Scottish Law Commission

Discussion Paper No 107

DILIGENCE AGAINST LAND

October 1998

This Discussion Paper is published for comment and criticism and does not represent the final views of the Scottish Law Commission

The Commission would be grateful if comments on this discussion paper were submitted by 27 February 1999. Comments may be made on all or any of the matters raised in the paper. All correspondence should be addressed to:

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NOTES

1. In writing a later report on this subject, the Commission may find it useful to be able to refer to, and attribute, comments submitted in response to this paper. If no request for confidentiality is made, the Commission will assume that comments on the paper may be used in this way.

2. Those who wish copies, or further copies, of this paper for the purpose of commenting on it should contact the Commission at the above address.

DISCUSSION PAPER ON DILIGENCE AGAINST LAND

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TABLE OF ABBREVIATIONS

1970 Act = Conveyancing and Feudal Reform (Scotland) Act 1970 (c.35).
1974 Act = Land Tenure Reform (Scotland) Act 1974 (c.38).
1979 Act = Land Registration (Scotland) Act 1979 (c.33).
1986 Act = Insolvency Act 1986 (c.45).
1987 Act = Debtors (Scotland) Act 1987 (c.18).

Graham Stewart
: J Graham Stewart, *The Law of Diligence* (Edinburgh, 1898).

Gretton
: G L Gretton, *The Law of Inhibition and Adjudication* (2d edn) (Edinburgh, 1996).

OCR
: Ordinary Cause Rules [of the sheriff court] 1993 (as amended).

RCS
: Rules of the Court of Session 1994 (as amended).

Stair Memorial Encyclopaedia
: *The Laws of Scotland, Stair Memorial Encyclopaedia* (25 vols, 1986 - 1995).

PART 1 INTRODUCTION

Purpose of Discussion Paper

1.1 In this Discussion Paper,[1] we consider the reform of the law relating to diligence against land. Two diligences against land are available to unsecured creditors, namely adjudication for debt and inhibition. The main features of adjudication are described in paragraph 1.3 below. An inhibition is served on the debtor and registered in the Register of Inhibitions and Adjudications (commonly referred to as the personal register). It operates as a personal prohibition against the debtor disposing of, or creating securities over, his heritable property or contracting further debts to the prejudice of the inhibiting creditor. Inhibition gives the inhibiting creditor a right to reduce deeds granted in breach of the inhibition and a preference over post-inhibition deeds and debts in any process of ranking of creditors on the proceeds of sale of the debtor's heritable property.

The property registers and registration

1.2 There are in Scotland two public registers relating to rights in land. The first is the Register of Sasines, set up in 1617,[2] in which the deeds creating or transferring real rights in land are recorded or registered, originally by being transcribed into the folio volumes but now by photocopying them. The Register of Sasines is being gradually replaced by the Land Register of Scotland set up under the Land Registration (Scotland) Act 1979. Whereas the Register of Sasines is a register of title deeds, the Land Register is a register of title. The Land Register is a computer-based register and the entries are updated to give effect to deeds presented to the Keeper. The deeds themselves do not enter the register. In this discussion paper we refer to the Register of Sasines and the Land Register of Scotland collectively as the "property registers" and use the term "registered" and cognate expressions for both registers. Although the term "registered" may give the wrong impression as regards the Land Register, it is a convenient short-hand term which is indeed used throughout the 1979 Act itself.[3]

Replacement of adjudication for debt by land attachment (Part 2)

1.3 Since its introduction in Scots law as long ago as 1672,[4] adjudication for debt has taken the form of a Court of Session decree vesting in the adjudging creditor a redeemable security over the adjudged property convertible by a further Court of Session decree[5] into a right of ownership (i.e. foreclosure) on the expiry of a minimum period of 10 years (the legal period of redemption[6]). In this form the diligence is archaic and cumbersome and can cause

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[1] This discussion paper is issued under our *Fifth Programme of Law Reform*, (1997) Scot Law Com No 159, Item 1, Civil Remedies - Diligence.
[2] Registration Act 1617, c 16.
[3] Section 1(3) of the 1979 Act defines "registered" to mean registered in the Land Register in accordance with the Act.
[4] Adjudications Act 1672, record edn c 45; 12mo edn c 19.
[5] A decree of declarator of expiry of the legal period of redemption.
[6] The legal period of redemption is commonly called simply "the legal".

injustice to both creditors and debtors. It is rarely used in modern practice.[7] Reform is needed because a diligence involving foreclosure after a minimum period of as long as 10 years, and making no provision for sale, is inappropriate in modern conditions.

1.4 We have already consulted on reform in our Discussion Paper No 78.[8] In Part 2 below we propose the replacement of adjudication by a new diligence to be called land attachment. We set out the detailed rules of our proposed scheme of land attachment in that Part and discuss some of the more important issues. This scheme has been devised in the light of comments on Discussion Paper No 78. The legislative scheme contained in that discussion paper was necessarily complicated principally because up-to-date computer searches of the Sasines Register were not then possible. The computerisation of the Sasines presentment book in 1993 has enabled us to frame a much simpler scheme.

1.5 In outline, the approach to reform follows that proposed in Discussion Paper No 78 and is based on the principles below.

* Adjudication for debt should be abolished.

* The new diligence of land attachment should take the form of an attachment followed by the remedy of sale (which the creditor may exercise relatively quickly) with foreclosure being available as a subsidiary and alternative remedy, authorised by the sheriff only in default of sale.

* The attachment would be effected, not by a Court of Session decree, but by a notice of land attachment registered by the creditor in the property registers in pursuance of a warrant contained in a court decree for payment or its equivalent.

The legislative scheme for introducing land attachment is set out in a series of numbered "propositions" in Part 2, Section B, and again in Appendix A with a commentary. We invite comments by those interested.

1.6 Land attachment would be a simpler and more effective diligence than adjudication. The latter has fallen into disuse because it is so complex and fails to enforce payment within a reasonable period. Any modern legal system should have an effective diligence for the attachment and sale of land.

The main issues on land attachments

1.7 The introduction of land attachments raises some controversial or difficult issues. These issues may be grouped under the following headings.

1.8 **Safeguards for debtors**. There is a need for safeguards for debtors and their families. Some of those commenting on Discussion Paper No. 78 expressed concern that a new diligence replacing adjudication would be used much more frequently and could give rise to increased homelessness. The diligence might also be used inappropriately for small debts if

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[7] A short survey (unpublished) conducted on our behalf in 1986 of actions of adjudication for debt raised in the 5 years from 1981 to 1985 shows that 48 such actions were raised in that period, just under 10 (9.6) *per annum*. A copy of this survey may be made available on request.

[8] Discussion Paper No 78 on *Adjudications for Debt and Related Matters* (1988) (2 vols).

the expenses of diligence became chargeable against the debtor.[9] The proposed scheme of land attachment requires the creditor, after registering a notice of land attachment in the property registers,[10] to apply to the sheriff for a warrant of sale.[11] The sheriff is to have power to postpone the granting of a warrant of sale of a dwelling house in order to allow the debtor or other resident time to find alternative accommodation.[12] The sheriff may refuse warrant if the debt is disproportionately small in relation to the value of the property sought to be sold, or if the net free proceeds of sale available to the creditor are unlikely to exceed the expenses of sale, or if a sale would be unduly harsh in the circumstances.[13]

1.9 **Land attachments and the faith of the registers**. There is a paramount need to protect purchasers, heritable creditors, and others[14] transacting with a debtor on the faith of the registers from unforeseen land attachments. This raises such important and controversial issues as whether a land attachment should attach property which a disponee from the debtor holds on a delivered but unregistered disposition, and the need to ensure that the debtor's disponees, heritable creditors and lessees, if they observe the rules of good conveyancing practice, can obtain a good title free from land attachment.[15]

1.10 **Sequestrations, liquidations and the faith of the registers**. By statute, sequestrations and liquidations operate broadly speaking as global heritable diligences, - roughly as if they were adjudications of all the debtor's heritable property for the benefit of all his creditors. Similar issues arise therefore as to the protection of those taking title from the debtor on the faith of the registers from unforeseeable sequestrations or liquidations, and as to the power of a permanent trustee in a sequestration or liquidator to pass good title to a bona fide purchaser free from challenge by a person who has taken an unregistered title from the debtor.[16]

1.11 **Stoppage and cutting down of land attachments on sequestration or liquidation and abolition of equalisation of adjudications.** The existing principles on the stoppage of adjudications for debt on the debtor's sequestration or liquidation must in future apply to land attachments subject to minor reforms.[17] We also propose[18] the abolition of the present statutory rules[19] on the equalisation of adjudications (which provide for the *pari passu* ranking of adjudications within a year and a day after the first effectual adjudication). Instead, new provision should be made rendering ineffectual land attachments registered within a statutory period (of, say, six months) before sequestration or winding-up.[20] These

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[9] At present the expenses of an unopposed adjudication, amounting to several hundred pounds, are not chargeable against the debtor.
[10] Part 2, Section B, proposition 1.
[11] *Ibid*, proposition 10(1).
[12] *Ibid*, proposition 11(4).
[13] *Ibid*, proposition 11(1)(b) and (c) and (3). Moreover the diligence of land attachment could be suspended by a time to pay order under the Debtors (Scotland) Act 1987: see proposition 5.
[14] E.g. the debtor's lessee or assignee in a registrable lease.
[15] Section B, propositions 3(3) and 7; Part 2, Section C (paras 2.10 - 2.60).
[16] Section B, propositions 27; 28(3) - (5); 29; and 30(1) and (2); Part 2, Section C.
[17] Part 2, Section B, propositions 32 and 34.
[18] Part 2, Section B, proposition 26; Section D (paras 2.61 - 2.71).
[19] Diligence Act 1661.
[20] Section B, propositions 31 and 33 modelled on section 37(4) and (5) of the Bankruptcy (Scotland) Act 1985 (which relate to the effect of sequestration in rendering ineffectual prior arrestments and poindings).

proposals were first advanced in our Discussion Paper No 79 on *Equalisation of Diligences*[21] and we adhere to them.

Reform of inhibitions (Part 3)

1.12 In Part 3, we put forward proposals for reform of the law of inhibitions if they are to be retained. An inhibition prohibits the debtor from disposing of, or granting security over, his heritable property and the creditor may reduce any deed granted in breach of the inhibition. An inhibition also prohibits the debtor from incurring future debts. Deeds granted in breach of an inhibition are rare as it is established conveyancing practice to search the personal register before settlement. Suppliers of goods and services, however, do not search to see if their customers are inhibited, so that post-inhibition debts are relatively common. This gives rise to complex ranking in order to give effect to the inhibitor's preference by exclusion of such debts. One of our main proposals is that an inhibition should only prohibit future deeds and not future debts.[22] This would lead to a great simplification of the law, although it would lessen the effectiveness of inhibition from the creditor's point of view.

1.13 Those engaged in transactions involving heritable property will as a matter of good practice obtain a search in the personal register against the disponee. Occasionally, there is a failure to find an effective inhibition, usually because the disponer's designation as owner in the property registers does not match his designation as inhibitee in the personal register. The consequences for a disponee who has transacted in good faith and in ignorance of the inhibition are serious. We put forward proposals for protecting such people. In terms of our scheme a disponee who was justifiably ignorant of the existence of an inhibition at the time of delivery of the disposition or other deed would be protected against reduction by the inhibitor. In order to be regarded as justifiably ignorant a disponee would have had to obtain a clear personal search against the disponer and be otherwise unaware of the inhibition.[23]

1.14 An inhibition prohibits the debtor from voluntarily alienating or granting security over his heritable property. The inhibitor obtains a preference over any disponee by reducing (or threatening to reduce) any deed granted in breach of the inhibition. There is considerable uncertainty as to what preference, if any, an inhibitor obtains if the inhibitee's property is sold by a standard security holder. We put forward proposals to clarify this situation.[24]

1.15 Other reforms proposed in Part 3 include: providing that the warrant of execution in extracts of court decrees and their equivalents should contain a warrant to inhibit the debtor,[25] suggesting simpler and less expensive procedures for serving and registering inhibitions,[26] clarifying at what stage a purchaser of heritable property acquires a right that is affected by inhibition,[27] and confirming that it is competent for an inhibitor to bring an action

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[21] Discussion Paper No 79 (1988), Propositions 1 (para 2.29) and 2 (para 2.31).
[22] Proposal 5, para 3.22.
[23] Proposal 16, para 3.88.
[24] Proposal 30, para 3.164.
[25] Proposals 7, 8 and 10 at paras 3.39, 3.46 and 3.48.
[26] Proposal 12, para 3.69.
[27] Proposal 25, para 3.129.

of reduction outwith the five year life of the inhibition in respect of a deed granted in breach of the inhibition while it remained effective.[28]

Should inhibitions be abolished? (Part 4)

1.16 Our scheme for land attachment contains an attacher's notice of litigiosity which, on registration in the property registers, would have the same effect as an inhibition but limited to the property specified in the notice.[29] This notice of litigiosity would be followed by the registration in the property registers of a notice of land attachment attaching the land specified.[30] In Part 4, we discuss whether land attachment should replace inhibition as well as adjudication for debt. The main advantages of an inhibition stem from the fact that it is a general diligence affecting all the debtor's heritable property. The creditor does not need to spend money and effort in finding out what property the debtor owns before an inhibition can be used. This makes inhibition useful as a freeze diligence, especially on the dependence of actions or at the early stages of enforcement. Also inhibition affects heritable property which is not registered or not registrable in the property registers as well as registered property. Only the latter would in practice be attached by land attachment.

1.17 On the other hand it complicates the law to have two different diligences, an attacher's notice of litigiosity and an inhibition, having the same general effects. Another disadvantage of inhibitions is that they are registered in the personal register yet affect transactions involving property registered in the property register. This causes problems for those searching the registers in connection with conveyancing transactions and for the Keeper, since the connection between the person as inhibitee and as the owner of property may be missed. Attacher's notices of litigiosity, being "property-specific" and registered against the specified land in the property registers, would not suffer from these disadvantages.

Adjudication for debt attaching non-registrable property

1.18 Under our proposals, land attachment would replace adjudication for debt in its application to heritable property registrable in the property registers. Adjudication for debt however has a subsidiary role as the diligence for attaching heritable property which cannot be registered in the property registers (such as leases for under 20 years so far as attachable) and certain types of moveable property for which no other diligence is competent, including most forms of intellectual property (e.g. patents and copyright).[31] The main proposal in our forthcoming Discussion Paper No 108 on *Attachment Orders and Money Attachments* will be the introduction of a new form of diligence, to be called an attachment order, to replace adjudication for debt as the residual diligence.

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[28] Proposals 26 and 27 at paras 3.136 and 3.141.
[29] Part 2, proposition 6.
[30] Part 2, proposition 8.
[31] These are not arrestable because there is no person liable to account to the debtor in respect of the property.

Time scale for consultation

1.19 In Part 5, we list the proposals and questions on which views are invited. We should be grateful if comments were submitted by 27 February 1999.

PART 2 INTRODUCTION OF LAND ATTACHMENT AND RELATED ISSUES

A. PRELIMINARY

2.1 In this Part, we seek views on a legislative scheme for introducing the new diligence of land attachment which we propose should replace adjudication for debt of heritable property registrable in the property registers. Detailed propositions for such a scheme, together with consequential reforms of sequestration and liquidation, are set out in Section B for comment and criticism. These are repeated in Appendix A together with an explanatory commentary.

2.2 We have reached firm decisions on the key matters mentioned at para 1.5 above namely:

* Adjudication for debt of property registrable in the property registers should be abolished.

* The new diligence of land attachment should take the form of an attachment followed by the remedy of sale (which the creditor may exercise relatively quickly) with foreclosure being available as a subsidiary and alternative remedy, authorised by the sheriff only in default of sale.

* The attachment would be effected, not by a Court of Session decree, but by a notice of land attachment registered by the creditor in the property registers in pursuance of a warrant contained in a court decree for payment or its equivalent.

We would however be grateful for views on any other matters.

2.3 In particular we would draw attention to the following points.

* should warrants be granted automatically in decrees of the ordinary courts and other tribunals? (See proposition 4(a) and (c)).

* should warrants for summary diligence include land attachment? See proposition 4(b).

* are safeguards for debtors and their families satisfactory? See e.g. propositions on time to pay orders (proposition 5) and the sheriff's powers to refuse or delay sale (proposition 11).

* should failure to post a copy of a notice of land attachment invalidate the diligence? See proposition 8(2))

* is the provision on attachment of a *pro indiviso* share of common property satisfactory? See proposition 10(2).

* are the provisions for attachment of a deceased debtor's property satisfactory? See propositions 22 and 23.

2.4 **Protection of faith of registers from creditors**. Section C makes provisional proposals for protecting persons transacting on the faith of the registers from land attachments, sequestrations and liquidations in the light of the recent decision of the House of Lords in *Sharp v Thomson*[1] and also proposals for regulating competitions between land attachments on the one hand and sequestrations and liquidations of the debtor on the other hand.

2.5 **Abolition of equalisation of adjudications**. Section D provisionally proposes the abolition of equalisation of the heritable diligences. The abolition of equalisation of adjudications for debt is a consequential of the abolition of that form of diligence. We propose that there should be no equalisation of land attachments but that there should be new provision for the cutting down of land attachments registered within 6 months before sequestration or liquidation.

2.6 **Attachment orders**. The replacement of adjudication for debt, in its application to heritable property not registrable in the property registers, by a new diligence to be called an attachment order will be proposed in our forthcoming Discussion Paper No 108 on *Attachment Orders and Money Attachments*.

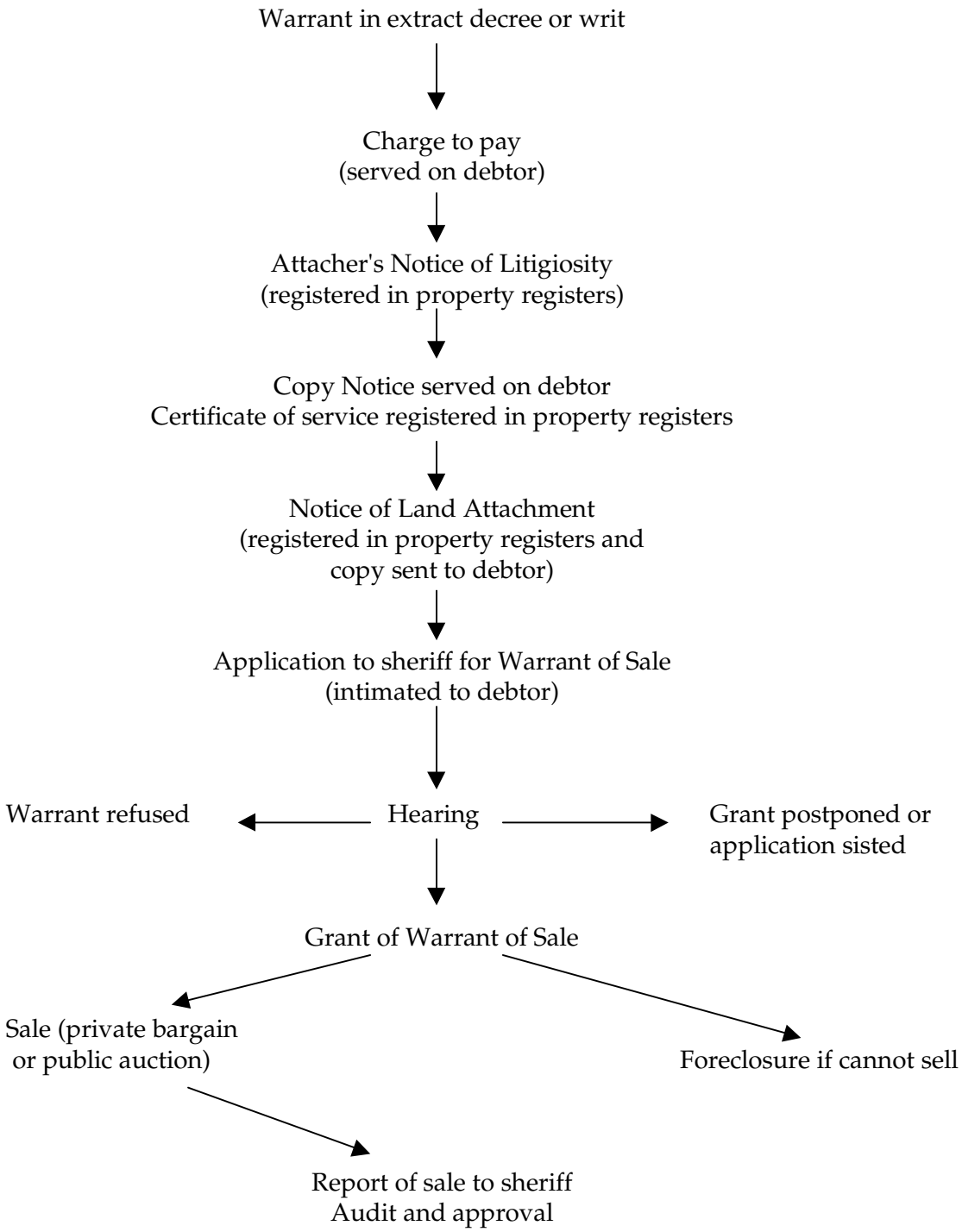
2.7 **Re-naming the Register of Inhibitions and Adjudications.** The Register of Inhibitions and Adjudications was created in 1924 by the amalgamation of the General Register of Inhibitions and Interdictions and the Register of Adjudications.[2] With the abolition of adjudications for debt, this name will cease to be suitable. We suggest that it should be re-named simply the Register of Inhibitions. In this paper we refer to it by its unofficial name, - "the personal register".

B. PROPOSITIONS FOR INTRODUCING LAND ATTACHMENTS OF REGISTRABLE HERITABLE PROPERTY ETC

2.8 In this Section we set out for comment and criticism detailed propositions for introducing land attachments, and related reforms of sequestration and liquidation.

[1] 1997 SC (HL) 66, reversing 1995 SC 455 (1st Div).
[2] Conveyancing (Scotland) Act 1924, s 44.

DIAGRAM OF MAIN STEPS IN LAND ATTACHMENT



SUMMARY OF PROPOSITIONS

(For a Table of Contents of propositions see Appendix A below).

CHAPTER I: LAND ATTACHMENT REPLACING ADJUDICATION FOR DEBT OF REGISTRABLE HERITABLE PROPERTY

(1) Introduction of new diligence of land attachment replacing adjudication for debt of registrable heritable property

1.(1) There should be a new diligence, to be known as land attachment and sale (or land attachment, for short) to enforce the payment of debt out of the proceeds of sale of heritable property belonging to a debtor whose title to the property is, at the date of execution of the land attachment, either registered in the property registers or capable of being so registered.

(2) A land attachment should be constituted as a real right attaching property by registration in the property registers of a document in a prescribed form, to be known as a notice of land attachment, and should be completed by a sale under the sheriff's warrant or by decree of foreclosure.

(3) In these propositions, the expression "attacher's notice of litigiosity" has reference to a document registrable in the property registers introduced by proposition 6 below.

(4) Adjudication for debt should:

(a) no longer be competent in cases where land attachment is competent; and

(b) should be abolished if attachment orders for the attachment of property not registrable in the property registers is introduced, as proposed in our forthcoming Discussion Paper No 108 on Attachment Orders and Money Attachments.

Right conferred on creditor by land attachment

2. The registration of a notice of land attachment should, as from the date of the registration, confer on the creditor a subordinate real right over the heritable property specified in the notice for securing payment to him of:

(a) the amount of the debt specified in the notice;

(b) accruing interest; and

(c) the expenses of the diligence in so far as chargeable against the debtor,

but subject to the claims of other creditors to be ranked and preferred as by law competent.

(2) Property attachable

3.(1) Heritable property attachable by land attachment should include a claim secured by a subordinate real right in security.

(2) The subordinate real rights attachable by land attachment should include:

(a) a lease registered in the property registers under the Registration of Leases (Scotland) Act 1857 or the Land Registration (Scotland) Act 1979; and

(b) an assignation in security of such a lease,

but should not include:

(i) a lease which, though registrable in the property registers under that Act, has not been so registered or an assignation in security of an unregistered lease;

(ii) a lease where assignation is excluded expressly or by implication;

(iii) a lease where assignation is excluded except with the landlord's consent, but we invite views on whether a clause providing that the landlord's consent should not be unreasonably withheld should be treated as excluding or permitting land attachment.

(3) For avoidance of doubt, it should be enacted that a land attachment should be treated as attaching property of the debtor where at the date of registration of the notice of land attachment:

(a) the debtor had previously granted and delivered a deed transferring the property to a third party; but

(b) the third party's title to the property has not been completed as a real right by registration of the deed in the property registers,

and accordingly in any competition between the attaching creditor and the third party, the debtor should not be treated as having been divested of his attachable right to the property by virtue of his delivery of the deed to the third party.

In this paragraph, a deed includes a disposition, an assignation, a translation of an assignation and any other divestitive deed.

(4) A land attachment enforcing a debt due by the debtor in his personal capacity should not attach property held by him in a different capacity, for example as trustee for any other person, and conversely a land attachment should not attach property held by the debtor in his personal capacity if it enforces a debt due by him in a different capacity.

(3) Attachment

Warrant for land attachment

4. A warrant for diligence in an extract of:

(a) a decree for the payment of money of the ordinary courts of law (Court of Session, High Court of Justiciary, Court of Teinds or a sheriff court);

(b) a document of debt registered for execution;

(c) an order of a court or tribunal deemed to have the same effect as a decree or extract registered writ;

(d) an order of a criminal court imposing a fine or other financial penalty or making a compensation order; or

(e) a liability order under the Child Support Act 1991,

should have the effect of authorising the creditor, among other things:

> *(i) to charge the debtor to pay the debt, interest and expenses within the days of charge on pain of attachment of land;*
>
> *(ii) after expiry of the days of charge without payment to register in the property registers an attacher's notice of litigiosity specifying the debtor's land affected by the litigiosity; and*
>
> *(iii) after the expiry of 14 days from the date of registration of the notice of litigiosity to register in the property registers a notice of land attachment over any land specified in the notice of litigiosity.*

Time to pay and preventing or freezing attachments

5.(1) An application for a time to pay order under the Debtors (Scotland) Act 1987 should be competent at any time after the service of a charge until the creditor's application for warrant to sell the attached land is granted. An interim order sisting diligence (section 6(3)) should prevent the creditor from taking further steps in the diligence, other than registering an attacher's notice of litigiosity, an inhibition or a notice of land attachment, and it should be incompetent for the court to grant a warrant to sell attached land and any pending application for warrant should fall.

(2) The making of a time to pay order should preclude the creditor from thereafter registering a notice of land attachment (but not an attacher's notice of litigiosity or an inhibition). If the creditor had registered a notice of land attachment before the sheriff made a time to pay order, the sheriff should be required to make an ancillary order prohibiting the creditor from taking any further steps in the diligence.

(3) While a time order under section 129 of the Consumer Credit Act 1974 is in effect, it should be incompetent to commence or continue diligence (other than registering an inhibition or an attacher's notice of litigiosity) against the individual concerned.

Attacher's notice of litigiosity

6.(1) After the days of charge have expired without payment, the creditor should be entitled to register in the property registers a document in a prescribed form to be known as an attacher's notice of litigiosity.

(2) An attacher's notice of litigiosity should:

> *(a) set out the names and designations of the creditor and debtor;*
>
> *(b) narrate the charge and its expiry without payment; and*
>
> *(c) specify the items of heritable property which the creditor proposes to attach by land attachment.*

(3) An attacher's notice of litigiosity should render litigious only those items and, subject to the reforms of inhibitions proposed in Part 3 of this Discussion Paper, should have the same effect as an inhibition restricted to those items.

(4) Unlike notices of litigiosity under the present law, an attacher's notice of litigiosity would not be registrable in the personal register.

(5) The attacher's notice of litigiosity should:

(a) be served on the debtor by an officer of court (messenger-at-arms or sheriff officer) whether before or after the date of registration of the notice; and

(b) take effect on the date of such registration, but if a certificate by the officer of court of service of the notice on the debtor has not been registered in the property registers within three weeks after that date, the notice should thereafter be deemed to be, and always to have been, void.

Mandatory delay between registration of notice of litigiosity and registration of land attachment

7. The registration of a notice of land attachment in the property registers should be effectual only if at the date of such registration:

(a) an attacher's notice of litigiosity specifying the attached property has been registered in the property registers at least 14 days before that date; and

(b) a certificate of service of the notice of litigiosity on the debtor is registered in the property registers, in accordance with proposition 6(5)(b) above, on or before that date.

Notice of land attachment

8.(1) The notice of land attachment should set out the names and designations of the creditor and debtor and specify:

(a) the decree or other document constituting the debt and containing the warrant for the diligence;

(b) the amount of the debt secured by the land attachment (principal sum, interest to date, the expenses of its registration and the preceding attacher's notice of litigiosity and of executing the prior charge, less payments to account); and

(c) the item or items of heritable property attached thereby, being all or part of the property specified in the notice of litigiosity.

(2) (a) At the same time as registering the notice of land attachment, the creditor should post a copy of the notice to the debtor at his last known address.

(b) The creditor's failure to post a copy should not invalidate the registration of the notice but, on such a failure, he should:

(i) not be entitled to recover his expenses of executing the diligence from the debtor except in so far as the court, on the creditor's application, otherwise orders; and

(ii) be liable to compensate the debtor for any patrimonial loss suffered by him as a direct and proximate consequence of the failure.

Other effects of land attachment

9. (1) After the notice of land attachment is registered, the sheriff on the creditor's application should have power to grant:

(a) authority to inspect the property attached, make any buildings safe or carry out emergency repairs;

(b) a warrant to eject any person occupying the property without title; and

(c) an order requiring the debtor's tenants of the attached property to pay their rents to the attaching creditor.

(2) A notice of land attachment should be deemed to contain an assignation to the creditor of titles, searches and unregistered conveyances.

(3) Registration of a notice of land attachment in respect of a moveable debt should not convert that debt into a heritable debt.

(4) The sale

Application for warrant of sale

10.(1) A creditor should not be entitled to sell the attached property unless a sheriff having jurisdiction over the place where any item or part of the attached heritable property is situated grants a warrant of sale. The sheriff clerk should fix a date for the hearing of the creditor's application at which the debtor, the creditor and other interested parties should be entitled to be heard.

(2) Where the attached property is a pro indiviso *share, the creditor should have a title to raise an action for division and sale which should be combined with proceedings in the diligence in a manner to be prescribed by rules of court, and the provisions on applications for warrant of sale proposed below should apply subject to those rules.*

Court's powers in an application for warrant of sale

11.(1) The sheriff should have power to refuse to grant a warrant of sale, of his own accord or on an objection by any interested person, on the ground that:

(a) the attachment is invalid or has ceased to have effect;

(b) the debt is disproportionately small in relation to the value of the attached land; or

(c) the net free proceeds of sale receivable by the attaching creditor are unlikely to exceed the expenses of sale.

(2) The sheriff should have power to refuse to grant a warrant of sale on an objection by the debtor's spouse if satisfied that the diligence was designed to defeat the spouse's occupancy rights under the Matrimonial Homes (Family Protection) (Scotland) Act 1981.

(3) The sheriff should have power, on an objection by any interested person, to refuse to grant a warrant of sale or to postpone the grant for a specified period not exceeding 12 months on the ground that a sale of the attached land would be unduly harsh in the circumstances.

(4) The sheriff should have power, on an objection by any interested person, to postpone the grant of a warrant of sale:

(a) for up to 12 months, where the property attached comprises or includes the principal or only residence of the debtor and one or more close relatives of the debtor; or, as the case may be,

(b) for up to 6 months, where the property attached comprises or includes the principal or only residence of one or more individuals, except where they occupy under a right, such as a lease or a liferent, which is binding on the creditor.

In sub-paragraph (a), the expression "close relative" has reference to a spouse, a child of the debtor or his spouse, or a child treated by the debtor as such a child.

(5) The sheriff should have power to refuse or to sist the application where another creditor has already been granted a warrant of sale, or intends to exercise a power of sale, of the attached land.

The warrant of sale

12.(1) Unless the sheriff otherwise directs, the grant of a warrant of sale should terminate the debtor's right to occupy the attached heritable property.

(2) The sheriff on granting warrant of sale should have power:

(a) to authorise the creditor to sell the attached property in lots or to sell part of the property and to sist the application as regards the remainder;

(b) to grant a warrant for ejection, on a 14 days' notice, of the debtor and any other occupiers (except those whose rights of occupation are effective against the creditor) from the attached property; and

(c) to grant ancillary orders in relation to the sale.

Conduct of the sale and the purchaser's title

13.(1) A creditor should be entitled, unless the sheriff orders otherwise, to sell the attached heritable property by private bargain or public auction after due advertisement. The creditor should be under a general duty to take all reasonable steps to ensure that the sale price is the best that can reasonably be obtained.

(2) An attachment and sale should be valid notwithstanding that the debtor and any other person to whom intimation has to be made is in nonage or under legal disability.

(3) The creditor should have a title, by virtue of the sheriff's warrant, to grant a disposition in favour of the purchaser in implement of the contract of sale. The disposition should be deemed to include an assignation by the debtor to the purchaser of all obligations of warrandice owed to the debtor and an obligation by the creditor of warrandice from his own facts and deeds. The creditor's right to the writs under proposition 9 would be assigned under the Land Registration (Scotland) Act 1979, s 16.

(4) A disposition by the creditor in favour of the purchaser, which bears to be in implement of the warrant of sale, should not be reducible on the ground of any latent error or irregularity in the diligence, provided that the warrant of sale and evidence of due advertisement were produced and were apparently in order.

Disburdenment of purchaser's title and ranking on proceeds of sale

14.(1) Registration of the purchaser's disposition in the property registers should have the effect of disburdening the heritable property disponed of the selling creditor's land attachment and all other rights and preferences ranking pari passu *with or postponed to that attachment, but not of any right or preference ranking prior to it.*

(2) The proceeds of sale should be applied to meet the following debts in the following order:

(a) the creditor's expenses in connection with the sale and any attempted sale incurred after the granting of the warrant of sale;

(b) the sums due to the creditors holding prior securities, attachments or diligences, except the amount due under a prior security which is not redeemed;

(c) the amount due to the attaching creditor (less the expenses in (a)), or where there are pari passu *attachments, diligences and securities the sums due to the attaching creditor and the others in their due proportions; and*

(d) the sums due to creditors with attachments, diligences or securities postponed to that of the attaching creditor, in accordance with their rankings.

Report of sale

15.(1) The creditor executing a warrant of sale should be required to submit to the sheriff a report on sale and diligence expenses in prescribed form within 28 days of the date of settlement of the sale.

(2) The sheriff should have power to make an order imposing on a creditor, who makes a report late without reasonable excuse or refuses to make a report, liability in whole or in part for the expenses of attachment otherwise chargeable against the debtor.

(3) The report of sale should be remitted by the sheriff to the auditor of court who should:

(a) tax the expenses chargeable against the debtor;

(b) certify the balance due to or by the debtor; and

(c) report to the sheriff,

after giving interested persons an opportunity to make representations on any alteration of the expenses or balance.

