-acquired assets or are not central to the paper's main proposals. The economic impact of the questions is not therefore examined any further.

²⁴ Securitisations involving the sale of a bank's or other lender's loan book is an obvious example. Factoring is another. See footnotes 1 and 4 above as to the types of organisation who are members of AFME and ABFA. There will be a degree of common membership.

²⁵ See para 1.3 above.

²⁶ See paras 2 to 5 above.

²⁷ In 2009, there were 324,110 enterprises in Scotland: Department for Business, Innovation and Skills, *Small and Medium-sized Enterprise Statistics for the UK and Regions* (2009) Table 22: Scotland <<http://stats.berr.gov.uk/ed/sme/>>. Despite the title of the study, it actually includes all enterprises, regardless of size. SMEs apparently account for 99.9% of all enterprises: DBIS, *Statistical Press Release* (2010) at 2 <http://stats.berr.gov.uk/ed/sme/Stats_Press_Release_2009.pdf>. The amount of SMEs in Scotland in 2009 was therefore approximately 323,786. The Federation of Small Businesses (FSB) in Scotland have also stated that SMEs make up 99% of Scottish businesses - see their website at <<http://www.fsb.org.uk/scotland>>.

the companies (almost 150,000) who are registered in Scotland.²⁸ There are a number of major financial institutions who may wish to sell their loan books. There are a number of major companies who may wish to use their stock, plant or machinery as collateral for a loan. And on the other side of the coin there are a number of financial institutions who wish to provide the funding sought.

11. What are the current difficulties with the law? The case for reform of the law on assignation of, and security over, incorporeal moveable property was set out in the following terms in our *Seventh Programme of Law Reform*.²⁹

"2.33 In modern times, both in a personal and especially in a commercial context, incorporeal moveables have become an increasingly important source of wealth. In type they are extremely diverse. Some may be extremely valuable, including company shares, insurance policies and intellectual property such as trade marks and patents. Of particular significance in the commercial field are receivables (book debts), that is to say, money owed but unpaid. For a trading business, receivables often constitute a substantial asset and hence an important potential source of security for credit.

2.34 The law in Scotland has not developed to match the growing importance of incorporeals. Except in relation to floating charges, the rules on the creation of securities over incorporeals have been largely unchanged since the Institutional writers. These rules largely pre-date the industrial revolution and are cumbersome and unsuited to modern commerce. No security right can be created in the strict sense of the term. Instead a person or business, wishing to borrow money on the credit of incorporeal moveables, must make an outright transfer of the property so that the bank or other creditor becomes the owner (subject to an obligation to reconvey when the debt is paid). This transfer is effected by a legal deed known as an assignation followed by formal intimation of the transfer to the person who owes the obligation that is being transferred.

2.35 The requirement of formal intimation in particular can be troublesome, especially in a commercial context. A business that wishes to assign book debts owed by 1000 customers must send a copy of the assignation to each; and as new debts become due, so new copies must be sent out. In practice the requirement of intimation may make assignation unattractive.

2.36 While a partial solution exists for companies (and limited liability partnerships) in their ability to grant security in the form of a floating charge over assets of any kind, including incorporeal moveables, an unincorporated business – typically a small business – or a sole trader is left without an effective method of borrowing money against book debts and other incorporeals.

2.37 From the lender's standpoint the value of the floating charge has been adversely affected by the Enterprise Act 2002. Under the Act it is usually no longer possible for the creditor under a floating charge to appoint a receiver for the purposes of enforcement. Furthermore, certain funds ring-fenced for ordinary creditors are not to be available to satisfy floating charges. In English law it is possible, subject to certain conditions, to create a fixed charge over book debts and other incorporeals

²⁸ According to figures by the then DTI, there were 113,200 Scottish companies on the register in March 2006: *Companies in 2005-2006* (2006) Annex 1, Table A1 <<http://www.bis.gov.uk/files/file34501.pdf>>. According to Companies House statistics for the end of February 2011, there were 148,636 companies and 2,336 LLPs registered in Scotland: Company Register Statistics for February 2011 <<http://www.companieshouse.gov.uk/about/busRegArchive/businessRegisterStatisticsFeb2011.pdf>>.

²⁹ Scot Law Com No 198 (2005), paras 2.33 to 2.39 (footnotes omitted).

without assignation and lenders have regularly sought to take such fixed, non-possessory security which will have priority over preferential debts. If a system of 'notice-filing' is introduced for companies in England and Wales, as is likely to be proposed, the security interest taken by the creditor will usually be a fixed security and the expectation is that the floating charge will fall out of use.³⁰

2.38 It is widely thought that the difficulty in creating an effective fixed security over receivables in Scotland places Scottish businesses at a competitive disadvantage which is not fully offset by the existence of the floating charge. For non-corporate borrowers, the difficulties associated with assignation cannot be even partially overcome by the floating charge.

2.39 While some consideration was given to securities over incorporeals in a government consultation paper issued in 1994, a more extended examination of the law is, in our view, now required. A necessary part of this review is to examine the law of "ordinary" assignation, that is, assignation as outright transfer, not in security."

12. This project was then carried forward into our *Eighth Programme of Law Reform* and supplemented by the addition of the law on security over corporeal moveable property for the reason that "It too is regarded by many as being outmoded".³¹

13. The preceding chapters also examine areas of the existing law where there are thought to be problems.³² The position can be summarised briefly as follows.

- The present law on assignation of incorporeal moveable property including assignation in security is both outdated and cumbersome in operation.
- The requirement for intimation causes problems particularly where multiple claims are being assigned or where after-acquired property, such as future receivables, is involved. There are also questions about what amounts to intimation.
- An assignation in security, being a full transfer of title from the debtor to the creditor, takes away too much from the debtor and gives too much to the creditor. If the purpose is to ensure payment of a debt it is not necessary for ownership of the collateral to pass to the creditor.
- An assignation in security does not allow (other than circuitously) the creation of multiple securities or the transfer of the debtor's rights.
- The law on security over corporeal moveable property is also outdated. For example it is not in general possible to have a non-possessory security. Certain aspects of the law of pledge also need to be clarified or updated.

³⁰ Events have of course moved on since this entry in the Seventh Programme was written. Notice filing has not been introduced and the floating charge remains in use.

³¹ Scot Law Com No 220 (2010) paras 2.4 to 2.6.

³² See Chapters 4, 6 and 7 for an outline of the current law on (1) outright assignations, (2) security over corporeal moveable property and (3) security over incorporeal moveable property. See also Chapter 5 on the nature of security rights. For reform options see Chapter 14 (Outright assignation), Chapter 15 (Possessory security over corporeal moveable property), Chapter 16 (Non-possessory security over corporeal moveable property), Chapter 17 (Special types of corporeal moveable property: ships, aircraft, motor vehicles, spacecraft, and rolling stock), Chapter 18 (Security over ordinary incorporeal moveable property), Chapter 19 (Security over special types of incorporeal moveable property), Chapter 20 (Registration and connected matters), Chapter 21 (Recharacterisation and registrability), and Chapter 22 (Floating liens and floating charges).

Risks arising from the current difficulties

14. In general an area of law that is outmoded or cumbersome to operate or uncertain is not economically efficient. Transaction costs are higher; or are so high as to deter people from entering a transaction in the first place; or encourage the use of alternative devices to circumvent the problems of the existing law. In areas of commercial law the result may be to place parties at a competitive disadvantage. Equally it may make Scotland a less attractive place to do business.

15. This area of law is no different. The extract from our *Seventh Programme of Law Reform* mentioned above identifies a number of risks that arise from the present state of the law on security over incorporeal moveable property. The law may lead to the following consequences:

- An unincorporated business, being unable to grant a floating charge, may have no effective method of borrowing money against book debts and other incorporeals.
- Scottish businesses may be at a competitive disadvantage due to the difficulty in creating an effective fixed security over receivables in Scotland.
- The absence of a fixed security coupled with the dilution of the floating charge by the Enterprise Act 2002, and the possibility under English law of creating a fixed charge over book debts and other incorporeals³³ without assignation may lead to the loss of legal financial and commercial business to England and elsewhere.³⁴

16. To these may be added:

- The risk for the debtor of the insolvency of the creditor.
- The development of certain arrangements, such as requiring the account debtor to continue to pay the debtor rather than the creditor, which in commercial terms make sense but which may cast doubt on the validity of the security
- The use of alternative devices such as trust to achieve the same objectives

17. Some of these risks can also arise as a result of the present state of the law on assignation of incorporeal moveable property. The outdated and cumbersome nature of the law coupled with the problems with intimation in the case of bulk sales of book debts or after-acquired property may place Scottish businesses at a competitive disadvantage and lead to the loss of legal financial and commercial business.³⁵ There are consumer protection issues involved in some cases where an individual debtor may be unsure as to the identity of the

³³ Intellectual property was another area brought to our attention where the difficulties with Scots law were thought on occasions to lead to the use of English law.