(4) On receiving the auditor's report, the sheriff, after giving interested persons an opportunity to be heard, should have power:

(a) to declare the above-mentioned balance to be due to or by the debtor, with or without modifications; or

(b) if the sheriff is satisfied that there has been a substantial irregularity in the diligence to declare the diligence to be void and make consequential orders.

Foreclosure

16.(1) A creditor who fails to sell the attached heritable property by public auction, or parts by private bargain and the rest by public auction, for sufficient to pay off the debt and prior and pari passu *creditors' rights and preferences, should be entitled to apply to the sheriff court which granted the warrant of sale for a decree of foreclosure.*

(2) The sheriff, after ordering such intimation and enquiry as seems fit and giving the applicant, the debtor and other creditors an opportunity to be heard, should have power:

(a) to sist the application for up to 3 months;

(b) to order the unsold property to be auctioned with a reserve price, or to be re-advertised for sale at that fixed price and if still unsold auctioned at that reserve price. The creditor should be entitled to bid and buy at the auction; and

(c) to grant decree of foreclosure, either immediately or in the event that the property remains unsold.

(3) Registration of the decree in the property registers should:

(a) extinguish the debtor's right to bring the attachment to an end by paying the debt;

(b) vest the creditor in the heritable property described at the upset price at which it was last auctioned; and

(c) disburden the property of the creditor's attachment and all postponed rights and preferences.

(5) Liability for diligence expenses

17.(1) The expenses properly incurred by a creditor in executing the diligence of land attachment should be chargeable against the debtor. The expenses should, unless paid by the debtor, be recoverable from the proceeds of the attachment concerned but (apart from the expenses of the charge) not by any other legal process except supervening insolvency processes or processes of ranking creditors' claims on the attached land.

(2) Any expenses not recovered by the time when the diligence is completed or ceases to have effect should cease to be chargeable against the debtor, except as aforesaid.

(3) Each party should bear his own expenses in relation to incidental court applications, but the debtor should be liable for the expenses of an application for warrant to sell on the basis that it was unopposed and the court should be empowered to award expenses not exceeding a prescribed sum if an application or an objection was frivolous.

(6) Transmission and termination of land attachments

Assignation of debt

18. An assignation of the debt should carry with it the benefit of steps in the diligence of land attachment already taken by the cedent in relation to that debt.

Duration of land attachment

19.(1) A notice of land attachment should cease to have effect on the expiry of a period of five years after the date of its registration.

(2) The creditor should be entitled not earlier than two months before the end of this period to extend the period for a further five years by registering a document in a prescribed form to be known as a notice of extension. More than one extension should be competent.

Termination of attachment by payment

20. The debtor should be entitled, at any time up to the conclusion of the contract of sale or the registration of a decree of foreclosure, to bring a land attachment to an end by paying or tendering the full amount (including expenses chargeable against the debtor) due to the creditor.

Discharge, recall and restriction

21.(1) A land attachment may be discharged or restricted by the creditor.

(2) A land attachment may be recalled or restricted by the sheriff on the ground that:

(a) the warrant is invalid in whole or in part;

(b) the execution of the diligence is irregular or incompetent; or

(c) the diligence has ceased to have effect.

Debtor's death before registration of land attachment

22.(1) A notice of land attachment registered after the death of the debtor in pursuance of a warrant contained in an extract of a decree or registered writ against the debtor should be ineffectual.

(2) Where an executor has confirmed to the estate of a deceased debtor, a creditor of the deceased should constitute his debt by decree for payment against the executor as under the present law and be entitled to do diligence under the decree against the executry estate in the normal way.

(3) Where no executor has confirmed to the estate of a deceased debtor, it should cease to be competent for the deceased's creditor to confirm as executor-creditor to the deceased debtor's heritable property, and land attachment should be competent as mentioned in the following paragraphs.

(4) Where on the expiry of six months after a debtor's death, the succession to his estate is vacant (i.e. no executor has confirmed to his estate and either no person has succeeded to the deceased's heritable property by virtue of a special destination or such a person has renounced his succession), a creditor of the deceased should be entitled to raise an action in the sheriff court of constitution of the debt and declarator of the extent of the debt due by the deceased to the pursuer (traditionally known as an action of constitution cognitionis causa tantum*). Decree in the action should grant warrant for land attachment in place of an action of adjudication for debt* contra haereditatem jacentem *(attaching the heritable property in the vacant succession by adjudication) which should cease to be competent. Provision should be made by rules of court adapting the statutory procedure in land attachment to the case of a vacant succession, including provision conferring powers on the sheriff to make ancillary orders dispensing with or modifying steps in that procedure.*

(5) With respect to special destinations, we confirm the two following recommendations made in a previous report. [3]

(a) A person who succeeds to heritable property by virtue of a special destination should be personally liable for the debts of the previous owner, unless the person renounces the

[3] Report on *Succession* (1990) Scot Law Com No 124.

succession. This liability should be limited to the value of the property at the date of the previous owner's death.[4]

(b) A destination in an assignation of a lease where assignation is permitted without the consent of the landlord should, so far as the rights of creditors of the assignees are concerned, have the same effect as the same destination in a disposition of feudal property.[5] *This paragraph is subject to proposition 3(2) above.*

A creditor of the deceased should be entitled to raise an action of declarator of the value of the property passing under the special destination, to constitute his debt by decree for payment against the person succeeding under the special destination and to do diligence under the decree against the person's attachable property in the normal way.

(6) A land attachment which is:

(a) used by the creditor of a deceased against the deceased's heritable property passing under a special destination; and

(b) registered within one year of the debtor's death,

should have priority in ranking over a land attachment against the property previously registered by a creditor of the person succeeding under the special destination.

Debtor's death after registration of land attachment

23. A creditor who had registered a notice of land attachment prior to the debtor's death should be entitled to proceed with the diligence. Provision should be made by rules of court adapting the statutory procedure in the diligence to that case, including provision conferring powers on the sheriff to make ancillary orders dispensing with or modifying steps in that procedure.

(7) Miscellaneous

Ascription of payments to account during land attachment

24. Sums paid while a land attachment is in effect and the proceeds of an attachment should be ascribed first to expenses, secondly to interest accrued to the date of registration of the notice of land attachment and lastly to the principal sum together with any further interest.

Transitional provisions

25.(1) An extract of a decree or other writ bearing a warrant for execution should be deemed to include a warrant for land attachment whether the extract was issued before or after commencement.

(2) It should be incompetent after commencement to bring an action of adjudication for debt. Actions of adjudication which are pending at commencement should proceed according to the existing law. The existing law should also continue to apply to decrees of adjudication granted prior to commencement.

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[4] *Ibid*, recommendation 29 (para 6.16).
[5] *Ibid*, recommendation 33 (para 6.29).

(3) Adjudications which had been equalised before commencement should remain equalised, but an adjudication granted after commencement should not be equalised with any pre-commencement adjudication. Attachments should not be equalised with adjudications.

(4) An adjudication registered within 6 months before a post-commencement sequestration or liquidation should be ineffectual to create a preference for the adjudger, whether the adjudication was registered before or after commencement.

CHAPTER II: ABOLITION OF EQUALISATION OF HERITABLE DILIGENCES

26.(1) The following statutory provisions should be repealed, namely:

(a) the Diligence Act 1661 (which makes provision for the pari passu *ranking of adjudications led within a year and a day of the first effectual adjudication); and*

(b) in the Bankruptcy (Scotland) Act 1985, s 37(1), paragraph (a) (which provides that in relation to diligence the order awarding sequestration has the effect of a decree of adjudication for debt duly recorded in the personal register).

(2) No similar provision should be made for the equalisation of land attachments.

CHAPTER III: CONSEQUENTIAL AMENDMENTS OF LAW ON SEQUESTRATION AND LIQUIDATION

(1) Protection of faith of registers from sequestration and liquidation

Sequestration: litigiosity and certified copy of first order

27.(1) The Bankruptcy (Scotland) Act 1985, section 14(2), should continue to provide that the recording in the personal register under section 14(1)(a) of a certified copy of the first order (i.e. the relevant court order within the meaning of that section awarding sequestration or granting warrant for citation of the debtor under section 12(2)) should have the effect, as from the date of sequestration, of an inhibition at the instance of the creditors who subsequently have claims in the sequestration accepted under section 49.

(2) The reference in section 14(2) to a citation in an adjudication of the debtor's heritable estate at the instance of those creditors should be repealed.

Sequestration: vesting of estate in permanent trustee and protection of the faith of the registers

28.(1) Subject to amendments proposed below, the Bankruptcy (Scotland) Act 1985, section 31(1), should continue to provide that the whole estate of the debtor shall vest in the permanent trustee as at the date of sequestration for the benefit of the creditors, and that:

(a) the estate should so vest by virtue of the act and warrant issued on confirmation of the permanent trustee's appointment; and

(b) the act and warrant should, in respect of the debtor's heritable estate in Scotland, have the same effect as if a decree of adjudication in implement of sale had been pronounced in favour of the permanent trustee.

(2) The reference in section 31(1)(b) of the 1985 Act to the act and warrant having effect also as if "a decree of adjudication for payment and in security of debt, subject to no legal reversion" had been pronounced, should be repealed.

(3) For avoidance of doubt, the 1985 Act should be amended to make it clear that the expression "the whole estate of the debtor" occurring in section 31(1) includes property of the debtor where at the date of sequestration:

> *(a) the debtor has previously granted and delivered a deed transferring or assigning the property to a third party ; but*
>
> *(b) the third party's title to the property has not been completed as a real right by registration of the deed in the property registers,*

and accordingly in any competition between the permanent trustee in the sequestration and the third party, the debtor should not be treated as having been divested of his attachable right to the property by virtue of his delivery of the deed to the third party.

(4) The registration in the property registers of any notice of title or other deed by which the permanent trustee:

> *(a) completes title to heritable property of the debtor in Scotland in his own name or in the name of the debtor for the benefit of the creditors in the sequestration; or*
>
> *(b) conveys such property to another person,*

before the expiry of a period of 14 days after the date of recording in the personal register of the first order under section 14(1)(a) of the 1985 Act, should be treated as ineffectual.

(5) The 1985 Act, section 32(9)(b) should be amended to ensure that section 32(8) (bar against dealing of debtor relating to his estate when vested in the permanent trustee) does not render ineffectual in a question with the permanent trustee any dealing, after the date of sequestration and before the registration under section 14(1)(a) of the first order in the personal register, by which the debtor delivers a deed transferring or assigning heritable property to a purchaser for value who at the time of delivery is unaware of the sequestration and had at that time no reason to believe that the debtor's estate was sequestrated or was the subject of sequestration proceedings.

(6) As under the existing law, the heritable property of the debtor should vest in the permanent trustee tantum et tale *as it stood vested in the debtor on the date of sequestration.*

Publication of statutory avoidance of disposition of heritable property in winding up of company by the court

29.(1) Section 127 of the Insolvency Act 1986 (which provides that a disposition of a company's property made after the commencement of its winding up is void unless the court orders otherwise) should be amended to provide that any disposition (within the meaning of section 127) of a company's heritable property in Scotland is void under the section only if it is made after the date when the fact of the commencement of the winding up first appears in the register of companies.

(2) Unless the court otherwise directs, the first order in a petition to the Court of Session or a sheriff court for the winding up of a company should include a direction to the clerk of the court forthwith to give notice in the prescribed form to the registrar of companies of the presentation of the petition.

Liquidation and protection of the faith of the registers

30.(1) The registration in the property registers of any notice of title or other deed by which the liquidator:

> *(a) completes title to heritable property of the company in Scotland in his own name or in the name of the company; or*
>
> *(b) conveys such property to another person,*

before the expiry of a period of 14 days after the date when the fact of the commencement of the winding up first appears in the register of companies should be treated as ineffectual.

(2) It should be made clear by statute that, in the case of a winding up by the court, the property of the company, over which the functions of the liquidator under the Insolvency Act 1986, sections 143(1), 144, 145 and Schedule 4 are exercisable, includes property which the company has disponed to a third party by a delivered deed but of which the company has not been divested by registration of the deed in the property registers. The liquidator's functions include getting in and realising the company's assets; taking property into his custody or under his control; obtaining a court order vesting property belonging to the company in him; recovery of property; powers of sale; and powers to execute deeds.

(3) A liquidator's powers over the company's property should be subject to the same qualifications as are imposed by the principle of tantum et tale *on the company's right on the date of the commencement of the winding up.*

(2) Cutting down, stoppage and ranking of land attachment on debtor's sequestration or liquidation

Cutting down and stoppage of land attachment on sequestration of debtor's estate

31.(1) No land attachment of a debtor's property registered:

> *(a) within the period of 6 months before the date of sequestration and whether or not subsisting at that date; or*
>
> *(b) on or after that date,*

should be effectual to create a preference for the attaching creditor (in a question with the permanent trustee),

(2) A creditor whose land attachment is registered within the above-mentioned period of 6 months should be entitled to payment, out of the proceeds of sale of the attached property, of the expenses incurred:

> *(a) in obtaining the extract of the decree or other document containing the warrant for land attachment;*
>
> *(b) in executing a charge to pay and steps in the diligence of land attachment; and*
>
> *(c) in taking any further necessary action in respect of the land attachment.*

Further provision: exceptions to stoppage of land attachment on sequestration

32.(1) On or after the date of sequestration of a debtor's estate, it should not be competent for a creditor:

(a) to register a notice of land attachment in the property registers; or

(b) to proceed with a diligence of land attachment already begun unless a contract of sale of the subjects has been concluded in exercise of the attaching creditor's power of sale or unless decree of foreclosure has been granted.

Section 37(8) of the Bankruptcy (Scotland) Act 1985 should be amended accordingly.

(2) On the date of sequestration of a debtor's estate, property belonging to the debtor which has been attached by land attachment should not vest in the permanent trustee if before that date:

(a) the property has been sold by the attaching creditor in implement of his power of sale and the debtor has been divested by the purchaser completing title by registration in the property registers; or

(b) decree of foreclosure has been granted in favour of the attaching creditor.

(3) (a) Where the attaching creditor, in exercise of his power of sale, has concluded a contract of sale of attached subjects which thereafter vest in the permanent trustee at the date of sequestration, the permanent trustee should be bound to concur in or to ratify the attaching creditor's disposition implementing the sale.

(b) Where the land attachment was registered before the commencement of the period of 6 months prior to the date of sequestration (and is thus not rendered ineffectual in a question with the permanent trustee in terms of proposition 31), the attaching creditor should be bound to account for and pay to the permanent trustee the net free proceeds of the sale after satisfying his own debt and diligence expenses, and any prior or pari passu *debt and expenses.*

(c) Where the land attachment was registered within the period of 6 months prior to the date of sequestration (and is thus rendered ineffectual in a question with the permanent trustee in terms of proposition 31), the attaching creditor should be bound to pay the whole proceeds of sale to the permanent trustee, under deduction of his diligence expenses.

(4) If the contract of sale is terminated before the attaching creditor's disposition is delivered to the purchaser, the permanent trustee should have power to sell the attached subjects with the attaching creditor's consent or, failing such consent, the authority of the court.

Cutting down and stoppage of land attachment on liquidation

33.(1) No land attachment of the property of a company registered:

(a) within the period of 6 months before the date of the court order for winding up of the company and whether or not subsisting at that date; or

(b) on or after that date,

should be effectual to create a preference for the attaching creditor (in a question with the liquidator).

(2) A creditor whose land attachment is registered within the above-mentioned period of 6 months should be entitled to payment, out of the attached property or the proceeds of its sale, of the expenses incurred:

(a) in obtaining the extract of the decree or other document containing the warrant for land attachment;

(b) in executing a charge to pay and steps in the diligence of land attachment; and

(c) in taking any further necessary action in respect of the land attachment.

Further provision: exceptions to stoppage of land attachment on liquidation

34.(1) On or after the date of commencement of winding up of the company, it should not be competent for a creditor:

(a) to register a notice of land attachment in the property registers; or

(b) to proceed with a diligence of land attachment already begun unless a contract of sale of the attached subjects has been concluded in implement of the attaching creditor's power of sale or unless decree of foreclosure had been granted.

Section 185 of the Insolvency Act 1986 should be amended accordingly.

(2) On the date of commencement of the winding up of a company, property belonging to the company which has been attached by land attachment should not be subject to the powers of the liquidator if before that date:

(a) the property has been sold by the attaching creditor in implement of his power of sale and the company has been divested by the purchaser completing title by registration in the property registers; or

(b) decree of foreclosure has been granted in favour of the attaching creditor.

(3) Where the attaching creditor has concluded a contract of sale of the attached subjects before the date of commencement of the winding up, proposition 32(3) above should apply with any necessary modifications.

(4) If the contract of sale is terminated before the attaching creditor's disposition is delivered to the purchaser, the liquidator should have power to sell the attached subjects with the attaching creditor's consent or, failing such consent, the authority of the court.

2.9

1. Views are invited on the foregoing propositions for introducing land attachments and for making consequential reforms of the law on sequestration and liquidation.

C. PROTECTING THE FAITH OF THE REGISTERS FROM LAND ATTACHMENTS, SEQUESTRATIONS AND LIQUIDATIONS

(1) Preliminary

2.10 Since at least the Real Rights Act 1693, the general rule has been that priority of right in ranking on heritable property depends on priority of registration in the property registers. Conform to this rule, in a competition between an adjudger and the debtor's disponee, there is no doubt that the criterion of priority[6] in the adjudication is the date of its registration in the property registers. In principle, in the proposed land attachment, the criterion of priority should likewise be the date of registration of the notice of land attachment. Until the recent decision of the House of Lords in *Sharp v Thomson*,[7] the predominant view was that a competing adjudication and disposition should be treated as independent rights running a race to complete title by registration.[8] In other words there is a "race to the register" between a debtor's disponee and his adjudging creditor, his trustee in sequestration or, if the debtor is a company, its liquidator. As a result of that case, however, doubts have arisen as to what is the correct point in a conveyancing transaction at which a person taking a title from a debtor (such as the debtor's disponee, heritable creditor, or lessee or assignee in a registrable lease) acquires a right which will have priority over a subsequently registered adjudication or a subsequent sequestration or liquidation (equivalent to a deemed adjudication).

2.11 ***Sharp v Thomson.*** In *Sharp v Thomson*, the Thomsons (a brother and sister) concluded missives to buy a house from Albyn Construction Ltd. They took entry on 12 June 1989 but (in a departure from good conveyancing practice) did not receive delivery of a disposition until more than a year later, 9 August 1990. It is not clear when the price was paid but it had certainly been paid by the date of delivery of the disposition. On the following day, 10 August 1990, the Bank of Scotland, who held a floating charge over Albyn Construction Ltd's whole "property and undertaking", appointed a receiver and the floating charge crystallised.[9] The disposition was not recorded in the Sasine Register until 21 August 1990.

2.12 The legal issue in *Sharp v Thomson* was whether the floating charge attached to the house at the time when the charge crystallised which was after delivery of the disposition and before the purchasers registered their disposition. That depended on whether at that time the house was comprised in Albyn Construction Ltd's "property and undertaking" within the meaning of the Companies Act 1985, s 462(1).[10] The Lord Ordinary and the First Division of the Court of Session held that ownership did not pass from the seller to the purchasers until the registration of their disposition, and accordingly that at the stage of delivery of a disposition, the house was still comprised in the company's "property and undertaking". The House of Lords however held that the word "property" was not a

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[6] Ie the point of time, or the step in the procedure, at which the law gives priority in ranking, called by American lawyers "the priority point" and by Graham Stewart "the criterion of preference".

[7] 1997 SC (HL) 66, reversing 1995 SC 455 (1st Div).

[8] See para 2.18 below.

[9] Normally the purchasers would have been protected against receivership by a certificate of non-crystallisation. But the certificate granted to the Thomsons expired long before crystallisation and no new certificate had been obtained by the Thomsons' solicitors to protect them.

[10] And the instrument creating the charge. The 1985 Act, s 462 (1) confers power on a company to create in favour of a creditor a floating charge "over all or any part of the property... which may from time to time be comprised in its property and undertaking".

technical legal expression and that the words "property and undertaking" had to be construed in a practical and realistic way as meaning property which was available for use of the company, in which it had a beneficial interest and which it was in law entitled to dispose or to encumber with a heritable security. The House of Lords further held that at the time when the floating charge crystallised, the company held the recorded title but had no beneficial interest in the property and that the ability to grant deeds in fraud of the disposition to the purchasers did not amount to a right of property in law. Their Lordships therefore decided that, since the floating charges legislation made available as security only property in which the company had a beneficial interest,[11] and the company had no such interest in the house at the date of crystallisation, the floating charge did not attach thereto.

(2) Defining the problem

2.13 How the law reformer defines the problem raised by *Sharp v Thomson* will to some extent determine the legislative solution. At one level, the problem in *Sharp v Thomson* is that where in an ordinary conveyancing transaction relating to heritable property, a disponee obtains delivery of a disposition at settlement in exchange for the price, but a creditor of the disponer completes title by registration first, the disponee may suffer a double loss; he stands to lose both the property purchased and the price paid for it. At least that seems to be how the House of Lords characterised the problem.[12]

2.14 The House of Lords took little account of the fact that the ordinary rules of good conveyancing practice - which are specifically designed to avoid the disaster which befell the Thomsons - were flouted. The purchasers' money was paid without taking a title or security in exchange and over a year was allowed to elapse before a title was delivered and registered. Laxity by solicitors in following conveyancing procedures is apt to produce unjust results for their clients. The law's response is generally to give the clients a remedy against the solicitors. The rules of property law and of good conveyancing practice cannot protect purchasers whose solicitors do not conform to those rules. Even the solution in *Sharp v Thomson*, for example, will not protect purchasers who pay the price before delivery of the disposition where competing creditors complete title before delivery.[13] If in *Sharp v Thomson*, for example, the floating charge had attached on 8 August rather than on 10 August (i.e. the day before the date of delivery of the disposition rather than the day after that date), the floating charge would have attached to the property.

2.15 The case raises an important question as to how best to enable persons transacting on the faith of the registers, who observe the requirements of good conveyancing practice, either to complete title safe from the threat of competing floating charges and unsecured creditors' remedies (heritable diligences, sequestration and liquidation) or, if the threat materialises, to withdraw timeously from the transaction. So viewed, the nature and extent of the problem is not serious but confined mainly to floating charges. Some fundamental criticisms of our law on completion of title however were made in *Sharp v Thomson:* we revert to these below.[14]

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[11] Insolvency Act 1986 s 53(7): "On the appointment of a receiver under this section, the floating charge by virtue of which he was appointed attaches to the property then subject to the charge ; and such attachment has effect as if the charge was a fixed security over the property to which it has attached".
[12] 1997 SC (HL) 66 at p 70 per Lord Jauncey; at p 82 per Lord Clyde.
[13] *Gibson v Hunter Home Designs Ltd* 1976 SC 23.
[14] See paras 2.24-2.28.

(3) The race to the registers

2.16 Until the decision of the House of Lords in that case, with few exceptions,[15] priority of right in ranking on heritable property depended on priority of registration in the property registers.[16] There was "a race to the register" between a debtor's disponee and his adjudging creditor, trustee in sequestration or liquidator as the case might be. Although it has sometimes been questioned whether there is a race to the register between a disponee and a trustee in sequestration or liquidator, virtually all commentators accept the existence of a race to the register between a heritable creditor and a trustee in sequestration or liquidator.[17] It appears that the great weight of authority supports (or at least before *Sharp v Thomson* supported) a race to the register between on the one hand disponees or heritable creditors and, on the other hand, adjudgers, trustees in sequestration or liquidators.[18] Moreover, as we note below, the draftsman of the Bankruptcy (Scotland) Act 1985, s31(1)(b) sought to preserve the race. In *Sharp v Thomson*, which concerned a competition between a disponee holding a delivered but unregistered disposition and an attached floating charge (equivalent to a registered heritable security), it was held that the delivery of the debtor's disposition invested the disponee, and divested the debtor, of any "beneficial interest" in the property disponed and that the debtor's "beneficial interest" took priority over the subsequently attached floating charge.

2.17 Previously the concept of "beneficial interest" had been largely confined to ranking competitions involving trusts.[19] It had never been applied to cases where two or more independent rights run a race to complete title (whether by registration in the case of land or intimation or registration in the case of incorporeal moveables). The rule that delivery (*traditio*) is required for transfer of ownership[20] applies to the transfer of land as well as

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[15] Eg the anomalous exception in the Insolvency Act 1986, s 60 (1). For criticism, see Scot Law Com No 164 (1998), paras 9.59 - 9.69; Discussion Paper No 78 (1988) vol 2, para 6.44.

[16] Ignoring specialities such as preferences created by inhibitions or by subordination agreements and the like.

[17] See eg A J McDonald, "Bankruptcy, Liquidation and Receivership and the Race to the Register" (1985) 30 JLSS 20 at pp 23,24; and conclusion 1 on p 24.

[18] See eg *Bell v Garthshore* (or *Gartshore*) (1737) Mor 2848, 2 Ross L C 410; *Mitchells v Ferguson* (1781) Mor 10296; Hailes 879; 3 Ross L C 120 (the pleadings in this case show that the debtor's disposition was delivered to a third party who, after payment of the price, held it for the disponee and accordingly it concerned a competition between an adjudger and a disponee holding a delivered but unregistered disposition); *Marshall v Wight* (1782) Mor 6927 (explained Hume, *Lectures* vol IV p 453); *Buchan v Farquharson* (1797) Mor 2905; *Gordon v Rae* (1822) 2 S 78; *Cormack v Anderson* (1829) 7 S 868; *Mansfield v Walker's Trs* (1835) 1 S & McL 203 at p 338 per Lord Brougham; *Viscount Melville v Paterson* (1842) 4 D 1311 at p1315 per Lord Ivory; *Lindsay v Giles* (1844) 6 D 771; *Boyes v Laurie* (1854) 16 D 860; *Smith v Frier* (1857) 19 D 384; *Tod's Trs v Wilson* (1869) 7 M 1100; *Morrison v Harrison* (1876) 3 R 406; *Clark v West Calder Oil Co* (1882) 9 R 1017; *Moncreiff's Tr v Balfour* 1928 SN 64 and 139; *Gibson v Hunter Home Designs Ltd (In Liquidation)* 1976 SC 23 at p 30 per Lord Cameron; Bankton, *Institute* III, 2,54; Erskine, *Institute* II,12,23; Hume, *Lectures* vol IV pp 182,183; p 452; Bell, *Commentaries* (7th edn) vol 2, p 338; G J Bell, *Commentaries on the Recent Statutes relative to Diligence etc* (1840) p 168; W Alexander, *Digest of the Bankrupt Act for Scotland 2 & 3 Vict. c.12* (1st edn;1839) pp 97,98; W Alexander, *Digest of the Bankruptcy (Scotland) Act, 1856* (1856) pp 150,151; A Montgomerie Bell, *Lectures on Conveyancing* vol 2 (3d edn; 1882) p 1192; Graham Stewart, *Diligence* (1898) pp 620,621; 635; Goudy, *Bankruptcy* (4th edn; 1914) pp 256,257; W Wallace, *Law of Bankruptcy in Scotland* (2d edn; 1914) pp 238,239; *Stair Memorial Encyclopaedia*, vol 8 (1992) s v "Diligence" para 209, note 1 (G L Gretton); ibid , vol 18 (1993) para 648 (K G C Reid); McBryde, *Bankruptcy* (2d edn; 1995) para 9-17 to 9-23; Wilson and Forte (eds), *Gloag and Henderson, The Law of Scotland* (10th edn; 1995) para 54.24. Contrary authorities generally related to jurisdiction or revenue law where different policy considerations apply.

[19] *Heritable Reversionary Co v Millar* (1892) 19 R (HL) 43, rev (1891) 18 R 1166.

[20] The brocard is *"traditionibus non nudis pactis dominia rerum transferuntur"* (by delivery not bare contract the ownership of things is transferred").

moveable property.[21] The culmination of centuries of development was that, in the modern law, for this purpose "delivery" of land means "registration of the document of transfer delivered to the transferee".[22] In *Sharp v Thomson*, however, this basic rule was taken to mean delivery of the document of transfer.[23] The difference is crucial.

2.18 Scots law draws a contrast between personal rights against a debtor which are treated as inherent qualifications of the debtor's real right[24] and personal rights against him which are steps towards the transfer by him of a real right.[25] While the former prevail over a creditor's real right, the latter do not. A classic affirmation of this distinction was made by Lord Kinloch in *Tod's Trs v Wilson*[26] who referred to*:*

> "the doctrine as to the trustee in a sequestration taking the bankrupt estate *tantum et tale* as it stood in the bankrupt. However this doctrine may apply in the case of rights held by the bankrupt under inherent qualifications, which are taken over by the trustee, it has no place whatever where there is a competition between the sequestration, on the one hand, and an assignation by the bankrupt on the other. These are simply two independent rights running a race against each other; and to apply the doctrine as contended for would be to give every unintimated assignation of any portion of the sequestrated estate a preference over the sequestration".

Heritable Reversionary Co v Millar[27] extended *tantum et tale* to latent trusts of registered heritable property but at the same time marginalised *tantum et tale* in competitions between latent trusts and sequestration creditors and instead based the priority of a latent trust on the concept of "beneficial interest". Nevertheless *Millar* did not involve a race to complete title and, since it was construed as confined to latent trusts, the concept of beneficial interest had similar practical effects to *tantum et tale* as applied to latent trusts. Potentially the effect of *Sharp v Thomson* is much more revolutionary. It extends the concept of "beneficial interest" outside trusts to at least one type of case where two independent rights, the floating charge and the disposition, run a race against each other.

2.19 The revolutionary potential of the case lies in this, that if the concept of beneficial interest extends to one type of race to complete title, why not to all races to complete title? In principle, there is no material difference.[28] The consequences for Scottish property law of such an extension, if it were to occur, would be far-reaching. It seems that there is now

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[21] The history is traced briefly in W M Gordon, *Studies in the Transfer of Property by Traditio* (1970) pp 222 - 236, and more fully in *Stair Memorial Encyclopaedia* vol 18, paras 87 - 93. On the development of the building blocks of property law, see also *Sharp v Thomson* 1995 SC 455 at pp 461 - 468 per Lord President Hope; at pp 482 - 484 per Lord Sutherland; at pp 488 - 504 per Lord Coulsfield.

[22] Gordon , *ibid*, p 236; *Sharp v Thomson* 1995 SC 455 at p 461 per Lord President Hope.

[23] 1997 SC (HL) 66 at p 71 per Lord Jauncey, citing J M Halliday, *Conveyancing Law and Practice* (2d edn; 1996), vol 1, para 1-13, which cites *Thomas v Lord Advocate* 1953 SC 151, a case (in which the brocard is not mentioned) on estate duty legislation.

[24] Eg the right of a beneficiary under a trust or a right to reduce a transfer to the bankrupt on the ground of fraud.

[25] Eg the delivery of a disposition to a disponee as a step towards his acquisition of a real right by registration in the property registers; or the delivery of an assignation as a step towards his acquisition of a real right by intimation.

[26] (1869) 7 M 1100 at p 1103 giving the opinion of the court.

[27] (1892) 19 R(HL) 43.

[28] Although the reasoning of the speeches of the House of Lords only applies to divestitive deeds: see para 2.31, head (1) below.

uncertainty in the legal profession as to the implications of the decision.[29] Practitioners are finding it difficult to advise clients with confidence.

(4) The law reform context

2.20 The task of the law reformer is to remove this uncertainty, while at the same time curing (to the extent necessary) the mischief identified in *Sharp v Thomson.* In this discussion paper we are only concerned with the regulation of competitions between (a) grantees in a debtor's deeds transferring or encumbering heritable property and (b) his creditors' heritable diligences, sequestrations or liquidations. Sequestrations and liquidations operate as global adjudications for the benefit of all creditors. Other competitions in ranking are or may be affected, or potentially affected, by *Sharp v Thomson.*

2.21 **Competitions between debtor's disponees etc. and floating charges.** Competitions between grantees in the deeds of a debtor company and floating charge holders are directly affected by the *ratio* of *Sharp v Thomson.* The Conveyancing Committee of the Law Society of Scotland have established a sub-committee to consider the problems raised by that case. The Law Society of Scotland's sub-committee represented to us that sequestrations in bankruptcy and liquidations do not in practice cause serious problems in the protection of persons transacting on the faith of the registers.[30] Floating charges, however, are very different. As the sub-committee pointed out, there is no way in which a purchaser's solicitor, however efficiently he may act, can avoid the inequitable result of the purchaser's loss of both property and price since "the floating charge attaches immediately by crystallisation without prior publication and so runs counter to the registration philosophy in the Scottish land registration system".[31] *Sharp v Thomson*, while solving that particular problem, creates problems for persons taking title from a receiver since a disponee of the company may have priority by reason of his latent "beneficial interest".

2.22 The Law Society's sub-committee are preparing representations to the Government on proposals for urgent legislation to provide a form of protection for the debtor's disponees and heritable creditors in competition with a floating charge holder which is more consistent than the "beneficial interest" concept with the fundamental principles of the Scottish system of land registration and property law. It is important that the solution adopted for that type of competition should cohere with the solution adopted for the competitions covered by this discussion paper. We have had the benefit of close liaison with the Law Society's sub-committee with a view to evolving a common approach.

2.23 **Other competitions**. Other competitions in ranking may be affected, or potentially affected, by the new "beneficial interest" priority point. These could include competitions

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[29] See J G Birrell, "*Sharp v Thomson*: the impact on banking and insolvency law" 1997 SLT (News) 151; D J Cusine, "*Sharp v Thomson*: the House of Lords strikes back" (1997) 26 *Green's Property Law Bulletin* 5; D Guild, "*Sharp v Thomson*: a practitioner's views" (1997) 42 JLSS 274; K G C Reid, "Jam today: *Sharp* in the House of Lords " 1997 SLT (News) 79; K G C Reid, "Equity Triumphant: *Sharp v Thomson*" (1997) 1 E L R 464; R Rennie, "*Sharp v Thomson*: the final act" (1997) 42 JLSS 130; D P Sellar, "Commercial law update" (1997) 42 JLSS 181 at p 181. There is a case in Aberdeen Sheriff Court, *Reid v Grainger*, debated before Sheriff Principal Risk on 9 June 1998, involving a competition between a sequestration and a disposition, which is at avizandum.

[30] Generally the solicitor of a purchaser or other disponee can, by following good conveyancing practice, protect the disponee from the disponer's sequestration or liquidation.

[31] For a critique of the system of registration of floating charges, see W W McBryde and D M Allan, "The Registration of Charges" 1982 SLT (News) 177.

affecting incorporeal moveables e.g. competitions between arrestments and assignations[32] which fall outwith the scope of this discussion paper. These wider implications may be resolved by the courts in an acceptable way. In the meantime the prudent course is to monitor the development of the law.

(5) Social policy and completion of title

2.24 In *Sharp v Thomson* two criticisms were made of our law on completion of title by registration, namely, (i) that it allows or condones fraud, or a result equivalent to fraud, by the debtor; and (ii) that it allows one man's property to be "confiscated" in order to satisfy another's debt. Despite Lord Clyde's disavowal of any intention to change the principles of Scottish property law, these criticisms are serious and, if they were to be accepted as valid, would require law reformers to make fundamental changes to Scottish property law, both heritable and moveable. It is thought however that both criticisms are misconceived.

2.25 **Allowing or condoning fraud**. The first criticism[33] has no factual basis. It is not true to say that where a debtor has granted and delivered a disposition, it would necessarily be a criminal fraud on his part to convey the same property to a second disponee.[34] The argument that after delivery of the disposition, the seller could not have resold to a third party without fraud proves too much. The legal restriction on a second sale is triggered by the missives for the first sale and not by the delivery of the disposition to the first disponee.[35] Yet nobody supposes that the beneficial interest arises at the stage of missives. Moreover even if it would have been fraud on the debtor's part to favour a particular creditor, it would not follow that that creditor is, or ought to be, barred from executing diligence:[36] "a bankrupt cannot grant a disposition to any particular creditor, but any particular creditor may adjudge".[37]

2.26 **The "confiscation" argument.**[38] The confiscation argument assumes that on delivery of the disposition, the purchaser acquires "ownership" at least in a popular sense and therefore to give priority to any competing creditor (or singular successor?) of the debtor

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[32] See our Report on *Diligence on the Dependence and Admiralty Arrestments* (1997) Scot Law Com No 164, paras 9.10 - 9.24.

[33] See *Heritable Reversionary Co v Millar* (1892) 19 R (HL) 43 at p 49 per Lord Watson: "a man's property … does not include estate in which he has no beneficial interest, and which he cannot dispose of without committing a fraud"; *ibid* at p 45 per Lord Herschell: "I cannot think that it was the intention of the Legislature to compel a bankrupt to convey to his trustee for the benefit of his creditors property which he could not dispose of to any creditor at the time of sequestration without being guilty of a criminal breach of trust". See also e.g. *Bowman v Wright* (1877) 4 R 322 at p 325 per Lord Justice-Clerk Moncreiff; *Thomas v Lord Advocate* 1953 SC 151 at p 161 per Lord Patrick; *Sharp v Thomson* 1997 SC(HL) 66 at p 77B per Lord Jauncey: "Had Albyn, after receiving the price and delivering the disposition to the Thomsons, carried out the same exercise with a third party or granted a standard security over the flat in exchange for a loan, it would have committed a fraud but the ability to commit such a fraud does not amount to a beneficial right of property (*Millar*)"

[34] In a large selling organisation, for example, one department effecting a sale may overlook a prior sale of the same property by another department. Again, if the seller, having got a better bargain through the second sale, pays back the price of the first sale to the first disponee with interest, he may be liable to the first disponee in damages for consequential loss, but he will not be guilty of the delict of fraud, still less for criminal fraud.

[35] See eg *Roger (Builders) Ltd v Fawdry* 1950 SC 483.

[36] *Mitchells v Ferguson* (1781) 3 Ross L C 120 at p 124; Hailes 879 at p 879 per Lord Braxfield.

[37] *Ibid*, Hailes 879 at p 880; 3 Ross L C 120 at pp 127,128.

[38] In *Sharp v Thomson*, it was said that if the court preferred the receiver, it would be tantamount to conferring "confiscatory powers upon receivers such as are given neither to trustees in bankruptcy nor to liquidators": 1997 SC (HL) 66 at p 77C per Lord Jauncey. Lord Clyde, quoting (at p 82 H,I) Lord Field in the *Millar* case, referred to "the great injustice of applying one man's property in satisfaction of another man's debt".

who wins the race to the register would be to allow him to "confiscate" someone else's property. It is difficult to see why the transfer of property should be taken to depend on loose popular usage rather than on the strict requirements of property law. It is unrealistic because, whatever the public think, conveyancers do not regard property as passing at that stage for the purpose of ranking.

2.27 The fact is that the race to complete title puts all disponees and creditors of an insolvent debtor on an equal footing. They have an equal chance. If a competing creditor supplies property, money or services to the debtor in the ordinary course of business and has not yet been paid, he has no preference for his claim against the permanent trustee or sequestration creditors.[39] All personal creditors rank *pari passu*, rateably according to the amount of their claims. They too have *ex hypothesi* lost property, money or services. Our law is clear that the other creditors are not unjustifiably enriched. So talk of "confiscation" is out of place. Sometimes it is said that they are not enriched because they cannot receive more than their debt and a creditor is never enriched merely by receipt of his debt.[40] Sometimes it is said that far from being enriched, the general creditors are "striving to avoid loss".[41] Sometimes it is said that the general creditors are enriched but justifiably, the justification being the principle of the parity of the general creditors of an insolvent.[42]

2.28 It is important to note that if a competing creditor *by error* supplies property, money or services to the debtor in the ordinary course of business and has not yet been paid, his personal right of recovery is not given any preference in the debtor's sequestration. In the leading case of *Mansfield v Walker's Trs*,[43] which involved a conveyancing error,[44] Lord Craigie[45] held it long established that "there are no equities in competitions among creditors".[46] Rights are upheld for the vigilant not those asleep; and although no one ought to be enriched from another's loss, yet in avoiding loss, "everyone is entitled to avail himself of the blunders of those whose interests are opposed to his."[47]. Lord Balgray commented:[48]

> "What therefore has taken place, must be viewed as having proceeded from inadvertency or mistake. This, no doubt, creates an obligation against the common debtor to apply the proper correction, - but this applies no further than the parties immediately concerned. Creditors certainly cannot benefit themselves by fraud, but being *certantes de damno vitando* [striving to avoid loss], they have always been

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[39] *Mess v Sime's Tr* (1898) 1 F (HL) 22 affirming (1898) 25 R 398.
[40] "*Suum recepit*": e.g. *Gloag and Henderson, The Law of Scotland* (10th edn; 1995) para 29.13: "The other creditors are not *lucrati* merely because the dividend on their debts is larger"; *Universal Import Export GmbH v Bank of Scotland* 1995 SC 73 at p 93 per Lord Caplan.
[41] "*Certantes de damno evitando*" : Hume, *Lectures* vol III p 168; Gloag, *Contract* (2d edn) p 331.
[42] N R Whitty, "Indirect Enrichment in Scots Law" 1994 J R 200 at pp 225,226.
[43] *Mansfield v Walker's Trs* (1833) 11 S 813 affd (1835) 1 S & McL 203; 3 Ross L C 139.
[44] A party lent a sum of money on the security of a property which he was led to believe extended to 95 acres but which in fact only extended to 5 acres. The borrower was sequestrated before the error was corrected. It was held that there was no fraud on the part of the borrower to affect the trustee and the general creditors: error did not suffice.
[45] (1833) 11 S 813 at p 828.
[46] Referring to *Duke of Norfolk v York Building Co Annuitants' Trs* (1752) Mor 7062, in which a company granted bonds of annuity and in security of these disponed their estates to a trustee. Some annuitants renewed their bonds in ignorance of the fact that they thereby lost the benefit of the security for the annuity. The security subjects were then adjudged by third parties who recorded their adjudications. Despite the annuitants' error, the Court of Session preferred the adjudgers and this was upheld by the House of Lords.
[47] (1833) 11 S 813 at p 828.
[48] *Ibid* at p 831.

considered to be entitled to take advantage of errors and mistakes, to the effect of obtaining a fair and equal distribution of their debtor's effects".

This approach seems right. On insolvency, personal creditors who make mistakes, or whose solicitors fail to conform to the ordinary rules of good conveyancing practice, should not be given a preference which is denied to unpaid suppliers of money, property or services who have made no mistakes and behaved impeccably throughout. The "confiscation" argument runs counter to our law on unjustified enrichment as applied in insolvency situations.

(6) Why protect debtor's singular successors against unsecured creditors' diligences?

2.29 Though in insolvency there is, or ought to be, a level playing field for personal creditors, there is nevertheless a strong justification for giving a debtor's disponees and heritable creditors special protection in a race to the register against his unsecured creditors' diligences. The justification is the same as that given by the common law authorities for protecting latent trusts from sequestration namely, that unsecured creditors (a) give no new consideration when using adjudication or sequestration[49] and (b) relied on the debtor's personal credit rather than on the faith of the registers when they originally gave him credit.[50] By contrast bona fide purchasers and heritable creditors do give new consideration and do rely on the faith of the registers.

(7) The options for reform

2.30 We have identified four possible policy options for protecting a debtor's bona fide singular successors, heritable creditors and lessees from unsecured creditors' diligences, namely:

(a) retention of the "beneficial interest" option in *Sharp v Thomson*;

(b) a constructive trust, or modified beneficial interest, taking priority over a creditor using land attachment, permanent trustee or liquidator but not over their bona fide, onerous singular successors;

(c) registration of land attachment in property registers to create real right defeasible by bona fide singular successor's completion of title within (say) 14 days; and

(d) registration of notice of litigiosity in the appropriate register, or of winding up in companies register, followed by indefeasible real right after mandatory delay of at least 14 days.

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[49] *Heritable Reversionary Co Ltd v Millar* (1892) 19 R (HL) 43 at pp 47,48 per Lord Watson explaining the ratio of *Thomson v Douglas, Heron and Co,*(1786) Mor 10229, Hailes 1002, 3 Ross L C 132; ibid (Hailes) per Lord Monboddo: "An heritable bond is good, because it is the price of the estate: the adjudger seeks to mend his former security".

[50] *Heritable Reversionary Co Ltd v Millar* (1891) 18 R 1166 at p 1175 per Lord McLaren (approved (1892) 19 R (HL) 43 at p 47 per Lord Watson) : "Creditors in general do not give credit to a bankrupt in reliance on any supposed presumption that property standing in his name is his private property. Unless they are going to advance money on heritable security they know nothing of his title deeds, and trust only to his personal credit"; *Gordon v Cheyne* 5 February 1824 FC at p 447: "creditors trust to the personal credit of their debtor, while purchasers advance their money for the specific subject itself, trusting nothing to his credit"; *Baron Hume's Lectures* vol IV pp 473,474

(a) One possible option: retain the "beneficial interest" option in *Sharp v Thomson*

2.31 As a law reform solution to the problem of "double loss", the "beneficial interest" concept introduced by *Sharp v Thomson* is unsatisfactory for the following reasons.

(1) In some important respects, the protection it affords is far too limited. The reasoning depends on the theory that delivery of a disposition divests the disponer of his beneficial interest leaving him with an unattachable bare title.[51] It follows that the beneficial interest option can apply only where the deed competing with the creditor's diligence or sequestration is a *divestitive* deed *transferring* a "beneficial interest" (such as a disposition or assignation of a lease) and not where it is a *non-divestitive* deed (such as a standard security or lease).[52] The latter creates a subordinate real right coexisting with and *encumbering* the disponer's real right of ownership and his "beneficial interest" which remain in existence and therefore attachable by his creditors. Yet a debtor's heritable creditors and lessees are as much entitled to protection against his unsecured creditors' diligences or sequestration as are his disponees and assignees. For they too give new consideration and rely on the faith of the registers.

(2) By pushing the priority point in an ordinary conveyancing transaction back (for some ranking purposes) from registration to the time of delivery of the disposition, the beneficial interest concept makes a major change to fundamental rules of property law and ranking. But such a major change goes far beyond what is necessary to solve the problem addressed in *Sharp v Thomson* (loss of both property and price). We agree with the Law Society of Scotland's sub-committee that that problem is not serious or extensive outwith competitions involving floating charges.

(3) By changing the priority point for some important types of competition,[53] while (apparently) leaving it unchanged for many other types of competition which are equally important,[54] the "beneficial interest" theory would create widespread incoherence of principle in the law.

(4) The existence of two major different priority points in ranking (registration and delivery of a deed) would be likely to give rise to new circles of priorities which are best avoided.[55] The present law on the creation of real rights by registration - by selecting a unique priority point of registration for all, or almost all, competitions - does avoid these complexities.

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[51] See eg *Sharp v Thomson* 1997 SC (HL) 66 at p 71A per Lord Jauncey: "in the end of the day it is not what rights the buyer acquires by delivery of the disposition with which this appeal is concerned but what rights are left in the seller".

[52] See e.g. J G Birrell, 1997 SLT (News) 151 at p 153.

[53] Eg competitions between a disponee and a floating charge holder; or possibly between a disponee and a land attachment, or a sequestration, or a liquidation.

[54] Eg competitions between two dispositions; between two standard securities; between a disposition and a standard security; between a disposition and a registrable lease.

[55] Eg (1) a delivery of a disposition (transferring a "beneficial interest") followed by registration of a land attachment followed by registration of a standard security. The disposition takes priority over the registered land attachment which takes priority over the registered standard security which takes priority over the disposition. (2) The same but substitute a sequestration or liquidation for a land attachment. (3) A delivery of a disposition followed by the crystallisation of a floating charge followed by registration of a fixed security. The disposition takes priority over the floating charge which takes priority over the standard security which takes priority over the disposition.

(5) As regards the faith of the registers, the unnecessarily far-reaching change creates a worse problem for bona fide purchasers than it solves. By giving priority to a latent, unwritten, unregistered and unregistrable act (the delivery of a deed), it does or would undermine the faith of the registers and the protection of bona fide purchasers taking title from receivers, creditors using land attachments, permanent trustees and liquidators.

(6) The requirements for the constitution, transmission and extinction of the new "beneficial interest" are indeterminate. It is not at all clear what the requirements for constitution are or should be.[56] Their inevitable complexity could destroy the clarity of outline and the simplicity of our property law for no good reason.

2.32 We conclude that the defects of the "beneficial interest" option far outweigh its benefits.

(b) Another possible option: modified beneficial interest or statutory constructive trust

2.33 Head (5) in paragraph 2.31 above mentions that a latent disponee's "beneficial interest" as introduced in *Sharp v Thomson* would prevail not only over the title of receivers, land attachers, permanent trustees and liquidators but also over the title of their bona fide, onerous singular successors and thereby breach the faith of the registers. The reason is purely technical. The decision in *Sharp v Thomson* depended (or was said to depend) on the construction of the word "property" in the floating charges legislation. Since the House of Lords held that a floating charge does not attach to property held by a purchaser from the company under a delivered disposition, therefore on attachment the receiver does not acquire a subordinate real right to that property. It follows that he cannot pass good title to a bona fide purchaser.

2.34 New legislation could however provide that (1) a statutory "beneficial interest" acquired by a disponee in an unregistered disposition would prevail over the right of an unsecured creditor using land attachment, permanent trustee, or liquidator but would not prevail over the rights of bona fide, onerous singular successors of the land attacher, permanent trustee or liquidator. (2) For the purpose of a competition between a debtor's disposition and his creditor's land attachment (or sequestration or liquidation), the debtor would not be treated as divested by the delivery of his disposition to a bona fide purchaser and his real right of ownership would continue to be attachable by unsecured creditors. (3) For the purpose of a competition between a standard security and a land attachment, the debtor would continue to be treated as vested in a real right of ownership attachable by unsecured creditors. (4) However, the unsecured creditor's title under his registered attachment (or the title of the permanent trustee or liquidator) would be treated as valid but voidable at the latent disponee's or heritable creditor's instance, not void. The result would be that the attaching creditor could pass a good title to his bona fide, onerous singular successors unless and until a notice of litigiosity on the dependence of the latent disponee's or heritable creditor's action of reduction of the land attachment was registered in the

[56] Eg should delivery of the disposition alone be enough? Should payment of the price and taking entry be added to delivery of the disposition? Should both or one of them suffice if the disposition is not delivered? What if there are other complications? What if the price is payable by instalments? Or the purchaser has borrowed from the seller? Or the purchaser has paid a deposit only, or made a retention pending completion of building work? What if the disposition is gratuitous? What if entry is to be given in stages to different parcels of the property sold?

personal register. The result would be similar to an unregistered "equitable interest" under English law.[57] There is a precedent of a kind in CREST transactions,[58] and from time to time[59] sellers have created express trusts to evade the need for the purchaser to race to the register.

2.35 This solution would cure the defects mentioned at heads (1) and (5) in para 2.31 above. But it would seem that the other objections in that paragraph would remain. A kind of statutory "beneficial interest" solution was recommended by this Commission in 1982[60] and rejected by government in promoting the Bankruptcy (Scotland) Act 1985, which by section 31(1)(b) preserved, or was intended to preserve, the race to the register. Moreover, constructive trusts have hitherto been confined in Scots law to the field of remedies for breach of fiduciary obligation.[61] In an ordinary conveyancing transaction, since the seller contracts for himself at arm's length and not for the purchaser, there is no fiduciary relationship or obligation at common law and the remedies are, as they ought to be, governed by the law of contract not the law of trusts. Introducing constructive trusts in conveyancing transactions would represent a major and unnecessary extension of trust law. This option should likewise be rejected.

(c) Another possible option: registration of land attachment to create real right defeasible within 14 days

2.36 The best path to reform would seem to lie in providing a reasonably secure method whereby a debtor's disponee or heritable creditor, or his lessee or assignee in a registrable lease, who observes the ordinary rules of good conveyancing practice, can be sure of obtaining a good title in priority to a land attachment, sequestration or liquidation.

2.37 In relation to land attachments, one way of achieving this might be to provide that an attaching creditor would obtain a real right on registration of his notice of land attachment in the property registers but its priority in ranking would be postponed to a debtor's deed (e.g. disposition, standard security, or lease) in favour of a third party registered within a statutory period of, say, 14 days thereafter. This would have some advantages, since advance notice by registration in the personal register would not be required and the priority would be clear on the face of the registers without a reduction. This option would not endanger the faith of the registers in contrast to the two preceding options.

2.38 This option however would have some disadvantages. (1) It would make a most unusual and perhaps unique departure from the general rule established in 1693 that in a competition between real rights, the date of registration of each real right determines its priority in competition with other registered real rights. The option would create a new risk of circles of priorities stemming from the defeasibility of real rights and set an unfortunate precedent. Hitherto that risk has stemmed only from inhibitions and notices of litigiosity. In Part 3 below we consider simplification of the complex ranking effect of inhibitions and it would be unfortunate if at the same time the legislation were to complicate the rules for

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[57] See C Harpum, "The Uses and Abuses of Constructive Trusts : The Experience of England and Wales" (1997) 1 E L R 437 especially at pp 452 - 459.
[58] The Uncertificated Securities Regulations 1995 (SI 1995/3272), reg 25(2).
[59] Eg during the strike at the registers, and more recently.
[60] *Report on Bankruptcy and Related Aspects of Insolvency and Liquidation* Scot Law Com No 68 (1982), paras 11.26 - 11.29.
[61] Including possibly the redress of the indirect enrichment of a third party deriving from the fiduciary's breach. The controlling study is now G L Gretton, "Constructive Trusts" (1997) 1 E L R 281 (Pt I); 408 (Pt II).

ranking creditors' real rights. (2) This option would not be suitable for cases in which a trustee in sequestration or liquidator completes title because *inter alia* in their case the creation of a temporarily defeasible real right is unnecessary having regard to the earlier registration of notice of the insolvency process in the personal register or register of companies. It would not promote coherence in the law to enact markedly different provision for land attachments. (3) Most important of all, this option would have the disadvantage that the land attachment would be defeasible by a deed *voluntarily* granted by the debtor in the 14 day period for the very purpose of escaping the attachment. In fairness to an attaching creditor, there is much to be said for the freeze on voluntary deeds which litigiosity would achieve. A personal prohibition followed by an attachment is a familiar and well understood concept in sequestrations and actions of adjudication. On balance for these reasons, we do not favour this option.

(d) Our preferred option: "handicap" for debtor's disponee etc. in race to register

2.39 Our preferred option is to obtain the desired result by making only necessary changes to the familiar requirements of property law, conveyancing and ranking on insolvency. The aim would be to ensure that the debtor's disponee or heritable creditor, or his lessee or assignee in a registrable lease, who observes the ordinary rules of good conveyancing practice, either (1) can, before settlement and payment of the price, loan or other consideration, identify the competing creditor's right from the registers while it is still personal and before it has become a real right by registration in the property registers, or (2) if the competing creditor's personal right enters the registers only on or after the date of settlement, can by reasonably prompt action always win his race to the property registers against that creditor. The faith of the registers and the race to the register would be preserved. But a debtor's disponee or heritable creditor, or his lessee or assignee in a registrable lease, would have a reasonable handicap such that, if the ordinary rules of good conveyancing practice are observed, he will always win that race. Our proposed scheme of reform is set out in the following paragraphs.

(i) Litigiosity or advance notification

2.40 We propose that a notice would be registered in the property registers - or possibly the personal register - in the case of land attachment; in the personal register in the case of sequestration; and in the register of companies in the case of liquidations.

(ia) Land attachment preceded by attacher's notice of litigiosity

2.41 **Overview**. In summary, as can be seen from the propositions in Section B above, we propose the following solution for land attachment.

> 1. An attacher's notice of litigiosity specifying the property to be attached, and rendering it litigious, would be registered without a requirement of prior service on the debtor.[62]
>
> 2. The attacher's notice of litigiosity, since it specifies the property, could and (it is thought) should be registered in the property registers.[63] This is an

[62] Proposition 6(1) and (3).
[63] Proposition 6(1).

innovation since it departs from the rule that notices of litigiosity are registrable only in the personal register. The notice should have effect from the date of its registration.

3. A copy of the attacher's notice of litigiosity must be served by an officer of court on the debtor.[64] In practice service would be done after registration in order not to alert the debtor to the notice.

4. The attacher's notice of litigiosity would cease to have effect unless the officer's certificate of service was registered within 3 weeks after the date of registration.[65]

5. At any time after the expiry of a period of 14 days after the date of registration of the attacher's notice of litigiosity, the creditor would be entitled to register in the property registers a notice of land attachment against some or all of the property specified in the attacher's notice of litigiosity.[66] Registration of a notice of land attachment would however be effectual only if the attacher's notice of litigiosity had been validated by registration of the certificate of service.[67] It is envisaged that in most cases the creditor would register both the notice of land attachment and the certificate of service at the same time.

2.42 In a land attachment, the notice would take the form of an attacher's notice of litigiosity. In contrast to a notice of summons of adjudication, whose use is optional, registration of the attacher's notice of litigiosity would be a mandatory prerequisite of land attachment.

2.43 **Attacher's notice of litigiosity not to be backdated to prior notice.** A notice of litigiosity would have the same effect as an inhibition restricted to the property specified in the notice.[68] An inhibition takes effect from the date of its registration in the personal register although it will have been served previously on the inhibitee. In order to prevent the inhibitee from taking immediate steps to defeat the inhibition, most inhibitions are preceded by a prior notice of inhibition which backdates the effect of the inhibition to the date of registration of the prior notice, i.e. a date before service of the inhibition itself on the inhibitee.[69] Land attachment would become unduly complicated if the notice of land attachment had to be preceded by an attacher's notice of litigiosity which in turn was backdated to a prior notice. The scheme outlined above[70] is designed to avoid this complication.

2.44 **Registration of attacher's notice of litigiosity in property registers?** The attacher's notice of litigiosity would operate as an inhibition but only in relation to the property specified in the notice.[71] Any voluntary deed granted by the debtor after registration of the

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[64] Proposition 6(5)(a).
[65] Proposition 6(5)(b).
[66] Proposition 7(a).
[67] Proposition 7(b).
[68] See Section B, proposition 6(3) above.
[69] Titles to Land Consolidation (Scotland) Act 1868, s 155 and Sch PP; see para 3.53 below.
[70] At para 2.41.
[71] Section B, proposition 6(3).

notice would be reducible at the instance of the creditor. The question is whether this notice should be registered in the personal register (as inhibitions and notices of litigiosity are at present) or in the property registers. In the foregoing scheme, it is assumed that the attacher's notice of litigiosity will be registered in property registers. In the Land Register, the notice would be noted on the title sheet of the property concerned.

2.45 This requires explanation and justification because traditionally notices of litigiosity are registrable only in the personal register. Registration in the property registers would make it easier to locate the notice of litigiosity in a search. It would also avoid the problems[72] arising from the need to relate entries in the personal register to those on the property registers. For these reasons, the Keeper of the Registers would prefer registration in the property registers. We provisionally agree and seek views.

(ib) Sequestration

2.46 We propose that, in a sequestration, the notice would continue to take the form of a certified copy interlocutor of the first order which would be registered forthwith in the personal register by the sheriff clerk as under the existing law.[73] On registration that interlocutor has effect as an inhibition,[74] which only affects future deeds if they are "voluntary".

2.47 This provision would not provide a comprehensive safeguard for bona fide purchasers because the Bankruptcy (Scotland) Act 1985, section 32(8), makes even a non-voluntary disposition by the debtor, if delivered to a purchaser after the date of sequestration, of no effect in a question with the permanent trustee.[75] In our legislative scheme, therefore, we propose that a new exception to this bar should be added by amending section 32(9)(b) in order to allow the delivery of a voluntary deed to a bona fide purchaser (i.e. taking without notice of the sequestration) after the date of sequestration but before the date when the certified copy of the first order is registered in the personal register.[76]

(ic) Liquidation

2.48 Under the Insolvency Act 1986, section 127, in a winding up by the court, any disposition of the company's property is void unless the court orders otherwise. For this purpose, a winding up by the court is deemed to commence at the time of the presentation of the petition for winding up,[77] except that where a resolution by the company for winding up has already been passed, the winding up is deemed to have commenced at the time of the passing of the resolution.[78] There is authority suggesting that a "disposition" alienating property of the company after the presentation of the petition for winding up is void under section 127 even though the alienation is the act not of the company being wound up but of

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[72] Discussed in paras 3.74 - 3.116 below.
[73] Bankruptcy (Scotland) Act 1985, s 14(1)(a). See Section B, proposition 27 above.
[74] Ibid, s 14(2).
[75] A similar result followed by construction of the vesting provisions: *Mansfield v Walker's Tr* (1835) 1 S & McL 203 at pp 336,337 per Lord Brougham LC, quoted in McBryde, *Bankruptcy* (2d edn) para 9-05.
[76] See Section B, proposition 28(5).
[77] 1986 Act, s 129(2). For the purpose of equalising adjudications under the Diligence Act 1661, the commencement of winding up is the day on which the winding up order is made. See para 2.62 below.
[78] 1986 Act, s 129(1).

another person.[79] A validating order under section 127 may be prospective or retrospective.[80] There is a view that in Scotland a validating order is required even where the disposition is not "voluntary" ie even where the disposition implements a contract entered into before the presentation of the petition for winding up or, as the case may be, the passing of the resolution.[81] Rules of court provide that the petition for winding up should be advertised "forthwith" in the Edinburgh Gazette[82] but searchers do not search the Gazette. The court may appoint a provisional liquidator at any time after the presentation of the petition.[83] "It is almost invariable practice to apply for the appointment of a provisional liquidator on presentation of the petition and (assuming the petition is prima facie justified) to grant the application unless the petition is opposed on grounds which appear substantial".[84] The provisional liquidator must then forthwith give notice of his appointment to the registrar of companies.[85] If there is no provisional liquidator, then the first entry of the winding up in the register of companies may be the appointment of an interim liquidator or a winding up order.[86]

2.49 A copy of a resolution for voluntary winding up must be forwarded to the registrar of companies within 15 days.[87] Section 127 does not invalidate a disposition made by a company during a voluntary winding up but if the voluntary winding up is superseded by a petition for winding up by the court, the commencement of the winding up is backdated to the date of the resolution.[88]

2.50 These enactments do not make adequate provision to warn conveyancers of the commencement of a winding up by the court. Because the winding up operates retrospectively to the unregistered date of presentation of the petition, a search in the register of companies may be clear despite the fact that the winding up has commenced and any disposition is invalid. There is no provision specifically designed to notify conveyancers of the commencement of the winding up. Unlike the first order in sequestration, neither the first order in a petition for winding up nor the resolution for winding up is registered in the personal register. Neither the presentation of a petition, nor even the first order in a petition for winding up, by itself triggers registration in the register of companies. The registration of the appointment of a provisional liquidator is likely to be the first indication of the winding up to appear in the register of companies. It has been suggested that a purchaser

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[79] *In re Gray's Inn Construction Co Ltd* [1980] 1 WLR 711(CA) at p 716 per Buckley LJ stating that where a bank of the company clears a third party's cheque, and credits the amount collected in reduction of its customer's overdraft, it makes a "disposition" within the meaning of section 127 on the customer's behalf in its own favour discharging pro tanto the customer's liability on the overdraft. Further all payments by the company's bank out of the company's account to third parties are "dispositions" within that meaning whether or not they exceed the payments in.

[80] *Re Tramway Building and Construction Co Ltd* [1988] Ch 293.

[81] *Stair Memorial Encyclopaedia*, vol 4 , para 753 which suggests that the English case of *Re French's Wine Bar Ltd* [1987] BCLC 499 would not be followed in Scotland.

[82] RCS 74.22 (1)(c)(i); Sheriff Court Company Insolvency Rules 1986, rule 19(6)(a).

[83] 1986 Act, s 135(1) and (3).

[84] D A Bennett, *Palmer's Company Insolvency in Scotland* (1993) para 434.

[85] Insolvency (Scotland) Rules 1986, rule 4.2(1)(a) (SI 1986/1915).

[86] For appointment of interim liquidator on the making of a winding up order, see 1986 Act, s 138; the appointment of the interim liquidator must be notified within 7 days to the registrar of companies : Insolvency (Scotland) Rules 1986, rule 4.18(4)(a).

[87] 1986 Act, s 84(3).

[88] Query: what is the effect of this on the operation of s 127? Is the invalidating provision backdated to the date of the resolution?

will probably be protected by the discretion of the court under the 1986 Act, section 127.[89] It is true that the sale of an asset at its full market value after presentation of the petition is likely to be validated by an order under section 127 since it does not reduce the value of the company's assets.[90] Having regard however to the importance of the faith of the registers and the traditional preference in Scottish property law and heritable conveyancing for fixed rules over judicial discretion, an order under section 127 should be treated as a longstop and no substitute for a fixed rule providing prior warning to conveyancers of the risk of invalidation. The risk may also be covered by a certificate of solvency.[91] A certificate of solvency is granted by a director or shareholder warranting inter alia that "so far as the grantor is aware" the company is solvent; and that no steps have been or are about to be taken to put into liquidation. It has been pointed out that the qualification "so far as aware" seriously weakens the protection and that in any event the certificate may well be worthless.[92] It is not surprising that solicitors' letters of obligation do not include searches in the register of companies. It cannot be right that legislation - even legislation on company law - should continue to ignore the fundamental principles of Scots law on the faith of the registers by invalidating dispositions without prior publication.

2.51 In our legislative scheme therefore we propose that the 1986 Act, section 127, should be amended so as to provide that any "disposition" of a company's heritable property in Scotland is void under section 127 only if it is made after the date when the fact of the commencement of the winding up first appears in the register of companies.[93]

2.52 We further propose that, unless the court otherwise directs, the first order in a petition to the Court of Session or a sheriff court for the winding up of a company should include a direction to the clerk of the court forthwith to give notice in the prescribed form to the registrar of companies of the presentation of the petition.[94] It is thought that the notice should be registered in the register of companies rather than the personal register, by analogy with the Bankruptcy (Scotland) Act 1985 section 14(1) and (2). The object of registration, however, is to publicise the effect of section 127 of the 1986 Act rather than to give the first order the effect of an inhibition at common law. Moreover there is understandable pressure to keep cross-border differences in company law to a minimum. For these reasons, the first option seems preferable.

(ii) Mandatory delay before completion of title

2.53 Our legislative scheme in Section B would provide for a mandatory minimum period of delay between (a) the registration of the attacher's notice of litigiosity, the first order in a sequestration and the fact of winding up in respectively the property registers, the personal register and the register of companies, and (b) the creation of a real right by the completion of title in the person of the attaching creditor, the permanent trustee in sequestration, or the liquidator, or his disponee, or the debtor for the benefit of his pre-sequestration creditors,[95] as

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[89] G L Gretton, *A Guide to Searches* (1991) p 31.
[90] *In re Gray's Inn Construction Co Ltd* [1980] 1 WLR 711(CA) at p 719 per Buckley LJ.
[91] Gretton, *A Guide to Searches* p 31.
[92] A J McDonald et al (eds), *Conveyancing Manual* (6th edn; 1997) para 35.18.
[93] Section B, proposition 29(1).
[94] *Ibid*, proposition 29(2).
[95] Bankruptcy (Scotland) Act 1985, s 31(3).

the case may be.[96] The period should be sufficiently long to enable a grantee, to whom a conveyance has been delivered on the date of such registration, to complete title by registering the conveyance in the property registers. We propose that the period of delay should be 14 days as in the "classic" letter of obligation.

2.54 The effect would be that if the grantee in the debtor's conveyance obtains an interim report on search, including a search of the Sasines presentment book, showing clear records up to a time shortly before settlement, and in particular disclosing no attacher's notice of litigiosity in the property registers, no certified copy first order (in a sequestration) in the personal register and (if the debtor is a company) no notice of the first order in the register of companies, he will know that if he completes title within 14 days after the end of the period of the interim search, his title cannot be defeated by any registered land attachment by a creditor of the grantor, nor any title of the grantor's permanent trustee in sequestration or liquidator. No such adverse title would be registrable in the "blind period" following the interim search.

(iii) Definition of "property" or "whole estate"

2.55 **Land attachment**. In order to remove the concept of "beneficial interest" from the race to the register, we propose above a statutory provision to the effect that a land attachment should be treated as attaching property of the debtor where, at the date of registration of the notice of land attachment, the debtor had previously granted and delivered a deed[97] transferring the property to a third party but the third party's title has not been completed as a real right by registration of the deed in the property registers.[98] Accordingly, in any competition between the attaching creditor and the third party, the debtor should not be treated as having been divested of his attachable right to the property by virtue of his delivery of the disposition to the third party. Such a provision is designed, for avoidance of doubt, to give effect to a fundamental principle of Scottish property law.

2.56 **Sequestration.** Likewise, for avoidance of doubt, in the case of sequestration, we propose[99] that a similar gloss should be made to the expression "the whole estate of the debtor" in the *chapeau* of the Bankruptcy (Scotland) Act 1985, section 31(1)[100] to reflect better the original Parliamentary intention. There is an argument that strictly speaking this is unnecessary because section 33(1)(b) of that Act provides that "the following property of the debtor shall not vest in the permanent trustee ... (b) property held on trust by the debtor for any other person". This provision implies that otherwise property held by the debtor on trust would vest in the permanent trustee which in turn implies that the expression "the whole estate of the debtor" includes property of which the debtor only has a bare title of ownership. The opportunity however should be taken to put the matter beyond doubt.

2.57 **Liquidation**. A liquidator is a manager of the company's property which does not vest in him by operation of law. There are, however, two rarely used provisions under which the liquidator may acquire a title to the company's property in his own name, namely

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[96] See proposition 7 (mandatory delay between registration of notice of litigiosity and registration of land attachment); proposition 28(4) (mandatory delay in sequestration); and proposition 30(1) (mandatory delay in winding up).
[97] Including a disposition, an assignation, a translation of an assignation and any other divestitive deed.
[98] Section B, proposition 3(3).
[99] *Ibid*, proposition 28(3).
[100] This matter seems to have been overlooked by the draftsman in preserving the race to the register.

by recording a notice of title in the property registers[101] or by obtaining a vesting order of the court.[102] Similar provision is needed with respect to them and with respect also to the functions of a liquidator (or provisional liquidator) over the property of a company being wound up by the court, including the function of getting in and realising the company's assets,[103] the duty to take into his custody or under his control all the property to which the company is entitled,[104] the power to recover the company's property[105] and other powers to deal with the company's property in a winding up.[106] As we propose above,[107] it should be made clear by statute that the property of the company, over which these powers of the liquidator are exercisable, includes property which the company has disponed to a third party by a delivered disposition but of which the company has not been divested by registration in the property registers. The fact that property of the company does not vest by operation of law in its liquidator should not be allowed to disturb the principle that the rules on creditors' rights in the liquidation of an insolvent company are, or ought to be, the same as in sequestration.