³⁴ See Appendix B for a description of the general rules of English law (including comparison with Scots law) and some other legal systems.

³⁵ Uncertainty as to what amounts to intimation may also increase transaction costs, not least by increasing the possibility of disputes.

creditor where the debt in question has been sold on.³⁶ The present law also leads to the use of alternative devices such as trusts.³⁷

18. The absence of a non-possessory fixed security over corporeal moveable property carries similar risks, ie competitive disadvantage, loss of business, use of alternative devices. The risk with the latter is not only higher transactional costs but also, in view of section 62(4) of the Sale of Goods Act 1979, the risk of invalidity as the common law requirement of delivery for ownership to pass is not satisfied.³⁸ Pledge is available, but that requires possession to be given up and so is of limited use in commercial cases. Certain of the pawnbroking provisions in the Consumer Credit Act 1974 may also operate in an unfair way.³⁹

19. To some the use of alternatives devices such as trust or quasi-securities to accomplish the same policy objectives of the law of assignation or the law of security compromises the publicity principle which is an important feature of Scots law.⁴⁰ The risk is that the use of these devices is economically less efficient. It makes it more difficult for third parties to discover the true position. It might lead to higher transaction costs. In the case of trust there is also a degree of uncertainty as to whether it can be used as a quasi-security.

20. Anything that potentially affects the competitiveness of Scottish businesses or could lead to loss of business in Scotland is of concern. This was a theme running through the evidence that we have gathered so far and to which we now turn. One concern in particular is that Scots law does not offer the same flexibility as English law and in some cases where a choice can be made the decision is taken to structure a particular deal under English law, involving, if necessary, the setting up of an English company, to avoid the complexities of the Scottish system.

Evidence of these difficulties

21. Evidence as to the existence of the problems identified in relation to the law on assignation of incorporeal moveable property and security over moveable property and the potential risks involved has been gathered from a number of sources.

22. A number of consultees who responded to our Discussion Paper on *Registration of Rights in Security by Companies*⁴¹ suggested that we look at this area. The Company Law Committee of the Law Society of Scotland said that they perceived a "disadvantage which Scottish businesses may be placed at with respect to those subject to English law. The Committee is aware of proposals to address these issues in the Commission's Law Reform Programme No 7 and would wish that they be given top priority." They added:

"The Committee believes that it is of considerable importance to the Scottish economy that these issues should be addressed as a matter of urgency. The Committee believes that the Scottish Law Commission should undertake a review of

³⁶ See para 14.38.

³⁷ For the use of trust in these areas, see paras 11.11 to 11.18.

³⁸ See paras 6.37 to 6.42.

³⁹ See paras 6.14 to 6.17 and 15.8.

⁴⁰ In Chapter 11 we examined the publicity principle in some detail – its rationale ((i) fairness in relation to third parties (ii) economic efficiency (iii) the prevention of fraudulent antedating and (iv) legal certainty), its relevance to various types of property, its use in German and US law, the principle and the trust, and its role in Scots law etc.

⁴¹ Scot Law Com DP No 121 (2002).

the substantive law of rights in security to ensure that Scots law is not perceived as an inferior system."

23. Some commercial practitioners were disappointed with the remit given to the Commission. They considered that the whole of the law on rights in security should be reviewed and that Scotland could potentially be disadvantaged if effort was not made to see if our very traditional approach to security law could still be squared with modern business practice.

24. Responses to our consultation on the *Seventh Programme of Law Reform*⁴² supported the proposal that we should carry out a project on assignation of, and security over, incorporeal moveable property. The Law Reform Committee of the Law Society of Scotland said that this area was ripe for review and that it was important to ensure that in cross-border issues the Scottish legal system would not be ignored or that other systems which do provide some sort of security would be preferred over the Scottish system. Support was also received from (among others) Robert Gordon University, the University of Abertay Dundee and the Society of Legal Scholars.

25. Responses to our consultation on our *Eighth Programme of Law Reform*⁴³ were equally supportive of our proposal to extend the project to security over corporeal moveable property. CBI Scotland expressed its interest in this area. The WS Society thought that the project should be given first priority "as there is no workable fixed security in Scots law." The Law Society agreed that this was an area worth looking at. Support was also received from leading academics, practitioners and the judges.

26. Prior to commencement of the project we conducted preliminary discussions with interested groups, including the financial sector,⁴⁴ about the underlying financial and economic background, current practices, and deficiencies that were thought to exist. As the project progressed we also benefited from the advice and assistance of our advisory group.⁴⁵

27. Over the years there have been a number of reviews of the relevant law.⁴⁶ The reviews are set out and considered in Chapter 10. Case law and academic writings have also been a source.

28. Finally mention should be made of the *Business Finance Report* of 2002 which is discussed in detail in Chapter 12, which considered the way the Scots law of moveable security worked in practice.

⁴² Scot Law Com No 198 (2005).

⁴³ Scot Law Com No 220 (2010).

⁴⁴ We had meetings with the following: CBI Scotland (Mr Iain McMillan, Director CBI Scotland, Mr John Alpine, National Australia Group Europe Limited, Mr Andrew Davison, Ernst & Young LLP, and Mr Bruce Wood, Morton Fraser LLP), the Royal Bank of Scotland Group plc (Mr R Beattie, Mr J Laing, and Mr J MacBean), Ms Caryn Penley, Ms Claire Massie and Mr Stephen Phillips of Dundas & Wilson LLP, Mr Neil Kelly of MacRoberts LLP, Mr Paul Hally and Mr Andrew Kinnes of Shepherd and Wedderburn LLP, Dr Hamish Patrick and Mr Graham Burnside of Tods Murray LLP, Ms Maureen Leslie of Active Corporate Recovery LLP, Mr Kenneth Pattullo of Begbies Traynor, and Mr David Wishart, Mr Alan Duncan, and Mr Douglas Thornton of HM Revenue and Customs.

⁴⁵ Dr Ross Anderson (University of Glasgow), Mr David Gibson (Burness LLP), Mr Andrew Kinnes (Shepherd and Wedderburn LLP), Dr Hamish Patrick (Tods Murray LLP), Mr Bruce Wood (Morton Fraser LLP), and Mr Scott Wortley (University of Edinburgh).

⁴⁶ Such as the Crowther, Halliday, Diamond and Murray Reports, and those undertaken by ourselves and the Law Commission of England and Wales.

29. In summary, the overall conclusion from the sources mentioned was that there were difficulties with the law in this area and that the law was in need of reform.

Aims and Objectives of the proposals for reform

30. Our aim is to modernise the law on the assignation of incorporeal moveable property and the law of security over corporeal and incorporeal moveable property principally through (1) the introduction of a new (proper) security over both corporeal and incorporeal moveable property, which, we provisionally suggest, would require to be registered in a new Register of Moveable Transactions, and (2) reforming certain aspects of the existing rules so as, for example, to enable title to an assignation or an assignation in security to be completed by registration in the new register. The overall objective would be to simplify Scots law making it more efficient in economic terms and thus more attractive to users or potential users with a view to promoting economic development of this part of the commercial, financial and legal sector in Scotland.

Options

31. In substance there are essentially two options. The first is to retain the status quo. The second is to introduce a new form of moveable security and to reform certain aspects of the existing law on assignation (including assignation in security) and pledge. However as it would be possible to reform the existing law on assignation etc without introducing a new form of moveable security we have split the second option into two. Option 2 relates to the new form of moveable security but also includes the proposals relating to assignation or assignation in security which presuppose the existence of a register. Option 3 relates to the proposed reforms of the existing law on assignation, assignation in security and pledge.

Option 1 The Status Quo

32. **Benefits and costs** It is difficult to identify any positive benefit from maintaining the status quo save there would be no implementation costs. On the other hand maintaining the status quo would mean that none of the problems with the current law which have been identified in the course of this discussion paper would be resolved. The law would continue to be outdated and cumbersome. It would remain economically inefficient in certain respects leaving Scottish businesses at a competitive disadvantage. The risk that legal, financial and commercial business would be lost would also remain. Moreover none of the net benefits of implementing Option 2 and Option 3 would be obtained.