(iv) Protection of bona fide purchaser deriving title from land attacher, permanent trustee or liquidator

2.58 The provision mentioned in the previous paragraph would make it unnecessary to enact an *ad hoc* statutory protection from a disponee's latent "beneficial interest" for bona fide purchasers deriving title from a land attacher, permanent trustee or liquidator. Having consulted the Law Society of Scotland's sub-committee, we do not think it necessary to propose an *ad hoc* provision protecting such bona fide purchasers against a challenge founded on a latent trust.[108]

(v) Constitutionality

2.59 Under the Scotland Bill,[109] diligence, property law, personal insolvency law, and certain aspects of corporate insolvency law are devolved matters. The Bill, however, provides a reservation in "relation to business associations" for (among other things) "the modes of, the grounds for and the general legal effect of winding up".[110] The exceptions from this reservation include "the effect of winding up on diligence" and "the avoidance and adjustment of prior transactions on winding up" (presumably the reduction of gratuitous alienations and unfair preferences).[111] It will be for consideration whether the rule governing

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[101] Titles to Land Consolidation (Scotland) Act 1868, s 25.
[102] Insolvency Act 1986, s 145(1): winding up by court, applied to voluntary winding up by 1986 Act, s 112(1).
[103] Insolvency Act 1986, s 143(1).
[104] *Ibid*, s 144(1).
[105] *Ibid*, s 145(2).
[106] *Ibid*, s 167 and Sch 4, e.g. power of sale (para 6); and power to execute deeds (para 7).
[107] Section B, proposition 30(2).
[108] The title of the permanent trustee to property held by the debtor in trust for another is void under statute (Bankruptcy (Scotland) Act 1985, s 33(1)(b)) and at common law since *Heritable Reversionary Co v Millar* (1892) 19 R (HL) 43. Professor A J McDonald pointed out that since 1892 there has been no reported case where a challenge was made even in the period before 1970 when *ex facie* absolute dispositions were a competent and common form of security. He further observed that in *Sibbald's Heirs v Harris* 1947 SC 601 (concerning the validity of a title based on a decree of service of heirs), Lord President Cooper was clearly opposed to any general rule to protect a purchaser against void titles.
[109] HL Bill 119, print of 20 May 1998 as amended in House of Lords Committee on 27 July 1998.
[110] Schedule 5, Head 3, Section 2.
[111] *Idem*.

the effect of winding up in a competition between the liquidator and the company's disponee will be within the Scottish Parliament's legislative competence.[112]

(vi) Proposals

2.60

> **2. We invite views on those propositions in the above legislative scheme which are specifically designed to protect persons transacting on the faith of the registers from:**
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> **land attachments (propositions 3(3) and 7);**
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> **sequestration (propositions 27 and 28(3) to (5)); and**
>
> **liquidation (propositions 29 and 30(1) and (2)).**

D. ABOLITION OF EQUALISATION OF HERITABLE DILIGENCES

The existing law

2.61 Equalisation of adjudications for debt was introduced by the Diligence Act 1661[113] (as read with the Adjudications Act 1672[114]) long before the introduction of sequestration in bankruptcy in 1772.[115] The 1661 Act proceeds on the narrative that:

> "creditors, in regard they live at distance or upon other occasions are prejudged and prevened (sic) by the more timeous diligence of other creditors so that, before they can know the condition of the common debtor, his estate is comprised and the posterior comprisers have only right to the legal reversion, which may and doth often prove ineffectual to them, not being able to satisfy and redeem the prior comprisings, (their means and money being in the hands of the common debtor) ...".

The 1661 Act provides that all adjudications for personal debts[116] before, or within a year and a day after, the first effectual adjudication should come in *pari passu* together as if one adjudication had been obtained for the whole of the sums in the several adjudications. The first effectual adjudication was declared to be that in which the first real right and infeftment was completed.[117] The equalised adjudgers have to indemnify the first effectual adjudger for all of his expenses. One difference from equalisation of arrestments and poindings under the Bankruptcy (Scotland) Act 1985[118] is that under the 1661 Act an unsecured creditor has to adjudge in order to claim equalisation whereas under the 1985 Act a creditor producing liquid grounds of debt or a decree for payment within the statutory equalisation period is entitled to

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[112] There are several tests of legislative competence: see Scotland Bill, clause 28 and Schedule 4.
[113] APS record edn, c 344; 12mo edn, c 62.
[114] APS record edn, c 45; 12mo edn, c 19. The equalisation rules in the Diligence Act 1661 applied to the ancient diligence of comprising and to adjudications *contra haereditatem jacentem*, and were extended to all other adjudications for debt by the Adjudications Act 1672 which abolished comprisings and replaced them with adjudications for debt.
[115] Bankruptcy Act 1772.
[116] Ie other than *debita fundi* which are a class of debts secured over land.
[117] Or the first exact diligence for obtaining the same, the word "diligence" being in this context a reference to the now obsolete process used by the adjudger to compel the superior to complete the adjudger's title.
[118] Sch 7, para 24.

rank as if he had executed an arrestment or poinding. If (contrary to our proposal) equalisation of land attachments were introduced, it would be for consideration whether a similar rule should apply.

2.62 When sequestrations and liquidations were introduced, the equalisation rules were not abolished. Rather sequestrations and liquidations were and are deemed by statute to be constructive adjudications[119] with the effect that the general body of creditors rank *pari passu* on the proceeds of the first effectual adjudication if the date of sequestration or (in a winding up by the court) the date of the court's winding up order[120] occurs within the statutory equalisation period.

Previous consideration

2.63 The abolition of equalisation of adjudications was proposed in our Discussion Paper No 79 on *Equalisation of Diligences.* On consultation, the Joint Committee[121] feared that if the diligence of adjudication were simplified, speeded up and made less expensive as suggested in Discussion Paper No 78, it would be used a great deal and in most cases to the advantage of individual creditors who have sufficient knowledge of the situation to utilise it to the disadvantage of the creditors as a whole. In our recent Report which recommended the abolition of equalisation of arrestments and poindings, we referred to the possibility that the provisions for equalisation of adjudications, if modernised and reformed, might meet that criticism.[122] They are after all expressly designed to prevent creditors with prior knowledge of the debtor's insolvency from stealing a march on the general body of creditors by using adjudication, - the very mischief identified by the Joint Committee.

The case for abolition

2.64 On reflection however, we think that the case for abolition outweighs the case for retention. The case for abolition is broadly the same as the case for abolishing equalisation of arrestments and poindings set out in Scot Law Com No 164[123] though there are differences.[124] The case for abolition is summarised below.

2.65 First, where a debtor is insolvent, fair sharing of his assets among *all* unsecured creditors is the only way of achieving satisfactory justice for the general body of creditors. While that can generally be achieved in the insolvency processes of sequestration or liquidation, it can hardly ever be achieved by equalisation, even if it is reformed, in the Scottish system of diligence for a number of practical reasons. Having regard to the widespread

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[119] Bankruptcy (Scotland) Act 1985, s 37(1)(a), applied to liquidations by the Insolvency Act 1986, s 185.
[120] 1985 Act s 37(1)(a); 1986 Act, s 185(1)(a);(2)(c);and (3); *Morrison v Integer Systems Control Ltd* 1989 SCLR 495 (Sh Ct). Not the date of commencement of the winding up which is the date of presentation of the petition for winding up or the date of the resolution to wind up as the case may be.
[121] Ie the Joint Committee of the Law Society of Scotland and the Society of Messenger-at-Arms and Sheriff Officers.
[122] Scot Law Com No 164 ,paras 9.35, 9.36.
[123] Ibid paras 9.37 - 9.45.
[124] For example in the case of equalisation of arrestments and poindings, it is possible that there can be multiple overlapping equalisation periods because on each occasion when apparent insolvency is constituted anew, a new statutory equalisation period comes into being: see our Discussion Paper No 79, paras 5.42 - 5.56; G L Gretton, "Multiple Notour Bankruptcy" (1983) 28 JLSS 18.

criticisms of advertisements of warrant sales identifying the debtor[125] we do not think that public opinion would accept newspaper advertisements to attract creditors' claims for fair sharing because of the embarrassment which they would cause to debtors. Such advertisements would also entail extra costs. It would be impracticable to introduce special provisions for the admission of claims not instantly verifiable such as exist in sequestrations.[126] Moreover if claims for equalisation or fair sharing were to become common, the result might be to impose unduly heavy burdens on creditors instructing land attachments.

2.66 Second, it follows that fair sharing of the fruits of land attachments under our system of equalisation would have to be limited to a relatively narrow class of unsecured creditors who have used land attachment or whose debts are instantly verifiable and who get to know about the land attachment in time to claim a ranking on the proceeds. This necessarily entails that the haphazard operation of the "first come, first served" principle is replaced by another principle which, while it purports to introduce fair sharing, is in fact just as haphazard in its operation as the "first come, first served" principle.

2.67 Third, if equalisation of land attachments were to be invoked frequently, or if it frequently rendered recourse to general insolvency processes unnecessary, there would be a stronger case for retaining equalisation. But neither result seems likely to be achieved even if equalisation were to be reformed.

2.68 Fourth, equalisation of land attachments would be unlikely in practice to prevent a race of diligences precipitating or aggravating the debtor's insolvency. It follows that abolition of equalisation would not take away an effective safeguard for debtors.

2.69 Fifth, one possible criticism is that the rules on equalisation are unfair to those creditors who are compelled by the rules to share the fruits of their diligences with other more idle or less meritorious creditors. On this view so-called fair sharing legitimises parasitic behaviour on the part of some creditors.[127] So far as Scots law is concerned however we doubt whether the concept of the idle parasite has much relevance. Nor is there evidence suggesting that a creditor who executes diligence first is generally more "meritorious" than a later creditor. Conversely, there is no reason to suppose that creditors executing diligence later are generally more "considerate" or "deserving" than creditors executing diligence first.[128] The fact that one creditor instructs diligence before another against the same debtor is likely to be attributable to fortuitous circumstances having nothing to do with commercial morality.[129] Neither "fair sharing" nor temporal priority

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[125] Report on *Diligence and Debtor Protection* Scot Law Com No 95 (1985) paras 2.68 and 5.162. Such advertisements are now virtually abolished: see Debtors (Scotland) Act 1987 s 34(5) as read with s 34(2) (restricting sales in debtors' dwellings).

[126] Cf Bankruptcy (Scotland) Act 1985, s 49.

[127] Cf Report of the Law Reform Commission of British Columbia on *Creditors' Relief Legislation: A New Approach* (1979) p 17.

[128] Cf Report of the Departmental Committee on the *Enforcement of Judgment Debts* (chairman: the Hon Mr Justice Payne) Cmnd 3909 (1969) para 304.

[129] Eg differences in the times of default, in the times when default was identified, and in the time-scale of the routine pre-litigation debt collection practices of the creditors or their agents; whether instalment arrangements were made and, if made, when they were broken; differing assessments of the prospects of recovery; and so on.

promotes commercial morality more than the other. Empirical research on creditors did not even mention equalisation as a factor influencing creditors' policies.[130]

2.70 Sixth, the "first come, first served" principle can be justified on the ground that a creditor who takes the trouble of enforcing his debt should enjoy the fruits of it unless the debtor is insolvent and the diligence is superseded by arrangements for fair sharing among all or almost all unsecured creditors. Since equalisation of land attachments outside sequestration or liquidation is unlikely to achieve that object, we believe that the considerable complications of the law which equalisation outside insolvency processes entails are not justified by the benefits. In other words, since considerations of fairness among creditors are evenly balanced, there is insufficient justification for maintaining a complicated system of equalisation rules.

Our proposals on equalisation and cutting down of land attachments

2.71

3. Views are specifically invited on:

proposition 26 which proposes that equalisation of adjudications for debt should be abolished and that no similar provision should be made for the equalisation of land attachments; and

propositions 31 and 33 which propose respectively that land attachments registered within 6 months prior to sequestration or liquidation should be ineffectual in a question with the permanent trustee or liquidator.

[130] See B Doig and A Millar, *Debt Recovery - A Review of Creditors' Practices and Policies* (Scottish Office Central Research Unit) (1981).

PART 3 REFORM OF INHIBITIONS

A. INTRODUCTION

3.1 In this Part we consider the reform of the law on inhibitions on the assumption that that form of diligence is to be retained, an issue on which we seek views in Part 4. Section B of this Part[1] explains the effects of inhibitions. In particular it explains how the exclusionary preference is worked out in a sequestration or other process where creditors are ranked according to their respective rights and preferences. A comparison is made with the rules for ranking subordination agreements in the USA (whereby a secured creditor will subordinate his prior security to that of an otherwise postponed creditor). The subordination rules achieve the same result as do the canons of ranking for inhibitions under Scots law. Appendix B below gives worked examples of inhibition and subordination agreement ranking. We propose that an inhibition should no longer have an effect against future debts. This would simplify considerably the ranking of creditors on property affected by an inhibition.

3.2 Section C[2] looks at how warrants to inhibit in execution are obtained, and whether a Court of Session or sheriff court decree, or a document having the effect of a decree, should automatically contain warrant to inhibit. Our recent Report on *Diligence on the Dependence and Admiralty Arrestments*[3] recommended that sheriffs should be empowered to grant warrant for inhibition on the dependence of actions before them.

3.3 In Section D[4] we consider the procedures involved in serving the inhibition on the inhibitee and registering the inhibition in the personal register. We invite views on a new procedure whereby the inhibition would be registered and then served subsequently-by postal or hand service-on the inhibitee. The inhibition would become effective on the first moment of the day in which it was served, so ensuring that the inhibitee could not easily take evasive action. Notices of inhibition would become unnecessary. We also seek views on the question of whether solicitors should be entitled to serve inhibitions by postal service.

3.4 In a transaction involving heritable property a search of the personal register is carried out to make sure that the owner who is selling or granting some other right is not inhibited. Section E[5] explores the problems involved in matching owners from their names and designations in the property registers with those of inhibitees in the personal register. Schemes are put forward in relation to the Register of Sasines and the Land Register to protect people transacting with inhibitees in good faith where the personal search failed to disclose the inhibition.

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[1] Paras 3.9 - 3.30.
[2] Paras 3.31 - 3.51.
[3] (1998) Scot Law Com No 164, recommendation 10 (para 3.97).
[4] Paras 3.52 - 3.73.
[5] Paras 3.74 - 3.116.

3.5 An inhibition does not affect the inhibitee's "after-acquired property", that is, lands which the inhibitee acquires after the date when the inhibition becomes effective.[6] Section F[7] examines the issue of when lands can be said to be acquired for this purpose in the context of a conveyance of heritable property to an inhibitee. Other topics dealt with include what constitutes a breach of inhibition and the time the inhibitor has in which to reduce such a deed.

3.6 Section G[8] considers some issues which arise where the inhibitee becomes insolvent. These include the ranking of the inhibitor in sequestrations, liquidations and trust deeds for creditors and how that ranking is altered if the inhibitee had granted and delivered a deed breaching the inhibition but the inhibitor has not reduced the deed.

3.7 Section H[9] deals with the position of inhibitors and other creditors when the inhibitee's heritable property is sold by a standard security holder or a receiver acting on behalf of the holder of a floating charge.

3.8 Various miscellaneous matters are contained in Section I.[10] These include the effect of an inhibition on a judicial factor appointed to the inhibitee and the liability of inhibitees for the expenses of the inhibition used against them.

B. THE EFFECT OF INHIBITIONS AND RANKING

Introduction

3.9 In this Section we discuss the effect of inhibitions and the canons of ranking which give inhibitors a preference by exclusion over later creditors. We consider whether this preference should be abolished so that inhibition would become merely a diligence preventing the inhibitee from disposing of or burdening his heritable property and giving the inhibitor a remedy against deeds granted in breach of the inhibition.

The effect of inhibitions

3.10 Bell[11] describes the effects of an inhibition as:

> "[F]orbidding a debtor to grant any conveyance, or to execute any deed, or to incur any other debt, by which the creditor may be disappointed in obtaining payment, or performance of the obligation whereupon the letters [of inhibition] proceed; and prohibiting the public from giving the debtor credit, or receiving from him conveyances out of which such effect may arise".

According to Graham Stewart[12]:-

> "Inhibition is merely a negative or prohibitory diligence. It strikes against subsequent debts and posterior voluntary conveyances, gratuitous or onerous, by the

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[6] Titles to Land Consolidation (Scotland) Act 1868, s 157.
[7] Paras 3.117 - 3.144.
[8] Paras 3.145 - 3.153.
[9] Paras 3.154 - 3.172.
[10] Paras 3.173 - 3.184.
[11] *Commentaries* vol 2, p 134.
[12] *Diligence* (1898), p 551.

person inhibited which are in any way prejudicial to the inhibitor. It gives title to challenge only voluntary acts and is no bar to what the debtor was bound to perform. It no way operates as a transfer of the possession or property of the subject to the inhibitor, vests no real right, and gives no title to rank with those who have acquired a real right by voluntary security or adjudication."

3.11 An inhibition does not effect an attachment and in this respect differs from an adjudication (or its proposed replacement, a land attachment), an arrestment or a poinding. It does not create a security in favour of the inhibitor over the inhibitee's heritable property, nor does it transfer any part of that property to the inhibiting creditor. In order to obtain payment, an inhibitor must generally use other diligence, such as an adjudication. But because property affected by an inhibition is not marketable, an inhibition acts as a compulsitor to payment. Moreover, in insolvency processes an inhibitor is entitled, by virtue of the inhibition itself, to obtain a preference over subsequent voluntary debts and deeds.

3.12 **Strikes at future deeds and debts.** The first main effect of an inhibition is to strike against any future deeds by the inhibitee voluntarily disponing the property affected by the inhibition or creating a subordinate real right (a standard security for example) over it ("post-inhibition deeds"). The modern form of the schedule of inhibition,[13] which is served by a messenger-at-arms on the inhibitee, "inhibits you from selling, disposing of, burdening or otherwise affecting your land and other heritable property to the prejudice of [the inhibitor]". A prejudicial transaction in contravention of the inhibition is not void but may be reduced by the inhibitor, who then becomes entitled to adjudge the property. The other main effect of an inhibition is against debts incurred after the date when the inhibition became effective ("post-inhibition debts"). The debts remain valid and can be enforced by diligence, but the inhibitor is entitled in bankruptcy or other ranking procedures to be ranked and preferred on the inhibitee's heritage affected by the inhibition as if the post-inhibition debts did not exist. Pre-inhibition creditors are however neither prejudiced nor benefited by the inhibition, and so rank as if the inhibition had never existed.

3.13 **Only voluntary deeds and debts.** An inhibition strikes only at obligations incurred voluntarily by the inhibitee after the inhibition.[14] Post-inhibition deeds or debts which the inhibitee is bound to grant or incur as a result of pre-inhibition obligations do not contravene the inhibition. For example, if an individual contracts in June 1998 to sell his home to a purchaser, an inhibition executed in August 1998 would not prevent his granting a disposition in September 1998. Another example would be rent or hire charges becoming due for a period after the inhibition in respect of a lease or hiring agreement entered into before the inhibition.[15] As these sums were due under an obligation incurred prior to the inhibition, the inhibitor would not gain any preference in relation to them.

3.14 **Bell's canons of ranking.** The "preference by exclusion" method of ranking mentioned in paragraph 3.12 above was developed by the Court of Session in a series of

[13] RCS, rule 16.15(1)(h) and Form 16-15F.
[14] Titles to Land Consolidation (Scotland) Act 1868, s 155.
[15] *Scottish Wagon Co Ltd v Hamilton's Tr* (1906) 13 SLT 779.

cases in the late 17th and 18th centuries.[16] These ranking rules were later codified by Bell in his five "canons of ranking":[17]

> "1. That the first operation in the ranking and division is, to set aside, for each of the creditors who hold real securities, the dividend to which his real right entitles him, without regard to the exclusive preferences.
>
> 2. That the rights of exclusion are then to be applied in the way of drawback, from the dividends of those creditors whose real securities are affected by them; taking care that they do not encroach on the dividends of other creditors.
>
> 3. That the holder of such exclusive right is entitled thus to draw back the difference between what he draws upon the first division, and what he would have drawn had the claim struck at by the inhibition not existed.
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> 4. That if the exclusive preference affects more than one real security, it is to be applied against those creditors only by whose ranking on their real right the holder of it suffers prejudice; against the last, for example, of the postponed creditors affected by it, in the first place; and so back, till the holder of the exclusion draws all that he would have been entitled to draw had the excluded claims not been ranked. If it affects a number of creditors entitled to rank *pari passu*, it will affect them proportionally to the amount of their several debts.
>
> 5. That where there are secondary consents and exclusions among those holding exclusive preferences, they are to have effect only against, and in favour of the parties by and to whom they are granted, without benefiting or hurting other creditors. This is to be accomplished by applying the original exclusion in the first place, and then giving to the person in whose favour the secondary consent is granted, a right to draw back, from him who grants it, a share of his dividend, equivalent to the sum which would have fallen to the person favoured, had the first exclusion not been in existence."

3.15 These canons have been approved and applied by the courts subsequently.[18] The fifth canon is of little practical use today. It deals with the situation where the inhibitor waives the preference, by consenting to the inhibitee contracting a debt or granting a security to a particular creditor. Such waivers are, we understand, unknown in modern practice. The workings of inhibition ranking rules are illustrated in Appendix B below with a series of examples.[19]

Abolition of the preference over future debts

3.16 As can be seen from the worked examples in Appendix B, the rules of inhibition ranking are not easy to apply. Other more complicated situations may be met with in practice. The complexity of inhibition ranking is inherent in the preference by way of exclusion. This may be illustrated by considering the system of rules which exists in the United States of America for ranking the claims of creditors where there has been a

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[16] The main cases are: *Miln v Nicholson's Creditors* (1698) Mor 2876, 1 Ross's Leading Cases 259; *Ranking of Cockburn of Langton's Creditors* (1709) Mor 2877, 1 Ross's Leading Cases 266; *Campbell v Drummond* (1730) Mor 2891, 1 Ross's Leading Cases 270; *Lithgow v Creditors of Armstrong of Whitehaugh* (1749) Mor 2896; and *Ranking of Cockburn of Langton's Creditors* (1760) Mor 6995, 1 Ross's Leading Cases 281.

[17] Bell, *Commentaries* vol 2, p 519.

[18] *Gordon v Campbell* (1842) 1 Bell 563 (HL); *Baird and Brown v Stirrat's Tr* (1872) 10 M 414; *Scottish Wagon Co Ltd v Hamilton's Tr* (1906) 13 SLT 779; *Halifax Building Society v Smith* 1985 SLT(Sh Ct) 25.

[19] Based on those in Gretton, Chapter 7.

subordination agreement. A simple example of a subordination agreement would be where there are three creditors A, B and C with securities ranking in that order, but A has agreed with C to subordinate A's security to that of the postponed creditor C.[20] A subordination agreement is very like an inhibition in that it confers a preference by exclusion on a creditor. In the case of an inhibition, such a preference arises by operation of law while the preference in a subordination agreement is contractual. The subordination rules are set out in Appendix B together with two worked examples. Although the rules are expressed in a different way from the Scottish inhibition ranking rules,[21] their effect is the same. If inhibitions are to confer a preference by exclusion, the ranking rules will have to stay in their present form, or something very similar, and cannot be simplified to any substantial extent. A great simplification however would be achieved if an inhibition, while continuing to render reducible future voluntary deeds, were to cease to confer a preference over post-inhibition debts.

3.17 This would simplify legal and commercial practice considerably. Giving effect to the inhibition ranking rules in a sequestration, liquidation, or sale by a secured creditor is difficult even on a theoretical level, particularly if more than one inhibition is involved. There are often practical difficulties as well. To operate the rules, one has to know whether the other creditors' debts were incurred before or after the date of the inhibition. The financial records of debtors are often incomplete and much time may have to be spent in trying to obtain the necessary information.

3.18 Another argument against the exclusionary preference over future debts is that it confers too great a benefit on the inhibitor as against other creditors. While it is reasonable to expect a creditor lending on heritable security to search the personal register in order to see whether the borrower is inhibited (and indeed it is standard practice to do so), it is unreasonable to expect suppliers of goods or services on credit to take such a step before making the supply. The counter-argument is that an inhibition does not stop the inhibitee from incurring debt; it only protects the inhibitor against debt subsequently contracted on which the subsequent creditors may use adjudication or the deemed adjudication of sequestration or liquidation.[22] Nevertheless, other things being equal, it is arguable that the general creditors should not be prejudiced by an inhibition of which they cannot reasonably be expected to be aware. In our view, the exclusionary preference should not be entirely abolished but it should only apply to future voluntary deeds violating the inhibition and not to subsequently contracted debts. Inhibitions could still create circles of priorities in a sequestration or liquidation since the reduction of a deed on the ground of inhibition would operate for the benefit of the inhibitor only and not the general creditors. There are however likely to be few of those cases in practice since persons taking title from an inhibitee in good faith would be deterred from settling the transaction by an interim search in the personal register which revealed the inhibition. In competition with post-inhibition debts, the inhibitor would secure a preference over the debtor's heritable property by using a land attachment which would not cause circles of priority in ranking.

3.19 **Diminishing effectiveness of inhibition.** It has to be recognised that one side effect of abolishing the preference over future debts would be to reduce the effectiveness of

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[20] This creates a circle of priorities in which A has priority over B who has priority over C who, by virtue of the subordination agreement, has priority over A.

[21] See G Gilmore, *Security Interests in Personal Property* vol 2 (1965) p 1021 quoted in Appendix B, para 8.

[22] Gretton, p 105, citing *Campbell's Tr v De Lisle's Executors* (1870) 9 M 252 per Lord Cowan.

inhibition. An inhibition would confer no preference in the inhibitee's sequestration or liquidation except in the unusual case where the debtor had granted a post-inhibition deed in breach of the inhibition; subject to that exception, the inhibitor would rank *pari passu* with the other unsecured creditors. An inhibition would become a "freeze diligence" which the inhibitor could follow up with a land attachment of part or all of the property affected by the inhibition and a reduction of any deed violating the inhibition. It would only be where the inhibitee granted, or sought to grant, a deed transferring or encumbering his heritable property that an inhibition would have any direct effect.

3.20 **Two or more inhibitions.** So far, we have dealt with situations where there was only one inhibition. Where there are two or more inhibitors whose inhibitions affect different debts, which inhibition is applied first for the purposes of calculating the amount due may make a difference to the result. This is illustrated by Example 6 in Appendix B. Bell states[23] that "Inhibitions do not give preference according to the rule '*Prior tempore potior jure*' ", but it is thought that he is referring to the preference by exclusion over post-inhibition deeds and debts rather than competition between two inhibitions. Bell goes on to deal with competition between inhibitions saying that if adjudications have followed on the inhibitions, the creditors rank according to the dates of their adjudications subject to the equalisation (under the Diligence Act 1661) of those within a year and a day of the first effectual adjudication.[24] Graham Stewart[25] repeats Bell's comments adding that it is assumed that one inhibition does not strike at the debt for which an adjudication has been led. The case of *Campbell v Drummond*[26] however provides some support for a rule that the first inhibition in time should be applied first.

3.21 The authorities are unclear and unsatisfactory and it is not certain what the correct solution is at present. Under our proposals, an inhibition by itself would confer no preference in ranking over subsequently contracted debts. A land attachment enforcing a post-inhibition debt would therefore not be reducible on the ground of inhibition. Inhibitors using land attachment should, like non-inhibiting attachers, rank according to the order of their land attachments. Thus, for example, if there were two creditors A and B who inhibited in that order but attached in the reverse order (B then A), they should rank according to the dates of their attachments.

3.22 Our view is that the advantages of abolishing the preference over future debts outweigh the disadvantages. Accordingly we propose that:

> **4.(1) An inhibition should continue to prohibit the inhibitee from granting any future voluntary deed relating to the heritable property affected by the inhibition to the prejudice of the inhibitor.**
>
> **(2) An inhibition should cease to prohibit the inhibitee from incurring debts after the date of the inhibition. Accordingly, the inhibitor should no longer enjoy a preference by exclusion over such debts in the ranking of creditors in a sequestration, liquidation or other process of ranking.**

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[23] *Commentaries* vol 2, p 141.
[24] *Ibid*, p 140. In Part 2, Section D, we propose the repeal of the Diligence Act 1661.
[25] P 561.
[26] (1730) Mor 2891; 1 Ross's Leading Cases 270; Graham Stewart, p 650.

Deeds granted in breach of an inhibition

3.23 We turn now to consider the remedy available to an inhibitor where the inhibitee has disposed of property affected by the inhibition or granted a subordinate real right (such as a standard security) over it in breach of the inhibition. Take, for example, a disposition by the inhibitee to a third party purchaser. At present the inhibitor may obtain from the Court of Session a decree of reduction of the third party's title on the ground of inhibition, traditionally termed a reduction *ex capite inhibitionis*. This reduction operates for the benefit of the inhibitor only (*ad hunc effectum*) and does not benefit other creditors, even other inhibitors.[27] As Professor Gretton says "... the deed or conveyance reduced does not become null as against all parties, but only as against the inhibitor. As against other parties it is of full force and effect".[28] The reduction entitles the inhibitor to adjudge the property even though for other purposes and as far as other creditors are concerned it remains the third party's property. The third party remains owner but the property is burdened with the inhibitor's adjudication. By virtue of the adjudication, the inhibitor may eject the third party purchaser and let the property to a tenant. If the debt remains unsatisfied after 10 years, the inhibiting adjudger may bring further proceedings to become absolute owner. Where the deed violating the inhibition is a standard security, the inhibitor may reduce and adjudge, or adjudge and reduce. Either way the effect is that the inhibitor's adjudication is ranked prior to the standard security.

3.24 We consider that the existing remedy of a reduction with limited effect followed by an adjudication, or under our proposals in Part 2 a land attachment, by the inhibitor is in principle correct. A catholic reduction having universal effect would be too drastic a remedy. In the above example of a sale by the inhibitee in breach of the inhibition, a catholic reduction would mean that the third party purchaser for value would lose the property entirely; that a heritable creditor taking a standard security over it from the third party would lose his security completely; and that the undeserving inhibitee would get the property back though he might not be able to repay the price to the purchaser or loan to the heritable creditor. Under our proposals in Section E of this Part, an inhibition would not affect a deed violating it if the grantee was justifiably ignorant of the inhibition at the time when the deed was delivered to him and his ignorance would be treated as justifiable if he had taken reasonable steps prior to his taking delivery of the deed to discover the inhibition.[29] In such circumstances reduction on the ground of inhibition of such a deed registered in the Sasine Register would be incompetent. Reduction of a deed registered in the Land Register would normally be incompetent unless the Keeper had discovered and entered the inhibition on the title sheet when registering the grantee's interest.[30] Exceptionally, the Land Register could be rectified to enter the inhibition later and allow reduction only if it could be shown that the grantee had been aware of the existence of the inhibition at delivery of the deed.[31] In short, grantees' titles would be immune from reduction on the ground of inhibition unless they had been fraudulent or had failed to follow good conveyancing practice.

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[27] Gretton, pp 128-131; *McLure v Baird* 19 Nov 1807 FC; Erskine, *Institute* II,11,14.
[28] Gretton, pp 129,130.
[29] Proposal 15 (para 3.88).
[30] Proposal 20(1) (para 3.111).
[31] Proposal 20(4) (para 3.111).

3.25 The replacement of adjudication by land attachment would mean that the inhibitor's remedy after reducing a deed violating the inhibition would be to register a notice of land attachment. The following examples illustrate how the remedy would work. It is assumed that the circumstances are such that reduction is competent.

1. The inhibitee, in breach of the inhibition, sells and dispones property to B who grants a standard security to C. The inhibitor reduces both the disposition and the standard security. By virtue of the reduction, the inhibitor is entitled to register a notice of land attachment against the property sold to B and that attachment will rank prior to the standard security to C.

2. The inhibitee grants a standard security over the property in breach of the inhibition. The inhibitor may either reduce and then register a notice of land attachment or register a notice of land attachment and then reduce. Either way the inhibitor's land attachment would rank prior to the standard security.

3. As in Example 2 but another creditor of another inhibitee registers a notice of land attachment after the registration of the standard security but before the registration of the inhibitor's land attachment. This gives rise to a circle of priorities and double-round ranking has to be used. In the first round, the creditors' claims are ranked in order of the dates of constitution of their real rights: the standard security, the other creditor's attachment, and the inhibitor's attachment. The inhibitor then draws back from the standard security holder what he would have got if the standard security had not been granted.

It should be pointed out that this circle of priorities can exist at present with the added complication that the other creditor's adjudication is reducible if the debt for which it was led was incurred after the inhibition became effective. It is not possible to avoid circles of priorities if the rules for ranking inhibitions require adjustments to be made, by double-round draw-back ranking, to the normal rules on ranking real rights by priority of dates of registration. The granting and registration of a deed in violation of an inhibition is a comparatively rare event, unlike the incurring of debt after an inhibition.

3.26 **Notice of litigiosity in action of reduction on ground of inhibition.** An inhibitor raising an action of reduction should be entitled, but not bound, to register a notice of litigiosity in connection with the action. This notice would serve as a warning to those considering entering into a transaction with the grantee and should prevent any disposition by the grantee taking effect pending the action. The notice would specify the property in the deed under reduction and should be registered in the property registers in the same way as an attacher's notice of litigiosity and for the same reasons.[32]

3.27 Besides replacing adjudication by land attachment, other amendments to, or clarifications of, the inhibitor's remedy might usefully be made. First, in the case of a disposition by an inhibitee to a third party in breach of the inhibition, it is supposed that the inhibitor's adjudication prevails over diligences against the property by creditors of the third party, but there is no authority to this effect. We consider that creditors of the third party using land attachments should be ranked after the inhibitor's attachment in the same way as secured creditors (whose securities could be reduced) of the third party would be.

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[32] See Part 2, Section B, Proposition 6.

3.28 Another area of uncertainty is the extent to which leases granted by inhibitees are reducible. Under the existing law, a lease for a fair rent and for an ordinary duration is not reducible on the ground of inhibition. "Fair rent" and "ordinary duration" are vague terms and such authorities as there are date from an era when the law of leases was very different from today.[33] Security of tenure which many classes of tenant now have means that the granting of a lease reduces substantially the value of the property. It is for consideration whether an inhibitor should be entitled to reduce any lease granted by the inhibitee in breach of the inhibition. If there was sufficient value in the landlord's interest to satisfy the inhibitor's debt, the inhibitor would have no need to reduce the lease. Tenants would be protected from reduction under our proposals if they had taken reasonable steps to discover the existence of the inhibition before taking a lease.[34] What are reasonable steps would depend on the type and duration of the lease. Obtaining a personal search against the landlord is good conveyancing practice for substantial commercial leases (such as those registrable in the Land Register) and this would certainly be sufficient for more modest transactions. A personal search would also prevent the tenant from taking a lease from a landlord who was bankrupt.