Option 2 A new form of moveable security⁴⁷

The introduction of a new security over moveable property

33. **Benefits** The first question that requires to be considered is whether the introduction of a new form of security has economic benefits. That in turn raises the basic question as to whether secured debt is efficient in economic terms.

34. We look at this matter in some detail in Chapter 12. There we consider the Modigliani-Miller theorem which suggests that it does not matter whether a business is

⁴⁷ For options for reform see Chapters 16 to 22.

financed by debt capital or equity capital provided that finance is available. We also consider the law and economics debate in the late 20th century about the benefits of secured finance. Some argue that the debtor's total interest bill is in effect no different because an unsecured creditor will charge a higher rate of interest to compensate for the reduced pool of assets available for their claims. Others argue that secured transactions are economically inefficient as they lead to loans that cannot be justified resulting in a misallocation of resources to the detriment of unsecured creditors. We mention the limited lifespan of moveable property and the problems in certain cases of being able to identify the assets forming the collateral.

35. We also refer to the important empirical study contained in the Scottish Executive Central Research Unit's *Report on Business Finance and Security over Moveable Property*⁴⁸ which reviewed the way the Scots law of moveable security worked in practice particularly in relation to small and medium sized enterprises (SMEs). Its overall conclusion was:

"The perception that Scots law creates problems for SMEs has not been backed by systematic evidence. More specifically, when this study was commissioned there was little empirical evidence to support the suggestion that business finance is more difficult to obtain in Scotland because SMEs are unable to grant a non-possessory security over moveable assets, or that it is more difficult for unincorporated Scottish SMEs to obtain finance because they cannot grant a floating charge."⁴⁹

36. We conclude that there is no reason why the law should not be reformed to make debt financing easier and that we should proceed, with some provisos, on the basis that security is probably economically beneficial in overall terms.

37. So what benefits might the new security bring? The new security would be a direct, proper, non-possessory security. It would engage and be subject to the general law of rights in security.⁵⁰ There would be no need to create a new set of rules. The rules for the most part are already there.

38. Being a proper security, none of the problems associated with an assignation in security over incorporeal moveable property would be present.⁵¹ The provider of the security, would not run the risk of the creditor's insolvency. It would be possible to create multiple securities over the same asset.⁵² The security could be used for "chargebacks".⁵³ It would be possible for the debtor to transfer their rights to a claim outright to another person.⁵⁴ There would no uncertainties as to who the account holder should be paying. Payment would be made to the holder of the claim, whose identity would not have changed with the grant of a security. All in all a security of this kind would match the expectations of both parties to the arrangement and should lead to efficiency savings.

⁴⁸ A digital version is available at <<http://www.scotland.gov.uk/cru/kd01/purple/bfas.pdf>>.

⁴⁹ Page 2 of the Report. However the Report did point out that other techniques, such as retention of title, hire purchase, finance leasing, trust, and the creative use of international private law had all been used to achieve the same objective of a non-possessory security over moveable assets, thus arguably making the absence of such a security less important.

⁵⁰ See for instance paras 16.59 and 16.60.

⁵¹ See paras 18.4 to 18.8.

⁵² See paras 5.26 and 5.27.

⁵³ Arrangements in which X, who has money on deposit with Y Bank, can use that deposit as collateral, not in favour of a third party, but in favour of Y Bank itself.

⁵⁴ See paras 5.30 and 5.31.

39. In the case of corporeal moveables the security would be a non-possessory security. It would enable existing assets to be used to raise finance without requiring possession to be given up.

40. The introduction of a new security will make the law clearer and simpler. That leads to a number of benefits, both directly⁵⁵ and indirectly. For instance the new security right should also remove the need to use artificial and non-transparent devices to achieve the same objectives. The use of alternative devices such as trust or quasi-securities⁵⁶ compromises the publicity principle which is an important feature of Scots law.⁵⁷ Instead of these back-door methods, it would be better to open the front door by introducing a new type of security right. Again this should lead to efficiency savings and remove the risk of invalidity that attach to some devices.