3.29 Reduction should not by itself render the lease void, but it should entitle the inhibitor to sell the property with vacant possession by virtue of his land attachment[35]. Making all leases in breach of inhibition reducible would create an additional ground on which tenants of dwelling houses, shops and small business premises could be ejected. Such tenants would have to obtain and retain a clear personal search against the landlord to be secure against reduction. Although a personal search is quick and relatively cheap (about £17 at current prices) it would add to the cost of leases, especially those where lawyers would not normally be involved.

3.30 We invite comments on the following proposals and question:

5.(1) Where an inhibitee grants a deed in breach of the inhibition, the inhibitor should be entitled to bring an action of reduction on the ground of inhibition and to attach the property affected by the deed in question. A reduction on the ground of inhibition should continue to benefit the inhibitor only.

(2) Should it be competent for an inhibitor to reduce a lease granted by the inhibitee in breach of the inhibition, whatever the terms of the lease?

(3) On commencing an action of reduction on the ground of inhibition, the inhibitor should be entitled to register in the property registers a notice of litigiosity specifying the land in the deed under reduction. An inhibitor who fails to obtain a decree of reduction should be bound to discharge the notice.

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[33] Bell, *Commentaries* vol 2, p 142; Hume, *Lectures* vol VI, p 70; *Wedgwood v Catto* 13 Nov 1817 FC; *Earl of Breadalbane v McLauchlan* (1802) Hume 242; *Gordon v Milne* (1780) Mor 7008; *Earl of Tullibardine v Dalzell* (no date) Mor 8370.

[34] See Proposal 16 at para 3.88 below.

[35] An attaching creditor will be bound by the terms of a lease granted prior to the date of registration of the notice of land attachment, if the tenant has taken possession or registered the lease before that date: Part 2, Proposition 12(2).

(4) It should be made clear that where the inhibitee breaches the inhibition by disposing of property to a third party, then any land attachments by creditors of the third party should be postponed to the reducing inhibitor's land attachment.

C. WARRANTS FOR INHIBITION IN EXECUTION OF DECREES AND OTHER DOCUMENTS

Introduction

3.31 In this Section we put forward provisional proposals in relation to warrants for inhibition in execution of court decrees, extracts of writs registered for execution and certain other orders. We confine the discussion to inhibitions in execution because the grant and recall of warrants for inhibition on the dependence of Court of Session or sheriff court actions and for inhibition in security of future and contingent debts is dealt with in our Report on *Diligence on the Dependence and Admiralty Arrestments*.[36]

Decrees and writs registered for execution

3.32 At present the warrant for execution contained in an extract of a decree of the ordinary courts of law (Court of Session, the High Court of Justiciary, the Court of Teinds, or the sheriff court) or an extract writ registered for execution in the Books of Council and Session or sheriff court books does not authorise inhibition.[37] A creditor seeking to enforce the decree or writ by inhibition has to apply for letters of inhibition to the Signet Office of the General Department of the Court of Session.[38] The application is in prescribed form and has to be accompanied by the extract decree or writ and any other necessary documents. The form of application will be signed by or on behalf of the Deputy Principal Clerk of Session if the application is in order and the applicant is entitled to a warrant for inhibition.[39] The signed application is then signeted and the signeted form of application constitutes the letters of inhibition. If the Deputy Principal Clerk refuses the application, it may be placed before a Lord Ordinary whose decision is final.

3.33 Two inter-related questions arise. First, should extracts of decrees, extract registered writs and similar orders and documents containing a warrant for execution, authorise inhibition? Second, should this rule apply to decrees etc. emanating from the sheriff court? A substantial number of applications for letters of inhibition in execution of decrees (Court of Session and sheriff court[40]) and extract registered writs are made each year.[41] In 1996, 1,230 letters of inhibition in execution of decrees and 145 letters in execution of registered writs were registered in the personal register.[42] All of these would have been preceded by an application to the Court of Session for letters of inhibition. This application procedure merely interposes an extra formal step which the creditor is forced to take in order to obtain a warrant for inhibition. It adds to the expense of the diligence[43] and creditors' agents and

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[36] Scot Law Com No 164 (1998) Parts 3, 5 and 6.
[37] Debtors (Scotland) Act 1987, s 87.
[38] RCS, rule 59.1 and Forms 59.1-A to D.
[39] For example, that the decree is for payment of money (including expenses).
[40] Mainly sheriff court decrees. Nearly all Court of Session inhibitions are on the dependence and are transformed automatically into inhibitions in execution on final decree being granted in favour of the inhibitor.
[41] In 1996 4243 applications were granted (information supplied by the General Department of the Court of Session). Most of these were for warrant to inhibit on the dependence of a sheriff court action.
[42] Information supplied by Mr Gavin Peterkin of the Registers of Scotland.
[43] A fee of £23 is charged in the Court of Session. The applicant's solicitor would also charge a fee.

Court of Session staff have to spend time in preparing and processing respectively the applications for letters. Moreover, the procedure does not provide any protection for debtors. The application is not intimated to them and they do not have an opportunity to oppose it.

Extract decrees to authorise inhibition

3.34 Since the present procedure is pointless, the options are that either the requirement to apply for letters of inhibition should be abolished, so that warrants for execution in extract decrees or writs would automatically authorise inhibition, or the procedure should be given an aim so that warrant for inhibition in execution would be granted by judges exercising a discretionary power, after hearing at least the creditor if not also the debtor. We strongly favour the first alternative, that of abolition. Creditors have an automatic right to enforce decrees and writs registered for execution by the diligences of arrestment and furthcoming, poinding and sale and arrestment against earnings. It is hard to see why such creditors should be required to satisfy a court as to the appropriateness of inhibition which is a much less intrusive diligence than those to which they have an automatic right. Inhibition in execution does not attach the debtor's heritage nor is an inhibiting creditor entitled to eject the debtor or sell the property by virtue of the inhibition.

3.35 It would be possible to restrict inhibition by reference to a lower limit on the monetary value of the debt sought to be enforced. For example, there could be a rule that inhibition in execution would not be competent in relation to decrees etc for less than £500. We are not in favour of introducing such a rule. Poinding and sale can be as expensive a diligence as inhibition, yet it is competent to enforce by the former diligence a monetary obligation however small contained in a decree or registered writ.[44]

Sheriff court extract decrees

3.36 For historical reasons, inhibition was and is purely a Court of Session process. This has long been criticised. The McKechnie Report recommended[45] that the sheriff should be given the same power as the Court of Session to grant warrants for inhibition, such warrants to have the same effect as a Court of Session warrant or signeted letters of inhibition. The report pointed out that the sheriff grants warrant to inhibit when awarding sequestration.[46] This recommendation was endorsed by the Grant Report.[47] Responses to a questionnaire issued by us following a seminar on diligence on 29 April 1995 showed overwhelming support for conferring on sheriffs jurisdiction to grant warrant for inhibition. In our view such a reform is long overdue. We have already recommended that sheriffs should be empowered to grant warrants for inhibition on the dependence of sheriff court actions, in addition to their existing power to grant warrants for arrestment on the dependence.[48] The expense of the only alternative - an application to the Court of Session - cannot be justified.

3.37 It might be argued that inhibition should not be available on all sheriff court decrees. Under the present law, letters of inhibition can be obtained on the basis of all sheriff court

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[44] The reforms we propose later to the method of execution of inhibition, if accepted, should reduce the cost.
[45] Report of the Departmental Committee on *Diligence* (Cmnd 456, 1958), paras 190, 191, recommendation 63.
[46] *Ibid*, para 191.
[47] Report of the Departmental Committee on *The Sheriff Court* (Cmnd 3248, 1967) para 125, recommendation 23.
[48] Report on *Diligence on the Dependence and Admiralty Arrestments*, Scot Law Com No 164 (1998), recommendation 10 (para 3.97).

decrees, - ordinary cause, summary cause or small claim decrees. At one time inhibition was not competent on small debt decrees,[49] but we do not think that the holders of summary cause or small claim decrees should be deprived of their right to inhibit in execution. The present monetary upper limits of £750[50] and £1,500[51] of principal sum (to which expenses may be added) for small claims and summary causes respectively mean that such decrees can be for substantial sums of money. Moreover, there is no lower monetary limit on writs registered for execution in the Books of Council and Session, which ground an application for letters of inhibition.

3.38 Until recently at least, letters of inhibition were competent on extracts of writs registered for execution in sheriff court books.[52] Letters in this and all other cases were obtained by way of a bill to the Court of Session. The bill procedure was replaced in October 1994 by an application. Rule 59.1(1)(c) of the Court of Session Rules deals with applications on the basis of deeds registered for execution. The associated form, Form 59.1-C, mentions only deeds registered in the Books of Council and Session. This may be an oversight. It is not clear whether letters of inhibition are no longer competent to enforce extracts of writs registered for execution in sheriff court books (which seems unlikely), or whether creditors seeking a warrant for inhibition must use the old bill procedure, or whether an application is competent under Rule 59.1(1)(c) subject to the applicant adapting Form 59.1-C to refer to the writ having been registered in the sheriff court books. Although the number of writs registered for execution in sheriff court books is small, we see no reason to prohibit their enforcement by means of inhibition, or to have a different procedure in relation to them.

3.39 We propose that:

> **6.(1) Warrants of execution contained in extract decrees of the Court of Session, the High Court of Justiciary, the Court of Teinds and the sheriff court and in extract writs registered for execution in the Books of Council and Session or sheriff court books should authorise inhibition as well as authorising arrestment in common form, poinding and arrestment of earnings. Accordingly, it should no longer be competent to obtain a warrant for inhibition in execution of such decrees or writs by way of an application for letters of inhibition.**
>
> **(2) An inhibition in pursuance of a warrant for execution contained in an extract of a sheriff court decree, or of a writ registered in the books of a sheriff court, should affect the inhibitee's heritable property throughout Scotland, not merely property within the sheriffdom.**

Need to retain letters of inhibition?

3.40 An application for letters of inhibition is necessary in order to obtain a warrant for inhibition except where warrant for inhibition on the dependence of a Court of Session action is sought. Our recent Report on *Diligence on the Dependence and Admiralty Arrestments*[53]

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[49] *Lamont* (1867) 6 M 84
[50] Small Claims (Scotland) Order 1988 (SI 1988/1999), art 2(a).
[51] Sheriff Court (Scotland) Act 1971, s 35(1)(a) as amended by the Sheriff Courts (Scotland) Act 1971 (Privative Jurisdiction and Summary Causes) Order 1988, (SI 1988/1993).
[52] Gretton, (1st edn), p 8.
[53] Scot Law Com No 164 (1998), Part 3; paras 6.59-6.64.

recommended a new procedure, involving an application to a judge, for obtaining warrant on the dependence of Court of Session and sheriff court actions and also warrant for inhibition in security of future or contingent debts. Given that, under our proposals in this Section, warrants for execution in extracts of decrees, registered writs and similar orders would authorise inhibition, the question arises whether there are any cases for which an application for letters of inhibition needs to be retained. A possible use for letters of inhibition might be to grant warrant for inhibition on the basis of a document of debt (other than a bill or promissory note), but we understand that inhibition on such documents is unknown in current practice. We would be grateful for views on whether there are situations where letters of inhibition would still be needed.

Inhibition in execution of other enforceable orders and awards

3.41 We turn now to consider the enforcement of orders and awards other than Court of Session and sheriff court decrees or registered writs and whether inhibition should be available for them. We do not attempt to give a complete list of such items but merely give examples of the various categories.

3.42 **(a) Order enforceable as a decree of court**. An order or determination of the Scottish Land Court is enforceable "as if it were a decree of the sheriff having jurisdiction in the area in which the order or determination is to be enforced".[54] A similar formula applies to a foreign maintenance order registered in the appropriate sheriff court under the terms of the Brussels or Lugano Conventions.[55] Non-maintenance foreign judgments registered in the Court of Session under these conventions are enforceable as if the judgments had originally been given by the Court of Session,[56] as are foreign judgments registered under the Administration of Justice Act 1920[57] or the Foreign Judgments (Reciprocal Enforcement) Act 1933.[58] An award of expenses made by the Scottish Solicitors' Discipline Tribunal is also enforceable as if it were an extract decree of the Court of Session.[59]

3.43 **(b) Award registrable in the Books of Council and Session**. An extract of an order of the Lands Tribunal for Scotland may be registered for execution in the Books of Council and Session and any extract will bear the normal warrant for execution.[60] Decrees-arbitral, however, are registrable only if the parties to the arbitration have consented (either in the submission to arbitration or subsequently) to registration for execution of the arbiter's award.[61]

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[54] Scottish Land Court Act 1993, Sch 1, para 16.
[55] Civil Jurisdiction and Judgments Act 1982, s 5(4). An order from a reciprocating country registered in a Scottish court under the Maintenance Orders (Reciprocal Enforcement) Act 1972 is enforceable as if it had been made by that court (s.8).
[56] 1982 Act, s 4(3).
[57] s 9(3).
[58] s 2(2).
[59] Solicitors (Scotland) Act 1980, Sch 4, paras 20-21.
[60] Lands Tribunal Act 1949, s 3(12) as amended by the Land Tenure Reform (Scotland) Act 1974, s 19.
[61] Hunter, *Law of Arbitration in Scotland* (1987) para 10.47. Some awards, mainly foreign arbitration awards, may be registered in the Register of Judgments if the Court of Session, on application, grants warrant for registration; see RCS, rule 62.

3.44 **(c) Award equivalent to extract registered decree-arbitral**. Any order for the payment of money made by an industrial tribunal[62] or an employment appeal tribunal[63] is enforceable as an extract registered decree-arbitral bearing a warrant for execution issued by the sheriff court of any sheriffdom in Scotland. The same formula is used for awards of expenses in local enquiries held under the Education (Scotland) Act 1980.[64] A slightly different formula is used in relation to awards of expenses in an appeal hearing against a decision by the Bank of England in relation to banking licences. The award is equivalent to an extract registered decree-arbitral bearing a warrant of execution issued from the Books of Council and Session.[65]

3.45 We proposed above[66] that the warrant for execution in extracts of decrees and registered writs should automatically authorise inhibition and that it should no longer be competent to apply to the Court of Session for letters of inhibition in these circumstances. Because the various awards and orders outlined above are enforceable as if they were decrees of court or registered writs, our proposal would automatically apply to them. We accept this as we see no reason to create a distinction between decrees and registered writs and their equivalents.

Inhibitions and criminal proceedings

3.46 Fines imposed by a criminal court are enforceable by civil diligence. Section 221 of the Criminal Procedure (Scotland) Act 1995, a consolidation measure,[67] provides that a warrant for civil diligence in the form prescribed by Act of Adjournal may be added to the finding of the court. In terms of rule 20.8 of the Act of Adjournal (Criminal Procedure Rules) 1996 every extract of a sentence of a fine or other financial penalty includes a warrant of execution whereby the court grants "warrant for all lawful execution". Such a warrant authorises poinding and sale, arrestment of earnings and arrestment of assets other than earnings.[68] Recovery by civil diligence is also available for compensation orders.[69] It would seem to be incompetent to apply for letters of inhibition on the basis of the warrant for execution in a fine or compensation order[70] since civil diligence for criminal penalties is regulated by statute rather than common law and the 1995 Act sets out exhaustively what diligences are authorised. We understand that in practice inhibition has not been used. We propose above that the warrant for execution on a Court of Session or sheriff court decree should authorise inhibition and we think that this should be extended to warrants for civil diligence on fines and compensation orders. If fines and compensation orders are to be enforceable by civil diligence (as they are), then there seems no reason why all the diligences available to civil creditors should not be competent. Inhibition would be a very useful diligence, particularly against corporate or self-employed offenders. Moreover, it would be anomalous if a compensation order made by a criminal court could not be enforced by

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[62] Employment Protection (Consolidation) Act 1978, Sch 9, para 7(2) as amended by the Employment Act 1980, Sch 1, para 27.
[63] 1978 Act, Sch 11, para 21A(2) as inserted by 1980 Act, Sch 1, para 29.
[64] Sch 1, para 8 as amended by Debtors (Scotland) Act 1987, Sch 6, para 22.
[65] Banking Act 1979 (Scottish Appeals) Regulations 1980 (SI 1980/348) reg 13.
[66] Proposal 3 (para 3.9).
[67] Civil diligence on summary fines goes back at least to the Summary Procedure (Scotland) Act 1864.
[68] 1995 Act, s 221.
[69] 1995 Act, s 252 applying s 221 to compensation orders.
[70] See Gretton, p 14 for a contrary view.

inhibition while damages awarded by a civil court in respect of the same act could be. We propose that:

> **7. The warrant for execution contained in the extract of an order imposing a fine or other financial penalty or of a compensation order should authorise inhibition in addition to arrestment of assets other than earnings, poinding and sale, and arrestment of earnings.**

3.47 Under section 32 of the Proceeds of Crime (Scotland) Act 1995, the Court of Session, on application by the Lord Advocate, may grant warrant for inhibition against any person interdicted by a restraint order or an interdict under section 28(8). The warrant has the effect of letters of inhibition and is to be registered forthwith in the personal register by the Lord Advocate. Restraint orders may be granted by the Court of Session where the criminal proceedings are taking place, or are to take place, in the High Court of Justiciary. Sheriffs may grant restraint orders in relation to proceedings in their courts.[71] We think that our proposed conferment of jurisdiction in relation to warrants for inhibition on sheriffs should extend to warrants in connection with sheriff court restraint orders. We therefore propose that:

> **8. Where a sheriff has granted a restraint order under section 28 of the Proceeds of Crime (Scotland) Act 1995, that sheriff or another sheriff of that sheriffdom should have power to grant, on application by the procurator-fiscal, warrant for inhibition against any person interdicted by that restraint order or an interdict under section 28(8).**

Child support liability orders

3.48 Section 38 of the Child Support Act 1991 provides that a liability order made by a sheriff in respect of arrears of child support is "apt to found a Bill of inhibition". Prior to the present procedure (introduced in 1994) whereby an "application" is presented for letters of inhibition, a bill for letters of inhibition had to be submitted to the Court of Session. It is not clear whether the Secretary of State for Social Security as creditor in the liability order would have to use the old procedure.[72] We think that inhibition should become one of the diligences which should be authorised by the warrant of execution on an extract of a liability order in the same way as inhibition would be authorised under Proposal 7 above[73] by the warrant for execution in an extract of a sheriff court decree. We propose that:

> **9. Section 38 of the Child Support Act 1991 (liability order by sheriff "apt to found Bill of inhibition") should be amended so that an extract of a liability order would automatically authorise inhibition at the instance of the Secretary of State for Social Security of the person against whom the order was made.**

Summary warrants for recovery of tax or rates arrears

3.49 Summary warrants are available for the enforcement of a variety of central and local government taxes and duties. The general scheme is that an official of the taxing authority

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[71] Proceeds of Crime (Scotland) Act 1995, s 28.
[72] In practice the application would be made by a designated official of the Child Support Agency, see *Secretary of State for Social Security v Love* 1996 GWD 6-352.
[73] Para 3.37.

applies for a summary warrant to the sheriff certifying that arrears of tax are due by the individual or individuals named and that a demand for payment has been made and has not been complied with. This application is granted summarily without intimation of the application to the individual or individuals concerned and without giving them any opportunity for opposing it. The summary warrant authorises the diligences of arrestment and furthcoming, poinding and sale and arrestment of earnings.[74] It has been held that letters of inhibition cannot be obtained on the basis of a summary warrant[75]. Inhibition in execution of such a warrant is incompetent and, since the debt is neither future nor contingent, inhibition in security is also incompetent.

3.50 Summary warrants are somewhat different from decrees, registered writs and the other awards and orders that are enforceable in a similar manner. In all those cases the debtor either had an opportunity to oppose the granting or had agreed in advance to diligence being done without the need for prior court action. In a summary warrant on the other hand there is no opportunity to oppose the granting in proceedings before the sheriff.[76] This could be seen as a justification for limiting the diligence authorised by summary warrants. But the diligences of arrestment and furthcoming and poinding and sale are much more intrusive than inhibition. They, unlike inhibition, involve the seizure and disposal of the debtor's assets. Inhibition, by contrast, is merely a preventive diligence whereby the debtor is prevented from voluntarily disposing of heritable property. The unavailability of inhibition on summary warrants means that a taxing authority wishing to inhibit has to bring an ordinary action for the tax arrears and abandon any previously obtained summary warrant. This is a duplication of legal procedure and furthermore local government, but not central government, cannot abandon a summary warrant once any diligence has been done on the basis of it.[77] Thus inhibition may be unavailable when it is most needed because one or more of the diligences authorised by the summary warrant have proved fruitless.

3.51 We invite views on the following question:

10. Should a summary warrant for arrears of local or central government tax authorise inhibition of the defaulter?

D. SERVICE AND REGISTRATION OF INHIBITIONS

Introduction

3.52 In this Section, we examine the existing system of registration of inhibitions and notices of inhibition which backdate the effectiveness of inhibitions registered within the next 21 days. We also consider the methods by which schedules of inhibition are served on inhibitees and the question of who should carry out such service. Proposals are put forward for making the procedure for executing the diligence of inhibition simpler and cheaper.

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[74] Local Government (Scotland) Act 1947, s 247 as substituted by Debtors (Scotland) Act 1987, Sch 4, para 1 (non domestic rates); Taxes Management Act 1970, s 63 as amended by Debtors (Scotland) Act 1987, Sch 4, para 2 (income tax, corporation tax and capital gains tax); Local Government Finance Act 1992, Sch 8 (council tax and water charges); Value Added Tax Act 1994, Sch 11, para 5 (VAT); Finance Act 1996, Sch 5, para 13(3)(landfill tax).

[75] *Commissioners of Customs and Excise, Applicants* 1992 SLT 11 (OH).

[76] Although a demand for payment must have been made to the alleged tax or rates defaulter and not complied with.

[77] Local Government (Scotland) Act 1947, s 247(5) as amended by the Debtors (Scotland) Act 1987, Sch 4; Local Government Finance Act 1992, Sch 8.

Existing procedure for service and registration of inhibitions

3.53 After obtaining a warrant for inhibition (letters of inhibition, summons or certified copy interlocutor),[78] the inhibitor instructs a messenger-at-arms[79] to serve a schedule of inhibition on the inhibitee. The schedule, which is in a prescribed form, contains the designations of the inhibitor and the inhibitee together with details of the warrant. It inhibits the inhibitee from "selling, disposing of, burdening or otherwise affecting your land and other heritable property to the prejudice of [name and address of inhibitor]".[80] When serving the schedule, the messenger must be in possession of the document containing the warrant to inhibit and must show that document to the inhibitee on request.[81]

3.54 Service is effected by any of the recognised modes of hand service, including personal service and service at the dwelling house or place of business. Although the Rules of the Court of Session 1994 abolished edictal service of most procedural writs, including summonses, edictal service of inhibitions was retained, presumably because the alternative of public advertisement of the inhibition would have been socially unacceptable. Edictal service involves the messenger leaving the schedule at the office of the Extractor of the Court of Session and sending a copy of the schedule to the inhibitee's address, or last known address, by registered or recorded delivery post. Edictal service has to be used where none of the other modes is applicable, for example, where an individual is not resident or present in Scotland.[82] Postal service of an inhibition is incompetent[83] except as an adjunct to edictal service.

3.55 After service of the schedule of inhibition on the inhibitee, the warrant for inhibition together with the messenger's prescribed form certificate of service (or execution)[84] of the schedule are presented for registration in the personal register. An inhibition is effective from the date of its registration, unless (as is the normal case) a notice of inhibition has been registered in the personal register not more than 21 days beforehand. Such a notice backdates the effectiveness of the inhibition to the date of the registration of the notice.[85] Notices of inhibition are not intimated to those who are shortly going to be inhibited.

Drawbacks of the existing procedure

3.56 The procedure for serving and registering inhibitions has scarcely changed in the past 130 years. The last major change took place in 1868 when publication of the inhibition at the head burgh of the inhibitee's domicile by the messenger reading it and affixing a copy to the mercat cross was rendered unnecessary by a provision deeming registration in the personal register to include this step.[86] It may be thought that the present procedure is unduly complex and expensive. The schedule of inhibition is served on the inhibitee before the inhibition becomes effective by registration of the warrant and certificate of service in the

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[78] See Section C above.
[79] Sheriff officers may serve the schedule in some circumstances: see Execution of Diligence (Scotland) Act 1926, s 1.
[80] RCS, Form 16.15-F replacing Schedule QQ to the Titles to Land Consolidation (Scotland) Act 1868.
[81] RCS, rule 16.12(6).
[82] RCS, rule 16.12(4).
[83] RCS, rule 16.12(2).
[84] RCS, Form 16.15H.
[85] Titles to Land Consolidation (Scotland) Act 1868, s 155. The notice is in the form of Schedule PP.
[86] Court of Session Act 1868, s 18; Graham Stewart, p 540.

personal register. This gap may extend to several days during which the inhibitee may take steps to render the inhibition wholly or partly ineffective. Most inhibitions (over 80%) are preceded by a notice of inhibition in order to backdate the effectiveness of the inhibition to a date before service on the inhibitee, but registering a notice adds about £50 to the cost of the diligence. Notices of inhibition also have drawbacks for inhibitees. During the period between registration of the notice and registration of the inhibition (which may last up to 21 days), they may unwittingly enter into obligations relating to their heritable property which they will be unable to implement because they have been retrospectively inhibited. This may result in their being liable in damages to the other party to the transaction.

3.57 At present the schedule of inhibition has to be hand served by a messenger-at-arms, which is expensive. The fee for service of an inhibition at the inhibitee's dwelling house (which requires the messenger and a witness to travel there and to hand the schedule personally to the inhibitee or leave it at the dwelling house) varies from £37.65 to £76.60 depending on the distance from the messenger's place of business to the house. Additional fees are payable for the time spent in travelling over 60 miles or on a ferry.[87] If postal service of inhibitions were competent, the diligence would be cheaper. Thus for example, postal service of charges or arrestments attracts a fixed fee of £26.50[88].

Proposals for simplifying the procedure

3.58 We put forward for consideration a simpler and less expensive procedure for serving and registering inhibitions. Our new scheme would be as follows:

(a) registration of a schedule of inhibition in prescribed form in the personal register; and

(b) service of a copy of the schedule on the inhibitee.

Registration of the schedule in the personal register on behalf of the inhibitor would as at present be carried out either personally or by post, although other methods might become competent in the future.[89] The inhibition would not generally[90] be effective at this stage but only after service of a copy of the schedule on the inhibitee.

3.59 Service on the inhibitee should be carried out by hand service by an officer of court (a messenger-at-arms or a sheriff officer depending on which court granted the warrant to inhibit[91]), by a registered or recorded delivery letter addressed to the inhibitee at the inhibitee's dwelling house, place of business, registered office etc., or edictally. Postal service should be competent only where the address for delivery was within the British Islands (ie the United Kingdom, the Channel Islands and the Isle of Man[92]) since that is the limit of the recorded delivery service. If the letter was returned as undelivered, the schedule

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[87] £17.80 per 30 minutes plus ferry dues. See also the General Regulations in Sch 1 to the Act of Sederunt (Fees of Messengers -at-Arms) 1994 (SI 1994/391).
[88] Act of Sederunt (Fees of Messengers-at-Arms)1997 (SI 1997/2825).
[89] Such as fax (RCS, rule 23.2 allows some Court of Session motions to be lodged by fax) or e-mail from authorised agents(New Brunswick has such a system for its Personal Property Security Register and a similar system is being piloted in Ontario for its Land Register).
[90] It would become effective on registration if service had already occurred, see para 3.63 below.
[91] Messengers are restricted to executing Court of Session warrants; Debtors (Scotland) Act 1987, s 77.
[92] Interpretation Act 1978, Sch 1.

of inhibition should have to be re-served by an officer of court if the place of service was within Scotland or edictally if the place of service was in another part of the British Islands. Edictal service would have to be used for all service outwith the British Islands and for service by officer of court outwith Scotland.

3.60 Where both postal and hand service are competent the inhibitor should be free to choose the mode of service and would be liable to pay the officer the appropriate fee. However, if the expenses of inhibitions are to be recoverable by inhibitors from inhibitees, the inhibitee should be liable only for the cost of postal service,[93] unless it was ineffective and the schedule had to be re-served by officer. Where re-service was necessary the inhibitee should be charged with the cost of the attempted postal service and the later hand service. A somewhat similar rule applies to the service of summonses and warrants of citation under the Citation Amendment (Scotland) Act 1882.[94]

3.61 Under our scheme an inhibition would generally become effective not on registration of the schedule in the personal register but on the service of the schedule on the inhibitee. Ideally an inhibition, being a personal prohibition, ought to come into effect at the same instant as it is brought to the inhibitee's attention by service of the schedule. However, we do not think it is necessary to use the precise time of service and there would be difficulties in such an approach. The precise time of service would have to be specified for each of the modes of service and those involved in service would have to note and certify that time. Neither officers of court[95] nor the Post Office[96] generally certify the time of service or delivery at present and should not be required to do so for inhibitions alone. Moreover, in many cases the time of service would not be the time when the inhibition actually came to the inhibitee's attention.

3.62 Since it is impracticable for an inhibition to become effective at the actual time of service of the schedule on the inhibitee the inhibition has to come into effect at a time fixed by law by reference to the date of service. The element of surprise which is achieved in the present system by notices of inhibition is one which we think must be retained if inhibition is to continue to be an effective diligence. By the time inhibitees are served with the schedule of inhibition it must be too late for them to take evasive action. We suggest that an inhibition should be deemed to come into effect on the first moment of the day of service. Any deed delivered or action taken on or after the day of service would be struck at by the inhibition and could not defeat it. Thus if a schedule of inhibition was served on the inhibitee by recorded delivery letter at 8 o'clock in the morning of August 16 it would be deemed to have come into effect at midnight on 15/16 August. It would have been in force for some eight hours by the time the inhibitee was served with the schedule. We do not consider that this minimal backdating would cause difficulties for inhibitees. They are most unlikely to have entered into obligations concerning their heritable property in ignorance of the inhibition during this period.[97]

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[93] We discuss in Section I below whether inhibitees should be chargeable with the expenses of inhibitions used against them.

[94] 1882 Act, s 6.

[95] RCS, Forms 16.15-H to K (certificates of execution of arrestments, charges and inhibitions) provide for the date of execution only. Form 16.3 (certificate of service of summons or intimation) does require the time to be mentioned where personal service occurred.

[96] The Post Office advice of delivery specifies the date of delivery only.

[97] Pre-existing obligations would not be struck at by the inhibition.

3.63 So far in discussing our new scheme it has been assumed that registration of the schedule of inhibition would have taken place before the schedule was served on the inhibitee. Cases will occur where registration and service take place on the same day (for example where schedules are posted on the same day to the personal register and the inhibitee) or where registration takes place later. We suggest that the inhibition should come into effect on the first moment of the day of service or the day of registration, whichever is the later. An inhibitor who fails to register first runs the risk that the inhibitee will have taken evasive action before the inhibition becomes effective by registration. We do not think that there is a similar risk in the reverse situation. Inhibitees are most unlikely to become aware of the registration of a schedule in the personal register before the inhibition becomes effective by service.

3.64 Under our scheme the time when an inhibition comes into effect will generally depend on the date of service of a schedule of inhibition on the inhibitee. Where the schedule was hand served the date of service would be known from the officer's certificate of service. The various enactments dealing with postal service adopt different solutions to fixing the date of service. Section 7 of the Interpretation Act 1978 provides that service is effected at the time when the letter would have been delivered in the ordinary course of post. This is too imprecise for the purposes of our scheme. Where a summons or warrant of citation is served postally the *induciae* (the number of days the recipient has in which to take some step) are to run from 24 hours after the time of posting.[98] The Court of Session rules for service of documents by post are in similar terms; the date of service being deemed to be the day after the date of posting.[99] In terms of section 2 of the Execution of Diligence (Scotland) Act 1926 postal service of an arrestment or charge is valid when the document is delivered to the arrestee or debtor. The sender can pay a small extra fee at the time of posting for an "advice of delivery" of registered and recorded delivery letters.[100] The sender will then be sent a card stating the date when delivery took place. We are not in favour of using a deemed date of service if the actual date can readily be ascertained (as it can be). However, there will be cases where the letter was delivered but the sender failed to request advice of delivery or failed to receive the advice. The actual date of delivery should also be capable of being established by evidence other than the advice document. Where there is no evidence, by advice or otherwise, we suggest that delivery should be deemed to have occurred on the third day after posting. Generally first class recorded delivery and registered letters are delivered on the day after they were posted, but some will take longer. The fact that in most cases the actual date of delivery will be two days earlier than the deemed date provides an incentive for senders to request advice of delivery. The Post Office advice document would have to be retained with the certificate of posting in case the date of delivery was challenged later. If the letter was returned as undelivered so that the schedule had to be re-served by officer, then the date of service would, of course, be the date as shown in the officer's certificate of service

3.65 Under the present law an inhibition prescribes on the lapse of five years from the date when it became effective.[101] This date is either the date of registration of the inhibition or the date of registration of a notice of inhibition if registered not more than 21 days prior to

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[98] Citation Amendment (Scotland) Act 1882, s 4(2).
[99] Rule 16.4(6).
[100] This is part of a scheme drawn up under s 28 of the Post Office Act 1969, and published in the *Edinburgh Gazette*.
[101] Conveyancing (Scotland) Act 1924, s 44(3)(a).

the inhibition. In our new scheme an inhibition becomes effective on service on the inhibitee, but this is not a publicly known date. We suggest that the five year period should run from the date of registration of the schedule in the personal register. In most cases the gap between registration and effectiveness would be a matter of days. This slight shortening of the prescriptive period would not materially prejudice inhibitors.

3.66 The main advantages of our proposed new scheme are that it would simplify the procedure for registration of inhibitions and in consequence save expense. First, notices of inhibition which backdate the effective date of an inhibition would be unnecessary and should be abolished. The element of surprise would be achieved by the inhibition becoming effective from the first moment of the day when the schedule is served on the inhibitee. Inhibition is a personal prohibition so that it seems wrong in principle for it to be made effective for a period of up to 21 days before service on the inhibitee. During this period inhibitees are unaware that they have been inhibited and might enter into obligations in relation to their heritable property which they would be unable to implement. This failure might give rise to a claim for substantial damages. Edictal service breaches this principle because the date of service is the date of delivery of the schedule of inhibition to the Extractor's office rather than the date of the inhibitee's receipt of the postal copy. This breach is unavoidable if the whereabouts of the inhibitee is unknown, and it would be difficult to ascertain the date of receipt of the postal copy by inhibitees outwith the British Islands. Second, inhibition would cost less for inhibitors and inhibitees and our scheme would also produce indirect savings for those operating and searching the personal register. There would be a very substantial decrease in the number of inhibition documents to be processed and entries to be searched since notices of inhibition would be abolished and a single document-the schedule of inhibition-would be presented for registration instead of the messenger's certificate of service and the warrant for inhibition.