41. The new security would require to be registered in order for it be valid.⁵⁸ The issue of registration involves consideration of the role of the publicity principle in this area. We consider both of these matters at various points in the paper.⁵⁹ We conclude that on balance registration has economic benefits. It may help to prevent fraud in the sense of falsifying the date of a security or double grants of security of the same assets to different people. It helps potential lenders to know the position. In an insolvency it would be easier for the liquidator etc to discover what rights creditors might have. It reduces the scope for disputes. In general financial institutions making business decisions would have access to better information. Registration would also be more economically efficient than intimation, particularly where bulk transactions are involved. A single registration would suffice. If the experience of New Zealand is anything to go by, both registration and searching could be done quickly and cheaply. There would be costs involved (see below) but these would be offset by the benefits of having an accessible online public register.

42. A further benefit is that the introduction of a new security and a new register would pave the way for further rationalisation and simplification of the law. Potentially it could lead to the disappearance of the floating charge. Quasi-security devices could also come under scrutiny.

43. In general therefore the introduction of a new security should bring economic benefits. It should lead to a reduction in overall transaction costs. It may make it easier for businesses to offer security to lenders. In turn it may make it easier for a lender to lend money. It may help to reduce any competitive disadvantage that Scottish businesses are under. It may make Scots law a more attractive vehicle to use for commercial transactions.

44. **Costs** There would inevitably be costs involved.

45. With any reform of an area of the law there may be costs for those affected. In this case businesses that wish to use the new security, financial institutions who wish to fund businesses, and professional advisers would all require to become familiar with the new

⁵⁵ See, for example, the discussion in the next paragraph on registration.

⁵⁶ Retention of title, hire-purchase, finance leasing.

⁵⁷ See para 41 below.

⁵⁸ There is of course already a requirement to register certain charges by companies in the Companies Register.

⁵⁹ See Chapter 11 and paras 14.5 to 14.27 in the context of assignation, and paras 16.13 to 16.17 and 18.14 to 18.17 in the context of the new security over corporeal and incorporeal moveable property,

rules. This would involve education and training. But business should find that the benefits outweigh the costs.

46. Then there would be the cost of establishing and running the new register. We have already referred to the start-up costs of establishing a register and then continuing to administer it. However the intention is that the register, like the Land Register, should be self financing.⁶⁰ Initial capital costs would be recouped from future income generated by the register. While it is difficult to know whether like is being compared to like, the New Zealand experience is at least indicative of what can be achieved. According to the Law Commission for England and Wales' *Report on Company Security Interests*⁶¹:

"The first project manager for the New Zealand registry, Andrew Bridgman, indicated that the costs to government of introducing the NZPPSR came to just over US\$1.2 million. Software development costs amounted to US\$846,800, with other costs (dedicated staff, hardware, publicity, travel, internal training and miscellaneous) adding an additional US\$234,000. With quality assurance and consultancy costs, the total was US\$1,180,000. He also indicated that the system paid for itself from fee income in the first few months: total net revenue for the transitional period of 1 May - 31 October 2002 was US\$1.6 million. Mr Bridgman noted that the costs were substantially reduced because: (a) development of the system was built off the back of an existing IT platform; (b) a trusted IT developer was used with low overheads and previous familiarity with government IT development, and (c) the development team used existing staff from high performing units within the Ministry."

47. We propose that the new register should be administered by the Keeper of the Registers of Scotland.⁶² The Keeper has a number of public registers in her charge, including the Land Register and the Register of Floating Charges. Placing the register with the Keeper should help to keep down the initial set-up costs for the type of reasons outlined by Mr Bridgman in the case of the New Zealand register. It might be possible to use existing infrastructures in relation to matters such as information technology and human resources. And the experience and expertise of existing staff in operating a registration system would be invaluable.

48. There would a number of costs for users of the registration system. There would be the hard costs of registration and searching. In both cases the fact that the register would be available and accessible online should keep costs down. As mentioned earlier about New Zealand, where the system was digital from the outset, a registration normally costs NZ\$3 and a search normally costs NZ\$1.⁶³ In the USA filing fees vary from state to state but are generally in the range of US\$10 to US\$30. The usual practice everywhere is for filing fees to be flat-rate, not ad valorem, so that a registration fee of (say) £10 might support financing of many millions of pounds.

49. The cost of registration would only be a new cost for securities not granted by companies. Companies are already required to register certain charges under Part 25 of the Companies Act 2006 in the Companies Register,⁶⁴ for which a fee is payable,⁶⁵ and

⁶⁰ The intention is that the new register be added to the responsibilities of the Keeper of the Registers of Scotland and funded initially on the same basis as the other registers in her stable.

⁶¹ Law Com No 296 (2005) para 2.9 n 11.

⁶² Or such other person as Scottish Ministers may appoint. See para 20.2 and proposal 71.

⁶³ See <<http://www.ppsr.govt.nz/cms>>. One NZ dollar = about 50p.

⁶⁴ Under s 878(7) the following charges require to be registered: - "(a) a charge on land or any interest in such land, ... (b) a security over incorporeal moveable property of any of the following categories— (i) goodwill, (ii) a

assuming that an order would be made under section 893 of the 2006 Act, registration in the new register would be sufficient. An additional fee for registration in the Companies Register would not be incurred.

50. There would also be the soft cost of staff time taken up in applying for the registration. But this would be unlikely to be large, especially if registration were to be done online. Registration could also reduce soft costs. It would be cheaper for third parties such as potential lenders to discover the true position. And it would be easier and quicker for a liquidator to discover what rights various creditors have.

51. Equally for the users there would be costs involved in training staff to register a security or to carry out a search. Again the experience in New Zealand may be informative. There the register is set up in such a way that it does not need to be operated by staff with particular financial or legal expertise. The training should be straightforward and nowadays most people are familiar with working online in one form or another. The Registers of Scotland might well provide training sessions.

Future assets⁶⁶

52. We consider here the economic impact of the proposal that the new security right should also be capable of covering future assets (except if the debtor were a consumer) with the security coming into existence when the debtor acquired the property in question. In this respect the new security would take on the shape of the floating lien found in the UCC-9 and thus would overlap with the floating charge. The analysis of the benefits and costs of this proposal would apply equally to the proposal that a registered assignment or a registered assignment in security should be capable of covering future assets also.⁶⁷

53. **Benefits** The proposal would allow sole traders and partnerships to grant a security over future assets in the way that a company can at present by using a floating charge. It might therefore increase the opportunity they have to raise finance to fund their business.

54. The fact of being an ordinary security would also bring benefits in terms of its legal nature. The general law of security is relatively well settled, in contrast to the conceptual uncertainty that surrounds the floating charge. Uncertainty may increase transactional costs, so conversely the availability of a security over future assets which engages an established area of law may reduce transaction costs.

patent or a licence under a patent, (iii) a trademark, (iv) a copyright or a licence under a copyright, (v) a registered design or a licence in respect of such a design, (vi) a design right or a licence under a design right, (vii) the book debts (whether book debts of the company or assigned to it), and (viii) uncalled share capital of the company or calls made but not paid, (c) a security over a ship or aircraft or any share in a ship, (d) a floating charge."

⁶⁵ The current cost is £13: Registrar of Companies (Fees) (Companies, Overseas Companies and Limited Liability Partnerships) Regulations 2009 (SI 2009/2101) sch 1 part 2 para 7(g) (companies); para 9(d) (LLPs); para 10(d) (overseas companies); and Registrar of Companies (Fees) (European Economic Interest Grouping and European Public Limited-Liability Company) Regulations 2009 (SI 2009/2403) sch 1 part 2 para 5(d) (European Economic Interest Groupings).

⁶⁶ See Chapter 16 (Non-possessory security over corporeal moveable property: reform options), paras 16.18 to 16.23, Chapter 18 (Security over ordinary incorporeal moveable property: reform options), paras 18.18 to 18.21, and Chapter 22 (Floating liens and floating charges).

⁶⁷ See paras 14.60 to 14.68.

55. A further possible benefit to some would be that the proposal might ultimately lead to the withering away of the floating charge, the presence of which in Scotland is not without problems.

56. **Costs** In as much as security rights prejudice other creditors, there would be a potential cost to such creditors, but it would not be an overall economic cost.⁶⁸ The proposal might also lead to over-collateralisation.

57. It would be possible to mitigate some of the costs to other creditors. It is proposed, for example, that for the purposes of insolvency law, the new security should be treated in substantially the same way as a floating charge. However the downside is that these mitigating features might not be attractive from the point of view of financial institutions.

Assignment and assignment in security⁶⁹

58. We consider here the proposal that title to an assignment or an assignment in security could be completed by registration in the Register of Moveable Transactions, in addition to completion by intimation.