3.67 The main disadvantage of the new scheme is that the personal register would contain inhibitions which were not effective because they had not, or had not yet, been followed up by service of the schedule on the inhibitees. A person inspecting the register would not know whether or not the individual in question was inhibited and if so when the inhibition had become effective. The fact, however, that an inhibition becomes effective only when a schedule is both served and registered provides a powerful incentive for inhibitors to serve and any searcher would assume that this step had been taken promptly. In the vast majority of cases the period of ineffectiveness, the period between the registration of the inhibition and service on the inhibitee, would be no more that a day or two. Moreover, the personal register is not a register of rights. It publicises the fact that certain events, such as inhibition or sequestration have occurred which affect, or may affect, a person's ability to deal with heritable property. The register at present contains many entries which for one reason or another are ineffective. Those involved in conveyancing transactions are accustomed to making further enquiries once an inhibition comes to light.

3.68 Another drawback is that inhibitors would have to retain the documents relating to service, delivery or posting[102] in order to be in a position to prove that the inhibition was effective, if that was challenged. Unless service could be established by such a document or other evidence the inhibition would be ineffective. The officer's certificate of hand service

[102] The date of posting would be relevant in those cases where delivery is deemed to occur three days after posting, see para 3.64 above.

would be sufficient evidence of the facts stated in it until reduced and any challenger would face a heavy burden. We suggest that the Post Office advice of delivery document or certificate of posting should be in a similar position. It seems unlikely that the need to retain for many years documents relating to service of inhibitions would be a major disadvantage. Solicitors are accustomed to retaining certificates of posting or service, such as those relating to summonses and charges, for a substantial period of time.

3.69 Further detailed provisions would be necessary to regulate the form of the schedule of inhibition and the addresses to which it should be sent (dwelling house, registered office, business address etc.). The letter containing the schedule should state that it was to be returned to the sender if undelivered. We envisage that the rules for serving the schedule would follow the existing rules of court for the execution of diligence with appropriate amendments.[103] The detailed provisions can be left to be made by the Court of Session by Act of Sederunt. At this stage we are concerned to obtain comments on the principle of our proposed new scheme. We therefore ask for views on the following question:

11. Should the present system of service and registration of an inhibition be replaced by a scheme along the following lines?

(a) A solicitor in possession of a warrant to inhibit should be entitled to register on behalf of the inhibitor a schedule of inhibition in the personal register.

(b) It should be competent to serve the schedule of inhibition on the inhibitee by means of hand service by officer of court or, if the place of service is within the British Islands, by registered or recorded delivery post. If postal service was ineffective the schedule should be re-served by officer of court.

(c) The inhibition should become effective on the first moment of the day when the schedule of inhibition was served on the inhibitee or the schedule was registered, whichever is the later. Where the schedule was served by post the date of service should be the date when it was delivered, as established by a document from the Post Office or other evidence. In the absence of such a document or other evidence a letter which was not returned as undelivered should be deemed to have been delivered on the third day after the date of posting.

(d) The inhibitee should be charged only the cost of postal service, unless re-service by officer of court was necessary in which case the inhibitee should be charged for the attempted postal service and the re-service.

(e) The schedule of inhibition and other documents connected with service and registration of inhibitions should be in a form prescribed by the Court of Session by Act of Sederunt. The Act of Sederunt should also contain rules relating to the modes of service of the schedule on the inhibitee.

Who should be entitled to serve schedules of inhibition?

3.70 At present the inhibitor's solicitor obtains the warrant to inhibit and instructs a messenger to inhibit the inhibitee. After serving a schedule of inhibition on the inhibitee, the

[103] RCS, rule 16, for example.

messenger returns the warrant to the solicitor together with a certificate of service. These documents are then presented for registration in the personal register, almost invariably by the solicitor. For so long as hand service of the schedule of inhibition (i.e. delivery to the inhibitee in person or leaving it at the dwelling house etc.) is required, this division of functions seems entirely satisfactory. We do not think solicitors should, or would wish to, perform hand service of schedules of inhibition. If however (as proposed above) the schedule of inhibition may be served by post, the division of functions appears to us to be less justifiable.

3.71 Who should be entitled to serve a schedule on the inhibitee by post under our new scheme? Should it be the inhibitor's solicitor or an officer of court, or should there be no restrictions on who could perform this task? In our view, there ought to be no question of this function or the completion of schedules and their presentment for registration in the personal register being entrusted to unqualified persons. An inhibition is a diligence and in the performance of all diligences strict standards of accuracy are required. There must be safeguards against undue delay in executing the creditor's instructions. The person executing the warrant of the court has to be responsible to the court and subject to its supervision, discipline and control; and parties should be safeguarded from blundered execution by bonds of caution and insurance.

3.72 It would be more convenient for the inhibitor's solicitor to undertake the whole process from obtaining the warrant and registering the inhibition to serving the schedule on the inhibitee by post. If the inhibition was on the dependence then a solicitor could serve the schedule of inhibition on the inhibitee/defender by post in the same letter as the summons or initial writ.[104] It would also be cheaper in that the solicitor would not have to charge a fee (currently £3.20[105]) for instructing an officer of court to serve the schedule.

3.73 There are however in our view arguments for officers of court retaining the function of serving schedules of inhibition. It has so far been a basic principle of diligence that it should be carried out only by an officer of court instructed by the creditor[106], and officers of court hold a public office with the exclusive right to execute diligence and the duty to act when instructed. Giving solicitors the function of postal service of diligence writs might seriously affect the viability of officers' businesses, particularly if postal service by solicitors was extended beyond inhibitions to charges, arrestments and earnings arrestments. There might be insufficient officers left to carry out hand service and those steps in diligence (such as a poinding or an ejection) which have to be carried out by officers. Prior to 1882 all court writs were hand served by officers. The Citation Amendment (Scotland) Act 1882 allowed solicitors to serve summonses and initial writs by post. This resulted in such a large reduction in the number of officers of court that for over 70 years it was difficult to get diligence done in the remoter areas of Scotland.[107] To elicit views we ask the following question:

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[104] Court of Session summonses and sheriff court initial writs may be served postally by solicitors or officers of court, Citation Amendment (Scotland) Act 1882, s 3; Court of Session Rules, rules 16.3 and 16.4.

[105] Act of Sederunt (Fees of Solicitors in the Sheriff Court) (Amendment and Further Provisions)1993, SI 1993/3080 as amended by SI 1996/236.

[106] *Stewart v Reid* 1934 SC 69.

[107] Report of the Departmental Committee on *Diligence* (1958) Cmnd 456 para 222.

12. Should it be competent for a solicitor to serve a schedule of inhibition by post or should this task continue to be carried out solely by officers of court?

E. INHIBITIONS AND THE PROPERTY REGISTERS

Introduction

3.74 The foundation of the Scottish system of heritable conveyancing is the principle that persons transacting with heritable property in good faith and for value should be entitled to rely with complete confidence on the faith of the property and personal registers. It is simply not acceptable that purchasers in good faith and for value can suffer loss through no fault of their own or their solicitors but because of a deficiency in the system of searching the registers. In this Section we identify a serious deficiency of that type in the system of searching the personal register. We also consider other difficulties associated with the fact that inhibitions registered in the personal register affect heritable property, title to which is registrable in the property registers. We mention them briefly here and discuss them at greater length later in this Section.

3.75 Normal procedures in ordinary transactions for the conveyance of heritable property include a search in the personal register ("a personal search") against the owner of the property (and certain of his predecessors in title) in order to discover whether there is an effective inhibition against those persons.[108] The personal search will be carried out, using where possible[109] the names and designations of the owner and others as they appear in the property registers, although if further information about a person is known (such as a previous address), this may well be included in the search instructions. If the personal search discloses an inhibition which strikes at the owner's title, the third party transacting with the owner/inhibitee will either decline to proceed with the transaction or will proceed only if the inhibition is discharged or restricted to other property. In a small number of cases, the personal search fails to disclose an effective inhibition and the transaction is settled in ignorance of the existence of the inhibition which comes to light later. Such cases, though small in number, may have very serious financial consequences for the third parties concerned where their titles are registered in the Register of Sasines. In the recent case of *Atlas Appointments Ltd v Tinsley*,[110] it was held that an inhibition is effective if the name and designation of the person in the inhibition is such as to make the identity of the inhibitee clear, even though it had not been discovered by a computer-assisted search. The case has highlighted this gap in the faith of the personal register and increased the likelihood of such unacceptable cases arising. It is a matter of high priority that this gap should be closed.

3.76 Where the third party's title is registered in the Land Register without the Keeper having discovered the inhibition and entered it on the title sheet, the title will generally be safe from later reduction and adjudication by the inhibitor. The inhibitor may proceed by reduction, rectification of the register to show the reduction and then registration of the decree of adjudication, but rectification is competent only in certain limited circumstances.

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[108] The question of the persons against whom a search in the personal register should be made, and over what period, is problematic. "The predominant current view is that there should be a personal search against the grantor of every conveyance since (but not including) the foundation writ, the period of search running back for five years from the date when that conveyance was made": Gretton and Reid, *Conveyancing* p 136.

[109] The name and designation of an owner whose title has not been registered will not appear in the property registers.

[110] 1997 SC 200.

Inhibitors may claim indemnity from the Keeper instead and we understand that substantial sums are paid out each year, even though the Keeper took all reasonable steps to discover the inhibition.

Deemed knowledge of a registered inhibition

3.77 Originally inhibitions were published to the public by a messenger-at-arms proclaiming the letters of inhibition at, and affixing them to, the mercat cross of the head burgh of the inhibitee's domicile.[111] They were then registered in one or more of the Particular Registers of Inhibitions concerned or in the General Register of Inhibitions. In 1868 the Particular Registers were discontinued and registration in the General Register of Inhibitions (which later became the Register of Inhibitions and Adjudications[112]) was made equivalent to publication.[113] The effect of publication, namely that the public were put on notice that they were prohibited from receiving conveyances from the inhibitee or giving the inhibitee credit,[114] was preserved.[115] People are deemed to know of the existence of an inhibition which has been registered. It follows that they cannot plead good faith if they accept a conveyance from, or give credit to, a person who is inhibited, even though they were unaware of the inhibition and had taken reasonable steps to discover its existence. They are therefore at risk of an action of reduction which may result in their having to pay the debt due to the inhibitor or losing the property they acquired from the inhibitee and may not be able to recover their loss from others.

3.78 As a result of that disadvantage, it is no longer appropriate that the public should be deemed to be aware of inhibitions simply because they have been registered. There has been a very large increase in the number of inhibitions and inhibition documents registered in the personal register over the last 40 years,[116] bringing with it an increased risk of professional searchers failing to discover a relevant registered inhibition. The rule, affirmed in *Atlas Appointments Ltd v Tinsley*,[117] that an inhibitee is bound by an inhibition irrespective of the name or designation he uses in later transactions is necessary for the effectiveness of the system of inhibitions.[118] But it is likely to give rise to more cases where an inhibition is effectual even though a search by modern methods in the personal register failed to discover it. Neither the inhibitor nor the third party may have been at fault. The inhibitor may have used a perfectly adequate and correct designation and the third party may have taken reasonable steps to discover the inhibition. There are inherent difficulties in searching the personal register in that the same individual may be named and or designed differently in the registered inhibition and in the solicitor's instructions to the searchers.

3.79 We propose that:

> **13. The registration of an inhibition in the personal register should no longer have the effect that every person is deemed to know of its existence, subject**

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[111] Graham Stewart, p 538.
[112] Conveyancing (Scotland) Act 1924, s 44.
[113] Land Registers (Scotland) Act 1868, s 16.
[114] Bell, *Commentaries* vol 2, p 134.
[115] 1868 Act, s 16.
[116] 1958, 635; 1959, 758; 1960, 674; Annual Reports of the Keeper of the Registers of Scotland. Many of these will have been notices or discharges of inhibitions or bankruptcy documents.
[117] 1997 SC 200.
[118] See paras 3.80 to 3.84 below.

however to Proposals 15 to 18 made below as to when persons transacting with heritable property should be bound by an inhibition affecting it.

Criteria of validity of inhibition

3.80 There are inherent difficulties in matching persons affected by inhibitions registered in the personal register and owners of heritable property registered in the property registers because each register may contain an equally correct but different designation. Two forms of the same name occurred in *Atlas Appointments Limited v Tinsley.*[119] An inhibition was registered against "Steve Tinsley, 68A Hamilton Place, Aberdeen". This was not discovered by searchers who had been instructed to search against "Stephen John Tinsley, 68A Hamilton Place, Aberdeen". The searchers searched the index of the personal register in 1990 using the Soundex computer searching programme which at that time was not designed to find "Steve" given "Stephen John". A manual search of the paper copy of the personal register index would have found the inhibition. In the Outer House, Lord McCluskey took the view that the inhibition was null on the ground that an error had been made in designing the inhibitee as "Steve Tinsley".[120] The Second Division, however, regarded both that designation and "Stephen John Tinsley" as accurate. All parties were agreed that the test was whether or not the disparity was capable of misleading someone searching the personal register.

3.81 The case was remitted to proof before answer on the basis that the pursuers undertook to prove that the disparity was not such as to mislead a competent searcher conducting a search of the personal register. On the facts Lord Penrose held it proved that Mr Tinsley was known interchangeably as "Steve" and "Stephen John"; that he was clearly identified by "Steve Tinsley" associated with his address (68A Hamilton Place Aberdeen); that a manual search of the name in the index and then the minute book would have found "Steve Tinsley" at that address; that the searcher would have made the connection with the name "Stephen John Tinsley" (specified in the memorandum of search) and included the entry against "Steve Tinsley" in the report of search. Nevertheless, Lord Penrose found for the defenders[121] on the ground that the designation of the inhibitee as "Steve Tinsley" was:

> "misleading in the sense that it misled a searcher using modern methods not only approved of but provided by the Keeper in a way that the evidence suggests was beyond criticism at the time by his professional colleagues. It is not enough that some searchers might have found the entry and made the connection using methods adopted and used by them. What one is concerned with is whether a search carried out in a reasonable manner using competent and appropriate methods would have failed. On the evidence that must be held to have been established".[122]

He also held "Steve Tinsley" to be "potentially misleading in respect that it does not directly identify the person in whose name title to heritable property stood in the Register of Sasines, but required to be linked with that person by extraneous means",[123] that is by evidence extrinsic to the register itself.

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[119] 1994 SC 582 (OH, Lord McCluskey, & 2d Div); 1996 SCLR 476 (OH, Lord Penrose); 1997 SC 200 (1st Div).
[120] 1994 SC 582 at p 587.
[121] 1996 SCLR 476(OH).
[122] *Ibid* at p 488 E,F.
[123] *Ibid* at p 489B.

3.82 Lord Penrose considered that "if a creditor fails to adopt the full designation of his debtor, the inhibition he obtains ... must be limited to the identification he has adopted".[124] In other words an inhibition could be effectual for some transactions but ineffectual for others, depending on the name the inhibitee used in each transaction. This "half-way house" was disapproved by the First Division as apt to undermine the system of inhibitions. If someone is bound by a registered inhibition, "then he must be bound irrespective of the name which he happens to use in any subsequent transaction".[125] Otherwise inhibitees could defeat an inhibition simply by using a different form of their names when granting a subsequent conveyance.

3.83 On reclaiming, the First Division disapproved the test previously accepted by both parties before the Second Division, namely whether the name used in the inhibition differed from the full name of the inhibitee in a way which is capable of misleading a competent searcher carrying out a search of the personal register.[126] The test was an impossible one for inhibitors or their solicitors to apply because they could not know whether a particular name was capable of misleading a competent searcher.[127] Moreover, there is nothing to stop searchers from keeping their knowledge of particular searching systems (eg the Soundex system) confidential.[128] Secondly, such a test could produce remarkably different results depending fortuitously on the time when it was applied and on fluctuations in the methods, techniques and practices of the professional searchers. The First Division emphasised the primacy of the terms of the actual entry in the personal register as distinct from its discoverability by a particular method of search. The argument that the entry had to have been discoverable by a Soundex-assisted search was wrong because "it attaches importance, not to the entries in the Register themselves, but to the way in which those entries are traced and to whether they could be traced by a particular method of searching".[129] The criterion of discoverability does have a subordinate evidential role. The fact that the terms of an entry are such that a searcher, "armed with the full name of the person to which the inhibition was intended to relate together with his address as shown in the entry, would be unable to find the entry", may be evidence that the entry does not identify the person. There, however, "it is the failure of the entry to identify the person inhibited, rather than the failure of the searcher to find the entry, that results in the conclusion that the inhibition is not valid".[130]

3.84 The decision in the *Tinsley* case clarifies the criterion for the validity of an inhibition. An inhibition is valid if the name and designation of the person specified therein as inhibitee is such as to make his identity clear to a third party. We do not think that any statutory formula could improve on this criterion. A statutory formula runs the risk of being inflexible and difficult to adjust to further developments. In our opinion the thrust of reform should not be towards weakening the requirements for the validity of an inhibition but rather towards protecting a deed violating an inhibition from reduction if it is in favour of an innocent third party who has transacted without negligence and in good faith in ignorance of the inhibition. We ask for views on the following proposition:

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[124] *Ibid* at p 487F.
[125] 1997 SC 200, per Lord President at p 206D.
[126] Per Lord Prosser, p 211; per Lord Macfadyen, p 215.
[127] *Idem*.
[128] *Idem*.
[129] Per Lord President, p 207C.
[130] Per Lord Macfadyen, p 215F-G.

14. Having regard to the protection for persons relying on the faith of the personal register suggested in Proposals 15 to 18 below, no amendment should be made of the existing criterion (affirmed in *Atlas Appointments Limited v Tinsley*) for the validity of an inhibition, namely that an inhibition is valid if the designation of the person in the inhibition is such as to make the identity of the person inhibited clear to a third party.

Protecting third parties in Sasine transactions

3.85 In Sasine transactions, the existing law does not adequately protect third parties who transact with inhibitees for value and in good faith in justifiable ignorance of the existence of an inhibition.[131] It is true that the third party is likely to have a claim against the inhibitee under any contract relating to the transaction (such as missives) or warrandice[132] and can probably claim under warrandice on paying the inhibitor, without waiting for the inhibitor to reduce and adjudge.[133] Remedies based on contract or warrandice however may be of limited or no value, as where the inhibitee is insolvent.

3.86 More importantly, in principle, a party transacting in good faith and for value on the faith of the registers should not require to resort to damages actions to compensate for loss caused to him by a gap in the faith of the registers of which he was justifiably ignorant. There is no doubt that such persons must be protected.[134] It seems unavoidable that the protection will have to be at the expense of inhibitors who would be prevented from making their inhibitions effectual. As between the inhibitor and the innocent purchaser, clearly the loss must fall on the former. The inhibitor has merely lost an opportunity to gain an advantage over other creditors. He may be left with an inhibition which, though valid, is ineffective because the inhibitee has no heritable property left. But all creditors doing diligence take the risk that it may not be effective. The third parties on the other hand will suffer very substantial financial loss in circumstances where they were not at fault and had taken reasonable steps to discover the inhibition and to avoid the loss. Later in this section we consider whether the inhibitor should be able to recover from persons other than the inhibitee.[135]

3.87 How then should third parties be protected? We suggest that a third party who had taken reasonable steps before delivery of the deed contravening the inhibition to discover the existence of an inhibition should be protected unless otherwise aware of its existence at delivery. A third party who obtained a clear personal search against the inhibitee before settlement of the transaction should be regarded as having taken reasonable steps.[136] Third parties would have to retain the clear personal search in order to provide evidence of their protected status. We return to the subject of personal searches in paragraphs 3.112 to 3.115 below. If the search were clear it would be for the inhibitor to show that the third party had at the date of settlement actual knowledge of the inhibition from another source. This

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[131] We deal with Land Register transactions at paras 3.97 to 3.111 below.
[132] Absolute warrandice may be express and is implied in any sale or security or other onerous transaction. It protects the third party from any acts or deeds of the grantor, from any defects in the title of the grantor and from eviction on any ground prior to the granting of the deed implementing the transaction. Halliday, *Conveyancing Practice* (1st edn), Vol 1, paras 4.32-33.
[133] Gretton, p 203.
[134] In Proposal 14 we propose that people should no longer be deemed to be aware of a registered inhibition.
[135] Paras 3.94 to 3.96.
[136] Such as the purchasers from the Tinsleys.

solution would not affect the validity of any inhibition which satisfied the test in *Atlas Appointments Ltd v Tinsley*.[137] Such an inhibition would be valid but would not bind a third party who was justifiably ignorant of the inhibition according to the foregoing test.

3.88 We propose that:

> **15. An inhibition should not affect a deed violating it if the grantee was justifiably ignorant of its existence at the time of delivery to him of the deed. For this purpose, the grantee's ignorance of the inhibition at that time should be treated as justifiable if he had taken reasonable steps to discover the inhibition before that time.**

3.89 **Should gratuitous third parties be protected?** Should the scheme for protecting third parties be confined to grantees for value or should it extend to donees? Extending protection to donees avoids the question of what value has to be given, full value or adequate consideration for example, and the evidential problems of establishing that that level of value was given. It might also be regarded as unfair to expose donees to the threat of reduction since they may have entered into obligations or re-arranged their affairs on the faith of the gift. On the other hand, in other areas of law onerous third parties are afforded a greater level of protection than gratuitous ones. Thus a trustee in sequestration may challenge an alienation made by the bankrupt, but the court cannot grant decree of reduction if the person seeking to uphold the alienation establishes that the alienation was made for adequate consideration.[138] Similarly, a court may not set aside a transaction by one spouse which had the effect of defeating in whole or in part any claim by the other spouse for aliment or financial provision on divorce if the third party acquired the property in good faith and for value.[139]

3.90 Where heritable property is donated it is not the practice to carry out a personal search against the donor. But if protection under our proposed scheme were to be extended to donees then they would have to obtain a clear search in order to have taken reasonable steps to discover the inhibition. In many cases extending protection to donees would not make much difference because many inhibitees are in financial difficulties and their estates will be sequestrated after the date of the gift. The gift could then be challenged as a gratuitous alienation under section 34 of the Bankruptcy (Scotland) Act 1985 or the common law.[140] The fact that the donee had obtained a clear personal search against the inhibitee would offer no protection against such a challenge.

3.91 In order to elicit views we ask the following question:

> **16. Should the solution for protecting third parties set out in Proposal 15 apply to gratuitous third parties?**

3.92 **Protecting singular successors: the "shelter principle".** So far we have considered the position of third parties transacting with inhibitees, but that of remoter singular

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[137] 1997 SC 200.

[138] Bankruptcy (Scotland) Act 1985, s 34(4)(b). The meaning of adequate consideration was dealt with in *Short's Tr v Chung* 1991 SLT 472, *Matheson's Tr v Matheson* 1992 SLT 685 and *MacFadyen's Tr v MacFadyen* 1994 SLT 1245.

[139] Family Law (Scotland) Act 1985, s 18(3).

[140] Gratuitous alienations are challengeable at common law, see McBryde, *Bankruptcy*, (2nd edn), 12.01-12.05; *Bank of Scotland, Petr* 1988 SLT 690.

successors in the progress of titles also needs to be considered. At present all those deriving title from an inhibitee in Sasines transactions are unprotected. The mere fact of registration of an inhibition in the personal register prevents any person from being in good faith since the register's contents are deemed to be known by everyone having an interest,[141] although we proposed above that this rule be changed.[142] Section 46 of the Conveyancing (Scotland) Act 1924 protects against reduction to some extent, but if an inhibitee sold the property affected by the inhibition to a third party who sold on to a fourth party that fourth party would not be protected if the inhibitor registered the decree of reduction before the fourth party registered his disposition.

3.93 We think that this gap should be closed by adopting what in other contexts has been called "the shelter principle".[143] Once property has passed through the patrimony of a singular successor of the inhibitee, then the title of all subsequent singular successors should also be unchallengeable even if they have knowledge of the inhibition. The protection of the inhibitee's immediate singular successor under our scheme would be substantially eroded unless subsequent singular successors are protected absolutely. For if the inhibition came to light after the third party had obtained a protected title, then he would in practice be unable to dispose of the property. Accordingly we propose that:

> **17. Where a singular successor deriving right directly from the inhibitee is protected under Proposal 15, that protection should enure for the benefit of every subsequent singular successor even if he was aware of the inhibition.**

3.94 **Compensation for the inhibitor?** Under our proposals for protecting those who transact with inhibitees in ignorance of the existence of the inhibition, the inhibitor would be unable to enforce the debt by reduction and land attachment of the property concerned. If a third party obtained a clear search against the inhibitee due to fault on the part of a person or persons involved in the search processes then arguably they should be liable in damages to the inhibitor. For example, the searchers may have missed an exact match or failed to disclose entries that were sufficiently close to warrant further investigation, while the instructing solicitors may have given the searchers an incorrect designation for their client. It may be said that those responsible for an easily foreseeable loss ought to pay. Furthermore, the imposition of liability would serve to check any laxity in the carrying out of personal searches. The damages would be the amount the inhibitor would have received had reduction and land attachment been permitted. Liability for damages for pure economic loss is limited for reasons of public policy and allowed only where there is sufficient proximity between the person at fault and the person who suffers loss for a duty of care to arise and it is fair, just and reasonable to impose liability.[144] We think that once our scheme of protection was in place there would be sufficient proximity between the inhibitor on the one hand and the searchers and the solicitors on the other hand for the imposition of a duty of care not to be unreasonable. They would be aware of the third party's existence, that the results of the search would be communicated to, and used by, the third party in connection with the transaction and that the third party would be protected, and any inhibitor prejudiced, by an incorrect clear search. Others besides searchers and instructing

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[141] Gretton, p 39, and see para 3.77 above.
[142] Proposal 14, para 3.79 above.
[143] This label, which was suggested to us by Professor Gretton, derives from the American law on negotiable instruments. We have no equivalent in our law.
[144] *Caparo Industries Ltd v Dickman* [1990] 2AC 605; *Nordic Oil Services v Berman* 1993 SLT 1164.

solicitors may have been at fault, such as the staff at the personal register who had transcribed the inhibitee's name wrongly when preparing the Minute Book or the index, and so may be liable to the inhibitor who thereby suffers loss.

3.95 If certain people are to have a duty of care to inhibitors then the standard of care has to be considered. One possibility is that a person's conduct would have to fall below that of a reasonable member of that occupation. Usual practice would be significant in deciding what a reasonable member, such as a searcher or solicitor, would do. Another test, used in the area of professional negligence where there may be a diversity of opinion and practice, would be that the person is at fault only if the course adopted was one which no member of ordinary skill of that profession would have adopted if acting with ordinary care.[145]

3.96 An alternative approach is that inhibitors should be left to bear the losses caused by their inability to reduce because a clear search was wrongly issued. Inhibitors perhaps ought to accept that their diligence for one reason or another will not always be successful. We invite views on the following questions.

18.(1) Where:

(a) the grantee in a deed violating an inhibition accepted delivery of the deed in reliance on an erroneous clear personal search and as a result was in justifiable ignorance of the existence of the inhibition; and

(b) the inhibitor is precluded, by legislation following on Proposal 15, from reducing the deed on the ground of inhibition,

should the inhibitor be entitled to claim damages from the person whose fault led to the issue of the erroneous search?

(2) If so, should the right to reparation or cause of action, the classes of persons who owe a duty of care, and the standard of care required, be regulated by statute or (as we would prefer) be left to development by the courts?

Inhibitions and protection of third parties in Land Register transactions

3.97 The next issue is the protection of third parties transacting on the faith of the Land Register and personal register with persons who unknown to them are inhibited. The current provisions of the Land Registration (Scotland) Act 1979 concerning inhibitions give rise to doubts and difficulties. We take the opportunity to propose changes to clarify the law and to reduce the Keeper's liability to pay indemnity to inhibitors who are deprived of remedies by the 1979 Act.

3.98 **Entering inhibitions** Under the Land Registration (Scotland) Act 1979, section 6(1)(c), the Keeper is under a statutory duty to enter on the title sheet of an interest in land registered in the Land Register "any subsisting entry in the Register of Inhibitions and Adjudications adverse to the interest". The Act is silent as to when this entering has to be done. It would be an impossible task for the Keeper to alter every affected title sheet as soon as inhibitions were registered in the personal register. It is in any event not clear that

[145] *Hunter v Hanley* 1955 SC 200

an inhibition is "adverse to the interest" of the inhibitee within the meaning of the Act. Professor Gretton cogently argues that the title of the inhibitee is not affected by registration of the inhibition and that the inhibition is adverse only to the interest of the inhibitee's singular successor who has transacted with the inhibitee in breach of the inhibition.[146] We understand that the current practice is that while an inhibition may come to the Keeper's attention earlier, for example when various interim reports on searches for incumbrances (Forms 10-13) are requested prior to settlement, the inhibition is entered in the relevant title sheet only when the Keeper registers the interest of the third party. For pre-settlement interim reports on search, the Keeper or an independent searcher searches the personal register and provides a note of any exact matches and matches that are close enough to warrant further investigation. On registering the third party's interest, the Keeper carries out a further more thorough search of the personal register (covering not only the exact name and designation given but also against likely variants) and enters on the title sheet any inhibition considered applicable. Occasionally, an inhibition is discovered and entered which was not disclosed in the interim report. It is necessary for the Keeper to enter an inhibition against the grantor of a disposition breaching the inhibition on the title sheet of the disponee's interest when registering that interest in order to alert the public to the existence of the inhibition and the possibility of reduction of the disponee's title. The reason is that it is not possible to search the Land Register against previous proprietors in order to discover whether they were inhibited.[147]

3.99 We think that the provisions of the 1979 Act relating to entering inhibitions on title sheets should be brought into line with current practice and therefore propose that:

> **19. Section 6(1)(c) of the Land Registration (Scotland) Act 1979 should be replaced, as far as inhibitions are concerned, by a provision directing the Keeper to enter an inhibition on a title sheet only:**
>
> > **(a) when registering the interest of a third party where the deed conveying or creating that interest was granted by the inhibitee in breach of the inhibition, or**
> >
> > **(b) after registration, on an application by the inhibitor for rectification under section 9 of the Act.**

3.100 **Amendment of 1979 Act, section 12(3)(k).** Section 12(3)(k) of the Land Registration (Scotland) Act 1979 provides that there shall be no indemnity in respect of loss as a result of rectification of the register or a refusal to rectify where:

> "the loss arises as a result of an error or omission in an office copy as to the effect of any subsisting adverse entry in the Register of Inhibitions and Adjudications affecting any person in respect of any registered interest in land, and that person's entitlement to that interest is neither disclosed in the register nor otherwise known to the Keeper."

This provision protects the Keeper where a copy of a title sheet is requested and issued without any instruction for a search in the personal register. The Keeper is not liable to indemnify a person who suffers loss as a result of the copy not disclosing a relevant

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[146] Gretton, pp 39 to 43.
[147] The Land Register, unlike the Sasine Register, shows only the current proprietors of registered interests.

inhibition unless the inhibition had already been entered on the title sheet or it was otherwise known to the Keeper.[148] It is for consideration whether this provision should be restricted to personal register entries other than inhibitions if section 6(1)(c) is replaced as proposed in Proposal 19. Liability would then arise only if the Keeper should have entered the inhibition on the title sheet on registering the third party's interest and had failed to do so.

3.101 **Inhibitor's remedies and the Land Register.** In current practice when the Keeper enters an inhibition on the title sheet on registering the third party's interest, a note is added under section 12(2) of the 1979 Act excluding indemnity against future reduction by the inhibitor.[149] The inhibitor may then apply for the register to be rectified to show on the title sheet any decree of reduction, since in terms of section 9(3)(a)(iv) rectification prejudicing a proprietor in possession (in this case the third party) is competent where the rectification relates to a matter in respect of which indemnity has been excluded under section 12(2) of the Act. After the reduction has been given effect by rectification, the inhibitor is entitled to register a decree of adjudication.[150] The Keeper inserts the inhibitor's name as adjudger in the Proprietorship Section of the third party's title sheet but would not delete that of the third party as proprietor. The adjudication would also be noted in the Charges Section of the title sheet.[151] This registration is automatic, even though it prejudices the third party, and is not subject to the restrictions which section 9(3) places on rectification.

3.102 Where the Keeper, on registering the third party's interest, fails to enter the inhibition, there will be no exclusion of indemnity against future reduction by the inhibitor. The inhibitor cannot apply for the register to be rectified so as to show the decree of reduction unless the third party has been fraudulent or careless. The reason is that where rectification would prejudice a proprietor in possession (in this case the third party), the Keeper's powers to rectify (and the court's power to order the Keeper to rectify[152]) are restricted to the circumstances specified in section 9(3) of the Land Registration (Scotland) Act 1979. The circumstances that might be applicable to transactions in breach of an inhibition are set out in the following sub-paragraphs of section 9(3)(a) namely that:

> "(iii) the inaccuracy has been caused wholly or substantially by the fraud or carelessness of the proprietor in possession; or
>
> (iv) the rectification relates to a matter in respect of which indemnity has been excluded under section 12(2) of this Act."

Sub-paragraph (iv) would not apply because, as mentioned above, indemnity would not have been excluded in respect of reduction by the inhibitor. As regards sub-paragraph (iii), both fraud and carelessness in connection with Land Register transactions are very uncommon. In the context of inhibitions, a third party taking title from an inhibitee might be fraudulent if he was aware of the existence of the inhibition in spite of obtaining a clear personal search. He might be careless if he did not instruct an interim report on a search of

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[148] *Registration of Title Practice Book*, para C(80); *Stair Memorial Encyclopaedia* "Conveyancing Including Registration of Title", Vol 6, para 766.
[149] Gretton, pp 40-41.
[150] 1979 Act, s 2.
[151] *Registration of Title Practice Book* D 4.13.
[152] 1979 Act, s 9(2).

the personal register before taking and inhibitee's deed in his favour and applying for registration of his interest.

3.103 Where the Keeper omits to enter the inhibition on the title sheet on registering the third party's interest and has not excluded indemnity under section 12(2), the inhibitor may apply to the Keeper for payment of indemnity. Section 12(1)(b) of the 1979 Act provides that a person who suffers loss as a result of a refusal or omission by the Keeper to make a rectification is entitled to be indemnified by the Keeper in respect of that loss. Unless the third party can be shown to have been fraudulent or careless, the Keeper is unable to rectify the register and will be bound to indemnify the inhibitor. Section 13(4) entitles the Keeper to reduce the amount of indemnity payable where the claimant has contributed to the loss by his fraud or carelessness. Thus, for example, an inhibitor whose inhibition is not discovered because of his careless failure to use in the inhibition documents the designation of the inhibitee in the property registers, may well be paid a reduced amount.[153] We understand that the Keeper pays substantial sums of money annually to inhibitors by way of indemnity.

3.104 **Does reduction on ground of inhibition affect accuracy of Land Register?** The current practice stems from the view that the Land Register is or becomes "inaccurate" if the inhibitor obtains a decree of reduction on the ground of inhibition (*ex capite inhibitionis*). The Land Register, so the argument goes, has to be rectified to correct this inaccuracy, to show the reduction and to allow the inhibitor to register the later decree of adjudication. The 1979 Act is not easy to interpret, but we think that the inhibitor may not have to proceed by way of rectification in order to give effect to the decree of reduction. A reduction on the ground of inhibition is different in character from a reduction on other grounds.[154] Usually a reduction has the effect of annulling a deed for all purposes; it is catholic in its effect. In a valid but voidable deed transferring a real right and registered in the Sasine register, for example, the result of the reduction of the deed is that the real right reverts from the grantee of the deed to the granter: the grantee is divested of his title to the property and the grantor is re-invested with his original title without the need for a reconveyance.[155] A reduction on the ground of inhibition however is limited and not catholic in its effect. It does not annul the deed for all purposes but only for the benefit of the inhibitor.[156] For all other purposes the deed remains perfectly effective. The grantee is not divested of ownership. The effect of the reduction is merely that, for the purposes of leading an adjudication, the inhibitor is entitled to act as if the deed did not exist.[157] Hence the inhibitor can adjudge the property notwithstanding the fact that it no longer belongs to the inhibitee. In other words, a reduction on the ground of inhibition is no more than a preliminary step on the road to adjudication or land attachment. Unlike other reductions, it does not bring about a change in real rights.