59. **Benefits and costs** We have already considered the benefits and costs of registration in relation to the introduction of a new security. Although registration would be optional, the same issues arise and the same conclusions would apply. In brief, registration is thought to have certain economic benefits.

60. One particular gain is that it would avoid the need for intimation in bulk transfers such as factoring and securitisations. This would be of significant benefit to those financial institutions that operate in these sectors. It would save administrative as well as legal costs. It would also remove uncertainties as to whether intimation had been properly made.

61. An additional point is that, as with the new security, there might be costs involved for the account debtor where payment was made, in ignorance of the registration, to the original creditor. However it would be possible to have a rule protecting an account debtor who paid in good faith.⁷⁰

Option 3 Other Reforms

Assignment⁷¹

62. We consider here the set of proposals on the subject of intimation. We propose that notification of an assignment to an account debtor should enable that person to understand what has happened and to understand that payment now requires to be made to the new creditor. This might be accompanied by the imposition of information duties on the person who is the new creditor (the assignee) with penalties for default.

63. **Benefits** By removing uncertainties that have emerged as to what amounts to intimation, this would put an account debtor in a better position, particularly where a

⁶⁸ Unless the radical view, mentioned in Chapter 12, that security is economically dysfunctional, is adopted.

⁶⁹ For options for reform see Chapter 14.

⁷⁰ See para 14.20.

⁷¹ For options for reform see Chapter 14.

consumer was involved.⁷² At present an account debtor may not realise that the debt has been transferred and that there is a new creditor to whom payment should be made. Little or no evidence as to the transfer may be supplied, or notice is hidden in the small print.

64. **Costs** We do not see costs in this proposal.

Pledge⁷³

65. (1) We consider here the proposal that pledge of a bill of lading should be regarded as a true pledge whereby the pledger keeps the right of ownership to the goods in question and the lender receives a right of security only. This is thought by some to be the existing law but the case of *Hamilton v Western Bank*,⁷⁴ which held that ownership passes to the lender in such circumstances, is an Inner House decision which has not been overruled.

66. **Benefits and costs** The benefit would lie in removing uncertainties from the law. Uncertainties increase transaction costs and raise the possibility of disputes. In addition there may be benefits in confirming that Scots law and English law are in general terms the same in this respect. It is not thought that clarifying the law will involve any significant costs.

67. (2) We also propose that redelivery of pledged goods or a pledged bill of lading should extinguish the pledge. This again may be the existing law but there is some uncertainty following the case of *North Western Bank, Limited v John Poynter, Son & Macdonalds*,⁷⁵ which held that if the pledgee re-delivers the pledged goods to the debtor the pledge is not extinguished. In the new scheme the creditor could protect its position, and avoid the extinction of the security, by a simple registration that could cover an indefinite number of transactions.

68. **Benefits and costs** The benefit again would lie in removing uncertainty from the present law. This would make the law more efficient in economic terms. It would also re-assert the main principle underlying the law of pledge, that possession of the goods in question has to be given to the creditor. Temporary delivery of the goods should be insufficient. The downside of the proposal, which may involve costs for financial institutions, is that the decision in *Poynter* is the legal basis for trust receipt financing which is widely used in practice in the case of imported goods. However the introduction of a registered non-possessory security would protect the bank's position in the same way easily and cheaply.

69. (3) Finally we propose that where under the Consumer Credit Act 1974 ownership of a pledged item is forfeited because the loan is below the prescribed limit (currently £75) but the value of the item is more than the loan the surplus should be payable to the pledger.

70. **Benefits and costs** In exceptional cases the provision for forfeiture may operate unfairly where the pledged item turns out to be worth more than the parties thought. This proposal removes the potential for unfairness to the benefit of the pledger. This might involve the pledgee incurring additional administrative expenses but the proposal allows such expenses to be recovered.

⁷² See para 14.38.

⁷³ For options for reform see Chapter 15.

⁷⁴ (1865) 19 D 152.

⁷⁵ (1894) 22 R (HL) 1; [1895] AC 56.

Conclusion

71. We have considered here the economic impact of the proposals for reform put forward in the discussion paper. We have concluded that Option 1 is not sustainable and that Options 2 and 3 bring benefits which outweigh any potential costs.

72. We would be grateful to receive comments from consultees on this economic impact assessment in particular as to what consultees regard as the costs and benefits of our proposals.

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