3.105 This means that, in land registration, reductions on the ground of inhibition should be treated differently from other reductions. By striking down a deed, a normal reduction

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[153] An inhibition which fails to meet the test for effectiveness laid down in *Atlas Appointments Ltd v Tinsley* 1997 SC 200 should not give rise to any payment of indemnity.

[154] See paras 3.23 - 3.30 above; Gretton, pp 129,130.

[155] In a Sasine title creating a subordinate real right, the result of a reduction of the subordinate real right is that the grantor's title is disburdened of the subordinate real right.

[156] It is sometimes said therefore that a reduction on the ground of inhibition is only declaratory paving the way for an adjudication but this view is inconsistent with the theory that a deed violating an inhibition is voidable and not void: see Gretton, p 103.

[157] Erskine, *Institute* II,11,14; *McLure v Baird* 19 Nov 1807 FC, Gretton, pp 128 to 131.

has the effect of making the Land Register inaccurate.[158] "Inaccuracy" is not defined in the Land Registration (Scotland) Act 1979. In *Short's Tr v Keeper of the Registers of Scotland*[159] (which concerned the reduction of a gratuitous alienation), Lord President Hope[160] said that "an entry is inaccurate if it appears that at the time it was made or in the light of subsequent events it ought not to have been made". If, after A has disponed land to B and B has been registered as proprietor, the disposition comes to be reduced, the register is then inaccurate. As long as the disposition stood, the register disclosed the true position. But following reduction, the "true" owner is A, not B. In continuing to show B as owner the register is therefore inaccurate. The inaccuracy is corrected by an application for rectification,[161] although in practice rectification may not be available against a proprietor in possession.[162] The position of a reduction on the ground of inhibition seems different. Since the deed in breach of the inhibition is not actually struck down by such a reduction, the register remains accurate throughout. The true owner remains B and not A. The register is concerned only with real rights, and so far as real rights are concerned, nothing has been changed by the reduction. On this view, since there is no inaccuracy, there can be no question of rectification of the register. Equally there can be no question of payment of indemnity to the inhibitor for refusal to rectify. The reduction need not enter the register at all. It is only the ultimate adjudication or land attachment which will enter the register.[163]

3.106 We think that the current situation is unsatisfactory. It is not clear whether the register must be rectified in order to register the inhibitor's reduction, so paving the way for registration of the adjudication or notice of land attachment. In order to allow rectification the Keeper excludes indemnity if he discovers and enters an inhibition, but he does not exclude indemnity if he fails to discover the inhibition. As a result, the Keeper is bound to pay indemnity to inhibitors in circumstances where he may not have been at fault in failing to discover the inhibition. The cost of this falls ultimately on other users of the Land Register since registration fees are adjusted to meet indemnity payments and the other expenses of running the register.[164]

3.107 Under our proposed new scheme for the protection of third parties in Land Register transactions, the key is the entry of the inhibition on the third party's title sheet. If the Keeper discovers and enters an inhibition, the inhibitor would be entitled to reduce and register an adjudication or notice of land attachment without rectification. The granting of a decree of reduction on the ground of inhibition would not be regarded as making the Land Register inaccurate. The Land Register would therefore not have to be rectified before the decree of reduction and any subsequent decree of adjudication or attacher's notice of litigiosity and notice of land attachment could be entered on the title sheet. The Keeper would not need to exclude indemnity against reduction and adjudication or land attachment; the presence of the inhibition being sufficient warning to those inspecting the register. If the Keeper fails to enter an inhibition, the inhibitor should be precluded from raising an action of reduction on the ground of inhibition for as long as no inhibition is entered. If reduction is incompetent then so is adjudication or land attachment by the

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[158] Land Registration (Scotland) Act 1979, s 9(1).
[159] 1994 SC 122, affd 1996 SC (HL) 14.
[160] 1994 SC 122 at p140F,G.
[161] *Short's Tr v Keeper of the Registers of Scotland* 1996 SC (HL) 14.
[162] Land Registration (Scotland) Act 1979, s 9(3).
[163] Since the adjudication or land attachment would enter the register by registration and not by rectification, there is no question of payment of indemnity.
[164] *Registration of Title Practice Book* para C 105.

inhibitor against the third party's registered interest. This tackles the problem at an early stage and prevents the inhibitor obtaining a decree of reduction which cannot be taken further. It also brings the process more under the control of the Keeper. If the Keeper is to confer protection against reduction upon the third party then this should depend on a step under the Keeper's control, entry of the inhibition on the title sheet.

3.108 The inhibitor would have two courses of action open to him if the inhibition was not entered on the title sheet. First, he could apply to the Keeper for the register to be rectified by entering the inhibition on the title sheet. This should be competent only if the third party had been fraudulent or careless.[165] Once the inhibition had been entered the inhibitor would be entitled to reduce and adjudge or use land attachment. The decree of reduction should be noted on the title sheet if the inhibitor applied for this to be done, but its absence should not be an inaccuracy which has to be corrected by way of rectification. The decree of adjudication or notice of land attachment would be entered on the title sheet by registration not rectification.

3.109 Second, the inhibitor could apply to the Keeper for a payment of indemnity arising out of the Keeper's inability to rectify and enter the inhibition where the third party had not been fraudulent or careless. We consider that such indemnity should be payable only where the Keeper had been at fault in failing to enter the inhibition on the title sheet. If the Keeper had taken reasonable steps to discover the inhibition but failed to find it he should not be liable, unless he was otherwise aware of it at the date of registration of the third party's interest. This is very similar to the test we proposed for the protection of third parties in Sasine transactions in Proposal 15 above.[166]

3.110 We deal in paragraphs 3.112 to 3.115 below with what constitutes reasonable steps. Section 13(4) of the 1979 Act empowers the Keeper to pay only a proportionate amount if the claimant for indemnity has contributed to the loss by his careless or fraudulent act or omission. This would enable the Keeper to pay less than the full amount where the inhibitor had not taken sufficient care to design the inhibitee, for example by not using or referring to the existing designation in the property registers.

3.111 We propose that:

> **20.(1) A reduction on the ground of inhibition (*ex capite inhibitionis*) should not be competent unless the inhibition was entered on the relevant Land Register title sheet in terms of Proposal 19.**
>
> **(2) The existence of such a reduction should not be regarded as creating an inaccuracy in the Land Register and accordingly it should not be necessary to rectify the Register before showing the reduction on the title sheet. The Keeper may note such a reduction on the relevant title sheet if aware of it, but should be bound to note it only on an application to that effect by the inhibitor.**
>
> **(3) A decree of adjudication or a notice of land attachment by the inhibitor following reduction should be entered by the Keeper on the relevant title sheet on an application by the inhibitor for its registration.**

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[165] Land Registration (Scotland) Act 1979, s 9(3)(a)(iii).
[166] Para 3.88.

(4) Where the Keeper did not enter the inhibition on the title sheet when registering the third party's interest, the inhibitor should be entitled to apply for the Land Register to be rectified by entering the inhibition in accordance with the existing rectification provisions in section 9 of the Land Registration (Scotland) Act 1979.

(5) The Keeper should be required to pay indemnity to an inhibitor who is prevented from reducing and adjudging or using land attachment by the omission of the inhibition from the title sheet only if the omission is due to fault on the part of the Keeper.

Computer-assisted searches and liability for issuing erroneous search

3.112 **Form of personal register.** The personal register is a paper register. It consists of photocopies of the warrants for inhibition and the messengers' certificates of execution of the schedules of inhibition on the inhibitees.[167] When the documents are presented for registration, very brief details of them are entered in the Presentment Book and a unique identification number is given to them. They are then examined in order to frame the entry for the Minute Book. The minute bears the identification number, specifies the type of warrant, sets out the designation of the inhibitor and the inhibitee exactly as in the warrant for inhibition and concludes with the name of the person who presented the documents for registration. Finally, the warrant for inhibition and the messenger's certificate of execution are photocopied and the original documents returned to the presenter. The photocopies are then bound up in volumes, known as the Record Volumes, which form the register itself. An alphabetical list of the names of inhibitees is then prepared, each entry containing the identification number, as an index to the register.

3.113 **Methods of search**. Currently three methods are used to search the personal register. The first is a manual search of the paper copy of the index. The second is a search of the computerised version of the index by means of a program which is designed to deal with common variants of names and diminutives of some forenames. The present program is called SSA which has replaced SOUNDEX. The last is a search by means of a program of a computerised database compiled by the search firm from entries in the Minute Book. These entries are supplied to searchers by the Keeper on a daily basis.[168] The First Division's recent decision in *Atlas Appointments Ltd v Tinsley*[169] emphasises the primacy of the actual entry in the personal register as distinct from its discoverability by a particular method of search. It was held that the validity of an inhibition could not depend on its discoverability by computer-assisted searches. Otherwise improvements to search programs would make a previously undiscovered inhibition discoverable and hence valid.[170] We would agree with this conclusion. Nevertheless, we think that the use of such programs is inevitable in view of the large number of entries that have to be searched. A personal search usually encompasses a five year period during which some 70,000 entries will have been made in the personal register.[171] A manual search of the register itself is quite impractical. A manual

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[167] Titles to Land Consolidation (Scotland) Act 1868, s 155.
[168] The Keeper had planned to withdraw this service, but was required to continue on an interim basis until a petition for judicial review was determined; *Millar & Bryce Ltd v Keeper of the Registers of Scotland* 1997 SLT 1000. The petition proceedings have been abandoned as the Keeper is to continue the service.
[169] 1997 SC 200.
[170] *Ibid* at p 216 per Lord Macfadyen.
[171] In 1996 there were 15,361 entries; unpublished information from the Registers of Scotland.

search of the index is sometimes done, although it is not without its problems and a computer search of it or a database derived from the Minute Book has advantages.

3.114 **Appropriate computer-assisted search as defence.** Earlier in this Section we raised the question whether an inhibitor should be entitled to claim damages from the person whose fault led to the issue of an erroneous search which failed to identify an existing inhibition.[172] In Land Register transactions a third party who had not been fraudulent or careless would be protected if the Keeper had not entered the inhibition on the title sheet when registering his interest, and the Keeper would not be liable to the inhibitor unless he had failed to take reasonable steps to discover the inhibition or was otherwise aware of it.[173] We think that use by a professional searcher or, as the case may be, the Keeper of an appropriate computer searching program should be regarded for these purposes as taking reasonable care or reasonable steps. Computer programs vary in their power and the way in which they have to be used for the best results. They are constantly being upgraded to take account of problems that have emerged. What was appropriate would depend on the state of the art from time to time. Those who used a program with known deficiencies of a substantial nature could be regarded as being at fault and might be found liable in damages to the inhibitor under our earlier proposals.

3.115 Comments are invited on the following proposition:

> **21.(1) Carrying out a computer-assisted search by means of an appropriate program should be regarded as taking reasonable care to discover the existence of an inhibition for the purpose of Proposals 18 and 20(5).**
>
> **(2) It is thought that legislation is unnecessary to achieve that result.**

Company number of inhibitee

3.116 We have received a suggestion that it should be mandatory to include the company number of an inhibited company in the inhibition documents presented for registration if the company was registered in a part of the United Kingdom. We think that this would improve the efficacy of inhibitions against companies. This number identifies the company uniquely. One company may have the same registered office and a very similar name as another, but no company has the same number as another. If the company number had to be included, then an inhibition where the number was omitted or mis-stated would have to be invalid, even if the company was designed correctly in all other particulars. We propose that:

> **22. Where the inhibitee is a company registered in a part of the United Kingdom, use of the correct company number on the inhibition documents registered in the personal register should be mandatory, on pain of invalidity of the inhibition.**

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[172] Proposal 19 (para 3.99).
[173] Para 3.109 and Proposal 20(5)(para 3.111).

F. PROPERTY SUBJECT TO INHIBITION AND PRESCRIPTION OF INHIBITIONS

Introduction

3.117 In this Section, we examine the rule that an inhibition does not affect land and other heritable rights acquired by the inhibitee after the date of the inhibition[174] and consider whether it should be retained, and if so at what stage in purchase of property such rights are acquired.

3.118 We also examine three questions which arise in connection with prescription of inhibitions. An inhibition is extinguished by negative prescription on the lapse of five years after the date on which it came into effect.[175] The first question is what kind of actings by the inhibitee in relation to heritable property constitute a contravention of the inhibition while it remains effective. The second is whether an inhibitor has to bring an action of reduction of any contravention within the five-year lifetime of the inhibition. Finally, we consider whether the normal rules of interruption of prescription apply to prescription of inhibitions.

Inhibition and after-acquired property

3.119 At common law an inhibition affected all the heritable property and rights owned by the inhibitee at the date of registration of the inhibition and all such lands and rights that the inhibitee acquired afterwards.[176] Implementing a recommendation by a Royal Commission,[177] legislation (now the Titles to Land Consolidation (Scotland) Act 1868) altered this rule by making inhibitions ineffective against after-acquired lands and rights (commonly known as *acquirenda*). Section 157 provides:

> "No inhibition to be recorded from and after the 31st day of December 1868 shall have any force or effect as against any lands to be acquired by the person or persons against whom such inhibition is used after the date of recording such inhibition, or of recording the previous notice thereof prescribed by this Act [ie the section 155 notice of inhibition which backdates the effect of an inhibition to the date of recording the notice of inhibition provided the inhibition is recorded not more than 21 days thereafter], as the case may be:…".

The section also contains a proviso excepting after-acquired lands under entails or other indefeasible titles which is of minimal practical significance nowadays. Section 3 defines "lands" as including "all heritable subjects, securities, and rights".

3.120 It has been suggested to us that the policy of section 157 should be reversed so that an inhibition would affect, as it did at common law, all heritable property of the inhibitee whether acquired before or after the registration of the inhibition. Most of the other diligences open to ordinary unsecured creditors (arrestment, poinding and adjudication) affect only the debtor's property at the date of attachment. The landlord's hypothec and a

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[174] Titles to Land Consolidation (Scotland) Act 1868, s 157.
[175] Conveyancing (Scotland) Act 1924, s 44(3)(a).
[176] Graham Stewart, p 550.
[177] *Second Report of the Law Commissioners, Scotland* (1835) p 19 (Chairman: G J Bell). The report simply states: "the inhibition ought not to have effect against estates subsequently acquired, but to be limited to that property which belongs to the debtor at the time of registration, leaving it to the creditor, if the debtor should afterwards acquire or succeed to other property, to use a new inhibition in order to affect it". The recommendation seems to have been part of a general policy of "reducing the diligence of inhibition within reasonable and beneficial limits": p 20.

floating charge give a non-possessory security over the property from time to time of the tenant or company, but at the date of sequestration[178] under the hypothec or crystallisation of the floating charge only the property then on the leased ground or owned by the debtor respectively is attached. We doubt whether creditors should be entitled to freeze whatever property their debtors acquire during the life-time of an inhibition, particularly where the inhibition was used on the dependence before the debt had been found to be due. On the whole we do not think that the case for this amendment has been made out. We propose that:

> **23. The present rule should remain whereby an inhibition does not affect heritable property belonging to the inhibitee acquired after the date when the inhibition became effective.**

When does the purchaser of heritable property acquire lands for the purposes of inhibition?

3.121 It is not clear at what date a person acquires "lands" (defined as including "all heritable subjects, securities, and rights") for the purposes of section 157 of the 1868 Act.[179] We restrict our discussion to the case of the purchase of heritable property because this is not only the most common type of conveyancing transaction but also the one where clarification is most needed. In this transaction there are three possible dates when it could be said that the purchaser acquires lands:

(a) the date on which missives for the purchase were concluded;

(b) the date on which the disposition was delivered to the purchaser; or

(c) the date on which the purchaser registered the disposition in the property registers.

One way of looking at this issue is to ask whether a purchaser under missives, or the holder of an unregistered disposition, has acquired heritable subjects or a right that is sufficiently heritable in character to be subject to an inhibition. Once the purchaser obtains a real right to the property by registering the disposition in the property registers, then he has clearly acquired lands which will be affected by a later inhibition.

3.122 Inhibition affects only heritable property. Graham Stewart[180] and Bell[181] both take the view that in deciding whether property is heritable, the rules regulating the competency of adjudication and arrestment are to be applied rather than the succession rules. According to Graham Stewart:[182]

> "All heritable estate, corporeal or incorporeal, belonging to the debtor whether he is infeft or uninfeft, may be adjudged. Not only proper feudal estate but all rights or interests connected with land-as liferents, heritable securities, real burdens, leases; and also rights of a heritable character, although unconnected with land-as annuities,

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[178] I.e. an action of sequestration enforcing the hypothec as distinct from sequestration in bankruptcy.
[179] See Gretton, pp 75 - 77.
[180] P 547.
[181] *Commentaries* vol 2, p 135.
[182] P 600.

> personal bonds heritable *destinatione*- and generally every right for which there is no other competent diligence, may be attached by adjudication."

However, while inhibition is competent only against adjudgeable property,[183] not all adjudgeable property is liable to be affected by inhibition.[184]

3.123 **Inhibition against purchaser registered between missives and delivery to him of disposition.** In the Outer House case of *Leeds Permanent Building Society v Aitken Malone and Mackay*[185] it was held that an inhibition against a purchaser, which was registered between missives and delivery of the disposition, did not affect the property because the right of a purchaser under missives was not a heritable right. For this proposition the Lord Ordinary relied on dicta by Lord President Emslie in *Gibson v Hunter Home Designs Ltd*[186] to the effect that no right of property vests in a purchaser until he takes delivery of the relevant disposition and that on:

> "delivery of the disposition the purchaser becomes vested in a personal right to the subjects in question and his acquisition of a real right to the subjects is dependent upon recording the disposition in the appropriate Register of Sasines. … Such right as the purchaser has, accordingly, is no more than a *jus crediti* until delivery of the disposition … has been made to him."[187]

The fact that the right of a purchaser under missives is heritable in the purchaser's succession was regarded as irrelevant because what is heritable for the purposes of succession is not necessarily heritable for the purposes of diligence.[188] Where a purchaser under missives assigns his contractual rights to a third party who then receives and registers a disposition, it is the practice for solicitors to instruct a search in the personal register against the assigning purchaser.[189] This may be erring on the side of caution rather than acceptance by the profession that the purchaser's right is one that is capable of being affected by an inhibition.

3.124 There at least two arguments for giving effect to an inhibition of a purchaser after missives. First, it would promote coherence in the law since the purchaser's right is heritable for succession purposes.[190] Second, unless a heritable right is "acquired" on conclusion of missives, there would be a substantial period when the property would be unavailable to creditors by way of inhibition. After missives a later inhibition by the seller's creditors does not affect the property because an inhibition strikes only at future voluntary transactions.[191] Moreover, generally the date of conclusion of missives, although not public knowledge, is

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[183] *Menzies v Murdoch* (1841) 4D 257, per Lord Fullerton at p 263

[184] Intellectual property rights, such as copyright, are attachable by adjudication since there is no other competent diligence, but they are moveable: e.g. Patents Act 1977, s 31; Registered Design Rights 1949, ss 2(1) and (2); 19910 and(2);Copyright, Design and Patents Act 1988, ss 90(1), s 51B(1) (inserted by SI 1996/2967); and 222; Trade Marks Act 1984, ss 24(1) and 102. See our forthcoming Discussion Paper on *Attachment Orders and Money Attachments*, Part 2.

[185] 1986 SLT 338.

[186] 1976 SC 23, at p 27.

[187] This analysis is controversial in so far as it implies that ownership passes on delivery of a disposition. See Part 2 above.

[188] See para 3.122 above.

[189] Gretton, p 189.

[190] *Ramsay v Ramsay* (1887) 15R 25.

[191] See para 3.13 above.

more easily ascertainable than the date of delivery of the disposition since such delivery is not usually evidenced in writing.

3.125 **Inhibition registered against purchaser between delivery and registration of disposition to him.** Turning to the next stage, has the holder of an unregistered disposition acquired heritable subjects or a heritable right for the purposes of inhibition? In *Low v Wedgwood*[192] it was held that an inhibition was effective against the holder of an unregistered assignation of a registered heritable security. The recent case of *Sharp v Thomson*[193] discussed in Part 2 above[194] has highlighted the uncertainty and divergent views about when property passes. Lord Jauncey considered that a significant change in the purchaser's position occurred on delivery of the disposition. In his opinion the purchaser's right moved from a personal right to demand implementation of the missives to "a personal right of ownership".[195] Lord Clyde took the view that although the holder of an unregistered disposition had only a personal right to the property and did not acquire a real right until the disposition was registered, the holder had acquired such rights as to make it reasonable to use the language of ownership in relation to him.[196] But it is agreed on all sides that a real right, ownership in the fullest sense, is not acquired by a disponee till registration in the property registers. In *Cheltenham & Gloucester Building Society v Mackin*,[197] involving a transaction where the purchasers were inhibited after delivery of the disposition but before it was registered, the sheriff held, on the basis of the First Division's analysis in *Sharp v Thomson*[198] as to when a purchaser acquired a real right, that the inhibition did not affect the land involved. But this is to confuse real rights and heritable rights.

3.126 **Analogy of inhibition against reversionary owner in *ex facie* absolute disposition.** Before the introduction of standard securities in 1970,[199] one of the main forms of heritable security was the *ex facie* absolute disposition qualified by a back letter. On the face of the property registers, the lender was the proprietor. In *Dryburgh v Gordon*,[200] the Lord Ordinary expressed the opinion that an inhibition against the borrower and reversionary owner in an *ex facie* absolute disposition was effective, but the Inner House reserved their opinion. The Lord Ordinary's view that such an unregistered heritable right (the right to have the property reconveyed on payment of the loan) could be subject to an inhibition was followed in *George M Allan Ltd v Waugh's Tr*.[201]

3.127 **Policy considerations**. The existing law as to whether the holder of an unregistered disposition of property has a heritable right, or heritable subjects, capable of being affected by a later inhibition is not clear. It should be noted that whether the holder has a real right or a right of property is a different question. Rights may be real without being heritable,[202]

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[192] 6 Dec 1814 FC.
[193] 1997 SC (HL) 66.
[194] Paras 2.10 - 2.28.
[195] 1997 SC (HL) 66 at pp 70 H,I and 74 C,D.
[196] Ibid at p 80E - G.
[197] 1997 GWD 32-1645, Temporary Sheriff Robertson at Cupar, 29 July 1997: an action for professional negligence against a solicitor acting for the building society.
[198] 1995 SC 382, reversed 1997 SC (HL) 46.
[199] Conveyancing and Feudal Reform (Scotland) Act 1970, Part II.
[200] (1896) 24R 1
[201] 1966 SLT (Sh Ct) 17.
[202] For example, the right of an assignee of a life policy where the assignation has been intimated to the life office.

and heritable without being real.[203] One argument in favour of allowing an inhibition to affect the property once the disposition is delivered is that a purchaser, on accepting delivery of the disposition and without registering it, acquires a heritable right having some of the important incidents of ownership. A person holding an unregistered disposition can sell the property in question and may grant a disposition[204] or standard security[205] in favour of a third party who will acquire a real right on registering that disposition or security. It is difficult to see why an inhibition should not prevent this. Another point in favour of using delivery of the disposition is that it provides some continuity of diligence against the purchaser. Before settlement (when the disposition is delivered in exchange for the price), the purchaser may have money in bank accounts which could be arrested by creditors; after settlement the purchaser has an asset which can be frozen in his hands by inhibition. A practical disadvantage, however, is that the date of delivery of the disposition is not public knowledge, is often not recorded in writing and may be difficult to ascertain later.[206]

3.128 **Inhibition registered against purchaser after registration of disposition to him**. The arguments for allowing an inhibition to be effective only after the disposition has been registered in the property registers are that that date would correspond with the acquisition of a real right to the property and, being on a public register, can be ascertained easily and is a matter of public knowledge. The disadvantage of using the date of registration is that the property in question would not be subject to inhibition for a considerable period. The only option which addresses this problem is treating the right of a purchaser under missives as liable to inhibition because the gap between delivery of the disposition and its registration in the property registers is usually only a few days.

3.129 Our tentative preference is for regarding heritable property as being acquired for inhibition purposes on conclusion of missives. Accordingly an inhibition after that date would prohibit the inhibitee not only from disposing of the property itself after settlement, but also from assigning his contractual rights under the missives. In order to elicit views we put forward the following proposal:

> **24. A person who has entered into a contract to purchase heritable property should be treated as having acquired that property for the purposes of section 157 of the Titles to Land (Consolidation) (Scotland) Act 1868 (inhibition not to affect lands acquired by inhibitee after date of registration of inhibition) at the date when the contract was concluded.**

Breach of inhibition and reduction within the prescriptive period

3.130 Section 42 of the Conveyancing (Scotland) Act 1874 provided that inhibitions prescribed on the lapse of five years from the date on which they took effect, but allowed them to be renewed for a further five years on registration of a memorandum to that effect. This provision was replaced by section 44(3)(a) of the Conveyancing (Scotland) Act 1924

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[203] For example, the personal right for succession purposes of a purchaser under missives (*Ramsay v Ramsay* (1887) 15R 25), or the personal right to a reconveyance of heritage made over to trustees for creditors (*Connell's JF v McWatt* 1961 SLT 203).

[204] Conveyancing (Scotland) Act 1924, s 3.

[205] Conveyancing and Feudal Reform (Scotland) Act 1970, s 12.

[206] In *Cheltenham & Gloucester Building Society v Mackin* 1997 GWD 32-1645 the date of delivery could not be ascertained from the files so the case proceeded on the basis that it had taken place before the first inhibition was executed.

which provides that inhibitions (and notices of litigiosity etc.) "shall prescribe and be of no effect on the lapse of five years from that date when the same shall respectively take effect". The 1924 Act also abolished renewal of inhibitions.[207]

3.131 **When does violation of inhibition by seller occur?** The first question for consideration is, - what act of an inhibitee constitutes a breach of an inhibition so that, if it is done within the present five year prescriptive period, the inhibitor will be entitled to reduce the transaction and to adjudge the property? To illustrate the problem, suppose A inhibits B, the inhibition becoming effective on 1 September 1992. On 1 August 1997 B concludes missives to sell the property to C. The disposition by B in favour of C is delivered on 29 August 1997 and C registers it in the property registers on 5 September. Has B breached the inhibition by concluding missives within the lifetime of the inhibition? Or must he have delivered the disposition within that time? Or has there been no breach because the purchaser C obtained a real right by registration only after the inhibition ceased to have effect on 1 September 1997?

3.132 The following discussion assumes that an inhibitor's right of reduction does not lapse when the inhibition prescribes.[208] The example of a sale of heritable property is used to illustrate the issues, but the same issues arise in other transactions, such as the granting of a heritable security over property. Clearly an inhibition is breached if all the steps necessary to give a third party transacting with the inhibitee a real right to the property in question have been completed while the inhibition subsists.

3.133 **Contract of sale by itself not a breach.** The current form of the schedule of inhibition[209] inhibits the inhibitee from "selling, disposing of, burdening or otherwise affecting your land and other heritable property to the prejudice of [the inhibitor]". The reference to the word "selling" might be construed as referring to missives of sale. Bell however describes the effect of an inhibition in terms of forbidding the inhibitee to grant any conveyance or execute any deed and prohibiting the public from receiving any conveyances from the inhibitee.[210] It is thought that the existing law does not treat the conclusion of missives as a breach of an inhibition. At the stage of conclusion of missives, the inhibitee is still the owner, the inhibitor can enforce the debt by adjudging the property (without the need to reduce the missives first) and the purchaser has merely a contractual right to acquire it.

3.134 **Delivery of disposition constitutes breach**. It is the delivery of the disposition which does and should constitute a breach of the inhibition rather than the divestiture of the inhibitee by the third party acquiring a real right. The earlier date accords with Bell's description of the effects of an inhibition referred to in the previous paragraph. Until the disposition is delivered, the inhibitee can prevent the purchaser from acquiring title to the property by refusing to implement the missives. He would then be liable in damages to the purchaser for breach of contract but that is not a breach of his obligation to the inhibitor. An inhibition does not prevent the disponee completing title by registering the disposition which he obtained from the inhibitee.[211] Delivery of the disposition is not a public act but the

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[207] S 44(6) repealing s 42 of, and Sch J to, the 1874 Act.
[208] See paras 3.137-141.
[209] RCS Form 16-15A (replacing Schedule QQ to the Titles to Land Consolidation (Scotland) Act 1868).
[210] *Commentaries* vol 2, p134.
[211] Graham Stewart, p 145.

inhibitor may take effective action on becoming aware of it. If the inhibitor became aware of the breach before the disposition was registered in the property registers, an adjudication could be led. In the leading case of *Mitchells v Ferguson*[212] it was decided that a debtor's property remains adjudgeable by his creditors until he is divested by his disponee registering the disposition.[213] The inhibitor is more likely to learn of the disposal after the disposition in favour of the third party disponee has been registered. In this situation the inhibitor must first reduce the third party's title before adjudging.

3.135 **Some practical difficulties in the delivery theory.** On the other hand, there are practical difficulties in treating the grantor's delivery of the disposition rather than the grantee's registration of the disposition as the act breaching the inhibition. First, the date of delivery is not publicly known and sometimes not recorded in solicitors' office files. It might therefore be difficult to ascertain it at some later date when the question of whether the inhibition had been breached arose. Second, use of the date of delivery might complicate searches in the personal register in subsequent transactions in the property. At present the predominant view is that there should be a personal search against each grantor since (but not including) the foundation writ, each one for five years prior to that grantor's divestiture (ie when the successor acquired a real right by registration).[214] This practice would have to change if delivery of the disposition constituted a breach. In the example in paragraph 3.131 above, a five year search from 5 September 1997 (when the purchaser's disposition was registered) would not disclose the inhibition of 1 September 1992 which would nevertheless be effective against delivery which took place on 29 August 1997. The five year search would have to be from the date of delivery of the disposition, but this date might be difficult to establish. To be absolutely safe one would have to search against all grantors since the foundation writ for the whole period of their ownership. In the vast majority of cases the interval between delivery and registration of the disposition is only a few days. A personal search for six years instead of five should suffice for all but the most exceptional cases, and we understand that this would increase the cost of the search by only about £1. These difficulties would not make the delivery theory unworkable.

3.136 In order to obtain views we put forward the following proposal:

> **25. Where an inhibitee executes and delivers a deed transferring or creating a real right in or over his heritable property in favour of a third party while the inhibition is in effect, the delivery of the deed (but not the conclusion of the antecedent contract) should be treated as a violation of the inhibition, even if the deed is not registered till after the inhibition is extinguished by prescription.**

Reduction competent after inhibition has prescribed?

3.137 Another question relating to prescription of inhibitions is how much time an inhibitor has to reduce a transaction which is in breach of the inhibition. Suppose F is inhibited by G with the inhibition taking effect on 15 February 1993. Later F sells property to H whose disposition is registered in the property registers on 2 January 1998. One view is that G, the inhibitor, cannot raise an action of reduction outwith the five year lifetime of the

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[212] (1781) Mor 10296; Hailes 879; 3 Ross L C 120.
[213] Doubt was cast on the authority of this decision by Lord Jauncey in *Sharp v Thomson* 1997 SC (HL) 66 at p 74E-I, but it is thought that it remains authoritative. See Part 2, footnote 14.
[214] Gretton and Reid, *Conveyancing* (1993) p 136.

inhibition itself, ie G has only until 15 February 1998 in which to act. In other words, the right to reduce by virtue of the inhibition prescribes at the same time as the inhibition itself. The other view is that, while the inhibition prescribes in five years, the right to reduce any deed violating the inhibition does not prescribe with the inhibition and that the creditor's right of reduction is not cut off till the expiry of the period of the long negative prescription, currently 20 years.[215] However, in Sasine transactions the purchaser H will be free from the threat of reduction before this, because positive prescription will render H's title unchallengeable after 10 years from the date of its registration.[216] In Land Register cases reduction will be incompetent unless the inhibition is entered on the title sheet,[217] and if it is then the 10 year positive prescriptive period should apply as it does where indemnity was excluded.[218]

3.138 There are no reported cases dealing with this question. Graham Stewart[219] supports the first view-the right to reduce prescribing with the inhibition-but against the background that inhibitions and hence the right to reduce could be renewed. Modern opinion seems divided, not only about the law but also about which view is generally accepted by the solicitors' profession.[220] Professor McDonald reports that the profession are apparently unanimously of the view that the right to reduce prescribes with the inhibition and act on that view in instructing searches (but he acknowledges Professor Gretton's point that this is by no means necessarily conclusive).[221] On Professor McDonald's view the memorandum of search should, and generally does, instruct a personal search against all grantors of conveyances within the period of the positive prescription, each one for five years prior to the date of completion of **the purchaser's** title (ie the purchaser in the instant transaction).[222] On the other hand Professors Gretton and Reid state "the current predominant view" to be that there should be a personal search against each grantor since (but not including) the foundation writ, each one for five years prior to **that grantor's** divestiture.[223]

3.139 In our provisional view, where a transaction in breach of the inhibition occurs within the statutory five year period the inhibitor should be entitled to raise an action of reduction after the lapse of the five year period. The alternative view seems to us illogical and to prejudice inhibiting creditors unduly. As Professor Gretton points out, it produces the strange effect that the right to reduce a deed which was delivered at the end of the first year of the inhibition prescribes in four years, while the right in relation to a deed delivered in the last week prescribes in a matter of days.[224] Inhibitees could therefore defeat inhibitions by disposing of their property shortly before the end of the five year period since the inhibitor is unlikely to get to know of the disposal in time to bring an action of reduction before the period elapses.

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[215] Prescription and Limitation (Scotland) Act 1973, s 8.
[216] 1973 Act, s 1, see para 3. 138 below.
[217] Proposal 20, para 3.111 above.
[218] 1973 Act, s 1(1)(b).
[219] *Diligence* p 575.
[220] D J Cusine, "Further Thoughts on Inhibitions" (1987) 32 JLSS 66 states that the question is open and reports Professor Halliday's views that the right to reduce prescribes with the inhibition. Gretton, p 68 inclines to the opposite view.
[221] *Conveyancing Manual,* (6th edn; 1993) para 33.35.
[222] *Ibid*, para 33.37.
[223] Gretton and Reid, *Conveyancing* (1993) p 136.
[224] Gretton, p 68.

3.140 As regards the duration of the time limit on the personal right to reduce a transaction contravening an inhibition, we see no reason to depart from the normal period of 20 years.[225] In the case of titles registered in the Sasine Register, the 20 year period of negative prescription (which extinguishes personal rights of reduction) would in practice be irrelevant because the inhibitor's personal right of reduction would be extinguished by the ten year period of the positive prescription period (which renders the title of a disponee unchallengeable). In the Land Register, if an inhibition is discovered, then the disponee's title will be registered with exclusion of indemnity from reduction by the inhibitor. Once again the right of reduction will prescribe after ten years when the disponee's title becomes unchallengeable.[226] A 10-year period in which to bring an effective action of reduction would not unduly lengthen personal searches in conveyancing transactions because it is already good practice to search against all grantors within the prescriptive progress of titles, each one for five years. If an inhibition was disclosed which appeared to have been breached within the five year period then further inquiries would have to be made since an action of reduction might still be competent.

3.141 We invite views on the following proposal and question:

> **26.(1) The provisions of section 44(3)(a) of the Conveyancing (Scotland) Act 1924 should be amended to make it clear that an inhibitor's right to reduce a deed in breach of an inhibition does not prescribe at the same time as the inhibition itself (ie five years after the date when the inhibition became effective).**
>
> **(2) If the right to reduce is not to prescribe at that time, should the normal prescriptive period of 20 years apply or should some other period be introduced, in each case running from the date of the breach?**

Interruption of prescription of inhibitions?

3.142 Another problem (which does not as yet appear to cause difficulty in practice but lurks below the surface) is whether, or how far, the five year period of the negative prescription of an inhibition is subject to the ordinary rules of interruption of the negative prescription. There are two main rules. First, if the obligation is the subject of a relevant claim by the creditor or a relevant acknowledgement by the debtor, then any time which has already run is cancelled so that a new prescriptive period has to run afresh. This applies to the five and twenty year negative prescriptions.[227] Second, time during which the creditor was under legal disability, or was induced not to act by the debtor's fraud or error, does not count. This applies to the five year prescription only.[228] It seems to be generally assumed by conveyancers that an inhibition is not subject to those rules but the basis of this assumption requires examination. There is no authority on the modern legislation. At common law it appears that an inhibition was extinguished by the negative prescription of 40 years.[229] There was a rule that the period of prescription commenced not from the date of the inhibition but

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[225] Prescription and Limitation (Scotland) Act 1973, s 8.
[226] 1973 Act, s 1(1)(b).
[227] 1973 Act, ss 6 and 7.
[228] 1973 Act, s 6(4).
[229] Graham Stewart, *Diligence* p 574; Bankton, *Institute* I,7,143, 144; Erskine, Institute III,7,36; III,7, 38. However Cusine (1987) 32 JLSS 66 at p 66 states: "At common law, it seems that inhibitions did not themselves prescribe, only the right to challenge deeds in contravention".

from the date of publication by infeftment of the right granted in breach of the inhibition.[230] This rule however seems to confuse prescription of the inhibition with prescription of the right to reduce.[231] Under the modern legislation[232] prescription of the inhibition runs from the date when the inhibition becomes effective by its registration or the registration of a prior notice of inhibition.

3.143 As regards interruption, according to Erskine, an action upon the debt secured by an inhibition did not interrupt prescription of the inhibition, with the qualification that a reduction on the ground of inhibition did have that effect.[233] The case which he cites[234] however seems not to support this qualification. The Court "thought it was of great inconvenience to the security of land rights, for which registers are only inspected for 40 years past, to find out inhibitions, which would not be secure, if possessing or pursuing upon the ground of the inhibition might perpetuate the same".[235] Bankton states the rule without the qualification.[236]

3.144 In our tentative view it would be useful to make clear by statute that the normal rules of interrupting prescription do not apply to the negative prescription of an inhibition. An inhibition should be extinguished on the expiry of five years from its date and that period should not be liable to extension, still less to interruption (ie cancellation of time already run so that a new five year period has to elapse), by acts of the inhibitor or acknowledgements of indebtedness by the inhibitee. We therefore propose that:

> **27. Section 44(3)(a) of the Conveyancing (Scotland) Act 1924 should be amended to make it clear that the rules of interruption of negative prescription do not apply to the prescription of inhibitions under that section.**

G. INSOLVENCY AND INHIBITIONS

Introduction

3.145 In this Section we examine some issues arising from the insolvency of inhibitees. Our discussion and proposals are based on the assumption that, as proposed in Section B above, an inhibition will no longer confer on the inhibitor a preference by exclusion over future debts incurred by the inhibitee.

Sequestration of inhibitee

3.146 The Bankruptcy (Scotland) Act 1985, section 31(2) provides:

> "The exercise by the permanent trustee of any power conferred on him by this Act in respect of any heritable estate vested in him by virtue of the act and warrant shall not

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[230] Bankton, *Institute* I,7,143; Erskine, *Institute* III,7,36; *Moutres v Porteous* (1682) Mor 6960.
[231] The basis of the rule was the doctrine of *non valens agere* (inability to take legal action) because in the eye of the law the inhibitor could not reduce till made aware of the offending deed by its publication in the property registers.
[232] Conveyancing (Scotland) Act 1924, s 44(3)(a); to a like effect Conveyancing (Scotland) Act 1874, s 42.
[233] Erskine, *Institute* III, 7, 38.
[234] *Kennoway v Crawford* (1681) Mor 5170.
[235] *Ibid* at p 5172.
[236] Bankton, *Institute* I, 7, 143.

be challengeable on the ground of any prior inhibition (reserving any effect of such inhibition on ranking)".

The result is that the permanent trustee has power to sell an inhibited debtor's heritable property free of the inhibition but, in ranking creditors on the proceeds of the sale of the property affected by the inhibition, effect is given to the inhibition's preference. We consider that the trustee should continue to be entitled to sell the property subject to an inhibition. If an inhibitor were entitled to reduce or to veto any sale by the trustee, he would gain priority over all the other unsecured creditors for the full amount of his debt. This would give inhibition too great an effect, since in the absence of sequestration the inhibitor would not, by virtue of the inhibition alone, be entitled to any payment.

3.147 Then there is the situation where the inhibitee has granted a deed in breach of the inhibition prior to sequestration but the inhibitor has not reduced and attached the property in question. In order to illustrate the options the deed breaching the inhibition is taken to be a disposition of the property to a third party. Where the inhibition became effective more than 60 days prior to the date of sequestration, the inhibitor may reduce the disposition, and attach the property. Any payment made by the third party in satisfaction of the inhibitor's debt may be retained by the inhibitor and not handed over to the trustee in sequestration.[237] The prohibition against adjudging on or after the date of sequestration[238] does not apply to an adjudication following on a reduction on the ground of inhibition of a disposal to a third party. This is because the reduction benefits only the inhibitor so that the property disposed of does not on reduction become part of the sequestrated estate.[239] If the inhibitee had granted a security in breach of the inhibition prior to sequestration, it seems that section 37(8) prevents the inhibitor from reducing and adjudging on or after sequestration.[240] If inhibitors are to be allowed to obtain a preference by reducing a disposition and attaching the disponed property, there would have to be a provision entitling them to proceed likewise in relation to a security.

3.148 Under section 37(2) and (3) of the Bankruptcy (Scotland) Act 1985 an inhibition taking effect within 60 days prior to sequestration is ineffectual to create a preference for the inhibitor. These provisions have been criticised by Professor Gretton on the ground that it is unclear whether the "relevant right of challenge" vesting in the permanent trustee includes the right to adjudge as well as the right to reduce and whether the inhibitor is entitled to a preference by exclusion over money received by the trustee as a result of a challenge.[241] We think that the trustee has to be able to adjudge (or in future to attach) as well as to reduce, since a reduction on the ground of inhibition is an empty remedy by itself. The second criticism would be partly resolved by our proposal that inhibition should no longer have any effect against future debts and that an inhibitor should not have a preference by exclusion of them. Where money is received by the trustee as a result of a reduction of a deed violating an inhibition rendered ineffectual by the provisions of section 37(2) and (3), the inhibitor should not have any preference over the money in the trustee's hands since that would be inconsistent with the policy of fair sharing among the creditors which underlies those provisions.

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[237] Gretton, p 161.
[238] 1985 Act, s 37(8).
[239] Gretton, pp 164 and 223.
[240] A security may be challenged by the trustee as an unfair preference under section 36 of the 1985 Act.
[241] Gretton, pp 160 to 164.

3.149 We propose that:

> **28.(1) A permanent trustee in sequestration should continue to be entitled to sell property free from challenge on the ground of any inhibition against the debtor, but reserving the effect (if any) of such an inhibition in giving the inhibitor priority in ranking over any post-inhibition deed.**
>
> **(2) Section 37(2) and (3) of the Bankruptcy (Scotland) Act 1985 (inhibitions within 60 days before the date of sequestration to be ineffectual in a question with the permanent trustee) should be amended to make it clear that the permanent trustee acquires right under those provisions not only to the inhibitor's right of reduction of any deed violating the inhibition but also to the inhibitor's right to attach the property conveyed by such a deed or, as the case may be, the inhibitor's preference over the deed. Further, where money is received by the permanent trustee as the result of a reduction of a deed violating an inhibition rendered ineffectual by the provisions of section 37(2) and (3), the inhibitor should not have any preference over the money in the trustee's hands.**

Sale by liquidator

3.150 A company may be wound up voluntarily or by the court, and in either case a liquidator is appointed to manage the winding up. In a winding up by the court the liquidator is expressly given[242] the same powers (subject to any orders made by the court) as a trustee on a bankrupt's estate. Such a liquidator therefore has power to sell property of the company covered by an inhibition free from that inhibition, but must give the inhibitor due ranking on the proceeds without the need for further diligence by the inhibitor.[243] There is no statutory provision expressly conferring such powers on liquidators in voluntary liquidations and there is doubt as to the position.[244] Voluntary liquidators used to have the same general powers as liquidators appointed by the court[245] but this is no longer the case. The general powers of voluntary liquidators are set out in sections 165 and 166 of the Insolvency Act 1986. It remains to note that under section 112 a voluntary liquidator may apply to the court for the court to exercise the powers it would have on a winding up by the court.

3.151 We consider that the liquidator in a creditors' voluntary liquidation should have the power to dispose of the company's property free of any inhibition. The inhibitor would rank on the proceeds along with other unsecured creditors. In a creditors' voluntary liquidation the company will be insolvent and the inhibitor should not be entitled to be paid in full as the price for discharging the inhibition. Put another way, a creditors' voluntary liquidation is a general ranking process just as much as a compulsory liquidation or a sequestration, and the inhibitor should rank in the same way. In a members' voluntary liquidation, however, the company is solvent and all creditors including the inhibitor should be paid in full. There is no reason why a liquidator in a members' voluntary liquidation should enjoy the power to sell notwithstanding the inhibition. We put forward the following proposals:

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[242] Insolvency Act 1986, s 169(2).
[243] Bankruptcy (Scotland) Act 1985, s 31(2).
[244] Gretton, p 177.
[245] Companies Act 1985, s 598(2)(now repealed).

29.(1) A liquidator in a creditors' voluntary winding up of a company should be entitled to dispose of the company's heritable property, notwithstanding the existence of an effectual inhibition, but the inhibitor should be entitled to rank on the proceeds of sale.

(2) This change should not be extended to a liquidator in a members' voluntary winding up.

Trust deeds for creditors

3.152 A trust deed for creditors is a deed granted by a person in favour of one or more trustees in terms of which the person's assets are transferred to the trustees for the benefit of that person's creditors.[246] Creditors who accede to the deed are bound by its terms but non-acceding creditors are not. A non-acceding creditor who has used an inhibition prior to the trust deed is entitled to reduce it as a voluntary disposition in breach of the inhibition and also to reduce any title subsequently granted by the trustee.[247] Where the trust deed falls within the statutory definition in section 5(4A) of the Bankruptcy (Scotland) Act 1985, it may be made a "protected trust deed". One effect of protection is that all creditors are deemed to be acceding creditors.

3.153 A protected trust deed does not render ineffectual an inhibition within 60 days of the deed. The only statutory provisions regarding creditors' claims in trust deeds deal with valuation of the claim. These apply unless the deed provides otherwise.[248] In practice trust deeds generally provide expressly for the ranking of creditors and the distribution of the estate in the same way as in a sequestration. Our proposed changes to ranking whereby inhibitors would no longer enjoy a preference by exclusion would thus be applied to such trust deeds. If the trust deed did not provide for creditors to be ranked as in a sequestration, a creditor who was thereby prejudiced could object to the trust deed becoming protected and petition for sequestration.[249] We think that there is no need to introduce a new statutory provision for protected trust deeds declaring that an inhibiting creditor should be treated in the same way as in a sequestration.

H. INHIBITIONS AND VOLUNTARY SECURITIES

Preliminary

3.154 In this Section we consider the interaction between inhibitions on the one hand and voluntary securities (standard securities and floating charges) on the other. Since 1970 the only competent form of fixed voluntary security over land has been a standard security.[250] Since 1961 a company has been able to create a floating charge over any or all of its property, heritable and moveable, from time to time comprised in its property and undertaking.[251] The present provisions relating to floating charges and their enforcement by way of receivership

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[246] McBryde, *Bankruptcy*, (2nd edn; 1995), para 20-10.
[247] In our forthcoming Discussion Paper on *Attachment Orders and Money Attachments* we propose that a non-acceding creditor should not be entitled to use adjudication, land attachment or an attachment order against property to which the trustee had taken title.
[248] 1985 Act, Sch 1.
[249] 1985 Act, Sch 5, para 7.
[250] Conveyancing and Feudal Reform (Scotland) Act 1970, s 9(3).
[251] Companies (Floating Charges) (Scotland) Act 1961.

are contained respectively in the Companies Act 1985[252] and the Insolvency Act 1986, Part III.[253]

Inhibition registered before standard security granted

3.155 Where an inhibitor reduces a standard security on the ground of inhibition and adjudges the security subjects, the adjudication ranks in priority to the standard security which remains valid, subsisting and effective in all other respects.[254] The inhibitor may not need to take this action in order to be paid as the standard security holder will not be able to realise the security standing the inhibition. The title is unmarketable unless the inhibition is discharged.

Inhibition registered after standard security granted

3.156 The secured creditor in a standard security granted before registration of the inhibition may proceed to sell the property and the purchaser obtains a title free of the inhibition.[255] The disposition by the selling creditor does not contravene the inhibition because it affects only subsequent voluntary deeds granted by the inhibitee. Any preference the inhibitor enjoys over the debtor and other creditors has to be worked out on the net free proceeds of sale.

3.157 Section 27(1) of the Conveyancing and Feudal Reform (Scotland) Act 1970 directs a selling standard security holder to hold the proceeds of sale in trust and to apply them in the following order:

> "(a) first, in payment of all expenses properly incurred by him in connection with the sale, or any attempted sale;
>
> (b) secondly, in payment of the whole amount due under any prior security to which the sale is not made subject;
>
> (c) thirdly, in payment of the whole amount due under the standard security, and in payment in due proportion, of the whole amount due under a security, if any, ranking *pari passu* with his own security, which has been duly recorded;
>
> (d) fourthly, in payment of any amounts due under any securities with a ranking postponed to that of his own security, according to their ranking."

Any surplus is payable to the previous owner/debtor or any person authorised to give a receipt for this amount.[256]

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[252] Ss 462-466.

[253] For a description of a floating charge, see *Gloag and Henderson, The Law of Scotland* (10th edn) para 51.28: "The charge lies dormant until the company is wound up or a receiver appointed leaving the company free in the meantime (subject to any restrictions in the agreement constituting the debt) to dispose of the property over which it extends; if it acquires new property that also may become subject to the charge. On the commencement of the winding up [now when a resolution for voluntary winding up is passed or a winding up order is made by the court][253], however, or on the appointment of a receiver, the charge crystallises or attaches to the property then comprised in the company's property and undertaking or such part of it as is subject to the charge."

[254] See para 3.23 above on the effect of reduction as benefiting only the inhibitor.

[255] Conveyancing and Feudal Reform (Scotland) Act 1970, s 26(1).

[256] 1970 Act, s 27(1).

3.158 It is not clear how these provisions operate if the owner has been inhibited after granting the standard security. The position is further complicated if other creditors seek to gain a preference by serving an arrestment on the selling creditor attaching the creditor's obligation to account under section 27(1) to the debtor.[257] The eight reported cases (seven in the sheriff court; one in the Outer House[258]) since 1966 are discussed with great ability in Professor Gretton's monograph.[259] which shows that they yield several inconsistent and conflicting approaches.

3.159 **The "inhibitee's voluntary act" approach**. As Professor Gretton explains, one approach is to say that since an inhibition strikes only at the debtor's voluntary acts, it does not affect a forced sale by a heritable creditor.[260] In *McGowan v Middlemass and Son Ltd*,[261] which involved the sale by a building society under a standard security, the society consigned the proceeds of sale in court whereupon they were arrested by several creditors. It was held that the inhibitor did not rank with the later arresting creditors. In *Ferguson and Foster v Dalbeattie Finance Co*[262] the free proceeds of sale were handed over to the inhibitee's agents. The claim of the inhibitor to the proceeds in preference to the inhibitee were rejected. In this case there were no other creditors who had arrested or used other diligence. The sheriff disapproved Graham Stewart's statements that "[i]f a bond holder whose security is prior to the inhibition were to sell the subjects in virtue of his bond, the inhibition would subsist over the balance of the price remaining after satisfying the prior securities." and that any discharge by the debtor to the bond holder would be a violation of the inhibition.[263] As the sheriff pointed out, the authority given in support of Graham Stewart's statement[264] does not in fact support it.

3.160 **The "postponed security" approach**. On this approach "an inhibition should be treated as a sort of postponed security".[265] In *George M Allan Ltd v Waugh's Tr*[266] a building society sold the inhibitee's home and handed the proceeds over to the subsequently appointed trustee in bankruptcy who refused to give any preference to the inhibitor. The sheriff held that the inhibitor was entitled to a preferential ranking in the sequestration. Although the building society's security was by means of an *ex facie* absolute disposition, the inhibition was regarded as effective over the heritable radical right which the inhibitee enjoyed, in the same way as it would have been effective had the inhibitee been the owner and the building society taken security by way of a bond and disposition in security (nowadays a standard security). The constructive conversion of the inhibitee's radical right from heritable to moveable property which took place on sale did not affect the effectiveness of the inhibition. This decision was followed by *Abbey National Building Society v Aziz.*[267] Moreover in *Halifax Building Society v Smith*[268] it was held that an inhibition was a security within the meaning of section 27(1)(d) of the 1970 Act.

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[257] *Lord Advocate v Bank of India* 1991 SCLR 320.
[258] See paras 3.159-3.162 below.
[259] Gretton, pp 142-150.
[260] Gretton, p 142.
[261] 1977 SLT (Sh Ct) 41.
[262] 1981 SLT (Sh Ct) 53.
[263] P 559.
[264] Bell, *Commentaries* vol 2 , p 139.
[265] Gretton, p 143.
[266] 1966 SLT (Sh Ct) 17.
[267] 1981 SLT (Sh Ct) 29.
[268] 1985 SLT (Sh Ct) 25.

3.161 **The "canons of ranking without inhibitor's attachment" approach**. In *Bank of Scotland v Lord Advocate*,[269] which related to a sale under powers in a bond and disposition in security and similar provisions on disposal of the proceeds of sale,[270] Lord Dunpark held that an inhibitor ranked on the proceeds preferably to creditors who had taken no steps to secure their debts and also to creditors whose preferences post-dated the inhibition (such as the creditor who had arrested in the hands of the clerk of court). In *Halifax Building Society v Smith*[271] in a very valuable judgment, Sheriff Principal Caplan held that an inhibition was a security within the meaning of section 27(1)(d) of the 1970 Act and therefore conferred an effective preference to the net proceeds of sale after deduction of the selling heritable creditor's debt and expenses. The preference was to be calculated using Bell's canons of ranking[272] whereby the inhibitor ranks as if debts incurred after the inhibition did not exist. Therefore the inhibitor ranked *pari passu* with pre-inhibition creditors and in preference to post-inhibition creditors. This was followed in *Abbey National Building Society v Barclays Bank plc*[273] where the sheriff also held that an arrestment by a creditor whose debt was created after the inhibition did not give that arresting creditor a preference over the inhibitor.

3.162 **The "canons of ranking with inhibitor's attachment" approach.** Professor Gretton argues that the third approach would be correct but for the fact that since an inhibitor has no active title to be paid by his debtor's debtor, he must "either have adjudged before the sale or arrested after it".[274] This is supported by *Alliance and Leicester Building Society v Hecht.*[275] Here, since the inhibitee had been sequestrated by the time of the sale, the sheriff directed the free proceeds of sale to be paid to the trustee who would rank and prefer the various arresting and inhibiting creditors. The inhibitions gave no right to payment and their priority had to be worked out in the ranking in the sequestration. He noted[276] that in *Halifax Building Society v Smith*,[277] in which it was held that an inhibition was a security, the court was not referred to *Scottish Waggon Co Ltd v Hamilton's Tr*[278] which decided the opposite.

Proposals for reforming or clarifying the law

3.163 The present uncertainty should be removed. Of the foregoing solutions, the last seems best, namely, that the inhibitor must have either adjudged the property or arrested the proceeds in order to rank on the surplus free proceeds in priority to the debtor. This solution accords best with the nature of an inhibition, namely, that it is prohibitory and does not by itself give the inhibitor any active title to demand payment.[279] Entitling the inhibitor to be paid ahead of the debtor by reason only of the inhibition would unduly enlarge the effect of the inhibition and confer a preference over all the other creditors who have not

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[269] 1977 SLT 24 (OH).
[270] This case was decided on sections 122 and 123 of the Titles to Land Consolidation (Scotland) Act 1868 which set out how the creditor is to account to the debtor and postponed creditors. These provisions are similar to but not exactly the same as those in the 1970 Act applicable to standard securities. Section 122 of the 1868 Act was regarded as making the selling creditor accountable not only to the debtor but also to other creditors and requiring consignation of the free proceeds in court for behoof of those having best right thereto.
[271] 1985 SLT (Sh Ct) 25.
[272] Set out in paragraph 3.14 above.
[273] 1990 SCLR 639 (Sh Ct).
[274] Gretton, p 145.
[275] 1991 SCLR 562 (Sh Ct).
[276] Ibid at p 568.
[277] 1985 SLT (Sh Ct) 25.
[278] (1906) 13 SLT 779.
[279] Bell, *Commentaries vol* 2, p 139.

done diligence, including those whose debts were incurred before the inhibition. The inhibitor is not left without a remedy if the proceeds are paid to the debtor, because the inhibitor could do diligence against the proceeds in the debtor's hands or sequestrate the debtor.[280] It has been argued that requiring adjudication or arrestment by the inhibitor could make an inhibition rather pointless because the inhibitor's preference outwith sequestration would then be determined by the adjudication or arrestment rather than the inhibition. This argument would be true if, as we propose, an inhibitor's present preference by exclusion of later debts was abolished. But a creditor might still derive some benefit from inhibiting after the debtor had granted a standard security. It would prevent later voluntary disposals or securities by the inhibitee of the same or other heritable property.

3.164 We propose that:

> **30. Where a heritable creditor sells property which is subject to an inhibition registered after the granting of the security, the inhibitor should be entitled to rank on the proceeds of sale along with other diligence creditors only if he has either:**
>
> **(a) attached the property by land attachment prior to the sale; or**
>
> **(b) arrested the proceeds of sale in the hands of the heritable creditor or other person who has an obligation to account to the debtor.**

3.165 If (contrary to our proposal) it was eventually decided that an inhibitor should rank on the proceeds of sale without first using arrestment or land attachment, then we think that his ranking should be postponed to creditors who used these diligences since inhibition is merely a prohibitory diligence.

Competition between inhibition and floating charge

3.166 **Inhibition registered between creation and crystallisation of floating charge.** Section 15(2)(a) of the Companies (Floating Charges and Receivers)(Scotland) Act 1972 provided that the rights of a receiver appointed on crystallisation of a floating charge were "subject to the rights of any person who has effectually executed diligence on all or any part of the property of the company prior to the appointment of the receiver".[281] In *Lord Advocate v Royal Bank of Scotland*[282] it was held that a bare arrestment, which had been executed between the creation and crystallisation of a floating charge, ranked after it. The ground of the decision was that a bare arrestment is not an "effectually executed diligence on all or any part of the property of the company" within the meaning of the above provision. This decision has been criticised[283] and we endorsed the criticisms in a recent report.[284] The legislation lays down a statutory hypothesis under which a floating charge has effect in ranking as a fixed security. The intention of Parliament in enacting section 1(2)(a) of the

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[280] Bankruptcy (Scotland) Act 1985, s 37(1).
[281] This provision has been replaced by one in almost identical terms in the Insolvency Act 1986, s 60(1)(b).
[282] 1977 SC 155.
[283] See W A Wilson, 1978 JR 253; J R Campbell, "Receivers' Powers" (1978) 23 JLSS 275; G L Gretton, "Diligence, Trusts and Floating Charges" (1981) 26 JLSS 57; A J Sim, "The Receiver and Effectually Executed Diligence" 1984 SLT(News) 25; J B St Clair and J E Drummond Young, *The Law of Corporate Insolvency in Scotland* (2nd edn, 1992) pp 213-215; but see J A D H "Inhibitions and Company Insolvencies: A Contrary View" 1983 SLT (News) 177.
[284] Report on *Diligence on the Dependence and Admiralty Arrestments* (1998) Scot Law Com No 164, paras 9.10 *et seq*.

Companies (Floating Charges) (Scotland) Act 1961, the precursor of section 15(2)(a) of the 1972 Act, was that diligence executed before the crystallisation of a floating charge should have priority over the charge unless the diligence had been rendered ineffectual by the statutory rule cutting down arrestments and poindings executed within 60 days before liquidation.[285] The *Royal Bank* case therefore gave lesser rights to arresters than Parliament intended.

3.167 It seems nevertheless to be accepted that the principle of the *Royal Bank* decision applies equally to inhibitions. In *Armour and Mycroft Petrs*[286] where the receivers sought an order enabling them to sell the company's property free of a post-creation inhibition the Lord Ordinary declined to decide whether an inhibition was effectually executed diligence but indicated[287] that a floating charge had priority over a post-creation inhibition. *Taymech Ltd v Rush & Tomkins*[288] proceeded on the basis that a floating charge enjoyed such priority. We support this view. An inhibition is a prohibitory diligence not attaching any particular asset and is even less an effectually executed diligence on any part of the property of the company than is an arrestment.

3.168 Receivers may face difficulties in selling property subject to a later inhibition. A purchaser cannot be compelled to accept a title which is subject to an undischarged inhibition executed after the creation of the floating charge. Although the inhibition is very probably ineffectual, the title though good is not fully marketable.[289] Unless the post-creation inhibitor is prepared to discharge the inhibition without payment, the receiver may have to petition for recall or apply to the court under section 61 of the Insolvency Act 1986 for authority to sell the property free of any "security, interest, burden, encumbrance or diligence". The Keeper, when registering in the Land Register the title of a person who purchases from a receiver, excludes indemnity in respect of an inhibition executed after the creation of a floating charge. This protects the Keeper from any claim for compensation but makes the title less marketable.

3.169 **Inhibition registered before creation of floating charge**. In *Iona Hotels Ltd v Craig*[290] the competing arrestment was executed before the creation of a floating charge. It was held (on the principle of litigiosity) that the arrestment had priority over the charge. In our recent report,[291] we welcomed the result reached in the *Iona Hotels* case but pointed out that the reasoning was fallacious since it confirmed the result of the *Royal Bank* case. It seems to be accepted (although there is no authority) that the decision in *Iona Hotels* applies to inhibitions so that an inhibition registered before the creation of a floating charge ranks above it. It seems to be accepted on all sides that an inhibition registered prior to the creation of a floating charge should have priority over it. But given the statutory hypothesis, it is still unclear why the priority point should be the creation rather than the crystallisation of the charge.

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[285] *Hansard*, HC, Scottish Standing Committee, 20 June 1961, cols 14 *et seq*; A J Sim, "The Receiver and Effectually Executed Diligence" 1984 SLT(News) 25 at p 28.
[286] 1983 SLT 453.
[287] P 546.
[288] 1990 SLT 681.
[289] *Dryburgh v Gordon* (1896) 24 R 1
[290] 1991 SLT 11.
[291] Report on *Diligence on the Dependence and Admiralty Arrestments* (1998) Scot Law Com No 164, paras 9.15 - 9.19.

3.170 The inhibitor may enforce this preference by a non-catholic reduction (for the inhibitor's benefit) of the floating charge and a disposition by the receiver and thereafter by adjudging (in future, attaching) the property in question. The court has power under section 61 of the Insolvency Act 1986 to authorise the receiver to sell property subject to a floating charge free of any effectual diligence if the diligence creditor refuses to consent to a sale. The provision empowering the court to grant "such authorisation ... on such terms and conditions as the court thinks fit" presumably should not be construed as including a term or condition prejudicing the inhibitor's preference.

3.171 **Ranking by receiver of inhibitions and other prior debts.** The position where a receiver sells is unclear. After satisfying the debt of the floating charge holder should the net free proceeds of sale be used to satisfy the inhibitor with any balance being paid to the debtor company, or should the company be paid the whole net free proceeds? In *Armour and Mycroft Petrs*[292] the Lord Ordinary granted an order under section 61 of the Insolvency Act 1986 allowing the receiver to sell free from any post-creation inhibition on condition that the receiver paid the inhibitor's debt out of the balance otherwise due to the company. Such an order is at the discretion of the court. One of the factors influencing the decision in *Armour and Mycroft Petrs*[293] was that there were no other receivers or secured creditors with claims on the free proceeds of sale. The possible existence of other unsecured creditors was not known.

3.172 **Summary.** In the Insolvency Act 1986, section 60(1) (governing the ranking of prior debts in receivership), which as have pointed out in another report requires reform,[294] no reference is made to inhibitions. The law on competitions between inhibitions and floating charges, and on the ranking of prior inhibitions and prior debts by receivers, undoubtedly requires reform. We repeat the conclusion in the same report that legislation on diligence would not be an appropriate vehicle for reform.[295] What is needed is legislation on floating charges which could tackle the problem at its root.

I. MISCELLANEOUS ISSUES

Preliminary

3.173 In this section we deal with sales by judicial factors and the inhibitee's liability for the expenses of inhibition.

Sales by judicial factors

3.174 A judicial factor is a person appointed by the court to take over the management of another's property and financial affairs. The present law is not clear regarding the effectiveness of an inhibition when a judicial factor sells inhibited property.[296] In *Ferguson v Murray*[297] a judicial factor was appointed to manage heritable property belonging to a lapsed trust. The property was subject to a bond and the heritable creditor brought an action of maills and duties to ingather the rents. It was held that this diligence prevailed over a

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[292] 1983 SLT 453.
[293] 1983 SLT 453.
[294] Report on *Diligence on the Dependence and Admiralty Arrestments* (1998) Scot Law Com No 164, paras 9.59 - 9.69.
[295] *Ibid*, para 9.68; see also para 9.23.
[296] Gretton, p 89.
[297] (1853) 15D 682.

judicial factor as it would have prevailed over any trustees of the trust. It was observed that the situation might have been different if there had been several heritable creditors and the judicial factor had been appointed to collect the rents on behalf of all.[298] *Kerr v Brown*[299] was very similar except that diligence was an arrestment, which it was held prevailed over the judicial factor subsequently appointed to the lapsed trust. These cases suggest that an inhibition should remain effective against a judicial factor, but on the other hand an inhibition is a personal prohibition rather than an attaching diligence (such as an arrestment or maills and duties). Finally in *Reid's J F v Reid*[300] it was decided that, apart from various statutory provisions regarding claims of creditors, a judicial factor appointed on the estate of an insolvent deceased person was not assimilated to that of a trustee on a sequestrated estate. Professor Halliday considered it doubtful that such a judicial factor had power to sell free of an inhibition against the bankrupt.[301] A judicial factor may apply to the Accountant of Court under section 2 of the Trust (Scotland) Act 1961 for authority to sell property but this only authorises a sale which is or may be at variance with the terms and purposes of the judicial factory. It would not empower the Accountant of Court to sanction a sale in contravention of a valid and effective inhibition. A judicial factor may also apply to the court under section 7 of the Judicial Factors Act 1849 for special powers outwith the normal powers of administration. There is no closed list of special powers and what may be granted depends on the circumstances of the particular case.

3.175 It can be argued that an inhibition strikes only at voluntary acts of the inhibitee and that acts of the judicial factor are not acts of the inhibitee. We do not accept this argument. An inhibition should not be capable of being defeated simply because a judicial factor has been appointed to the inhibitee. We consider that it would be wrong in principle to give a judicial factor higher rights as against the inhibitee's creditors than the inhibitee has. In order to remove any doubts in the existing law we put forward the proposal that:

> **31. An inhibition against the owner of property subject to a judicial factory should be equally effective against the judicial factor.**

Expenses of inhibition in execution

3.176 We turn to deal with the expenses of inhibition in execution and the expenses of executing a warrant for inhibition on the dependence. Our recent Report on *Diligence on the Dependence and Admiralty Arrestments*[302] dealt with the question of expenses in relation to obtaining a warrant for inhibition on the dependence but left the review of the defender's liability for the expenses of its execution to this present discussion paper. We review such liability in paragraph 3.184 below after looking at the debtor's liability for the expenses of inhibition in execution.

3.177 A creditor using inhibition must pay all of the court dues, solicitors' and officers' fees and registration dues involved in obtaining the warrant for and executing the inhibition in execution. It is generally thought,[303] although direct authority is sparse,[304] that an inhibitor is

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[298] *Kay v Cleugh* (1840) 3D 252.
[299] 10 SLT (1902) 272.
[300] 1959 SLT 120.
[301] D J Cusine (ed), *Conveyancing Opinions of J M Halliday* (1992) p 581.
[302] Scot Law Com No 164 (1998).
[303] Graham Stewart, p 555; Gretton, p 45.
[304] *Clark v Scott and Connell*, (1878) Guthrie's Sh Ct Cases 204 seems to be the only reported case.

not entitled to recover these expenses of inhibition from the debtor. At common law, a diligence ceases to have effect if the debtor makes or tenders payment of the sum due under the decree only (ie without diligence expenses).[305] However, it appears in practice that many inhibitors will not grant a discharge of the inhibition unless they are paid in full; principal sum, interest, expenses of diligence and any expenses connected with the discharge.[306] Few inhibitees are prepared to petition the court for recall of an inhibition which the inhibitor refuses to discharge because the expenses of the inhibition have not been paid, even though the expenses of such a petition would be awarded against the inhibitor.[307]

3.178 The first question is whether the creditor should be entitled to recover the expenses of executing the inhibition from the inhibitee at all or whether they should remain the liability of the inhibitor. In most other diligences (arrestment, earnings arrestment, poinding and rent sequestration, but not adjudication or civil imprisonment) the expenses of the diligence are chargeable against the debtor. However, the rule that the debtor is not liable for the expenses of adjudication has to be seen against the background that the value of the land adjudged may vastly exceed the debt and an adjudger who obtains an irredeemable title may not to be required to account to the debtor for any excess.[308] We consider that in principle a debtor should be liable for the expenses of any diligence used to enforce payment of the debt. The debt has been found due by legal proceedings and if the debtor thereafter refuses to pay it seems only right that the creditor's expenses in enforcing payment should be borne by the debtor. Were this not the rule modest debts would become unenforceable. Debtors who are unable to pay their debts in a lump sum can obtain instalment decrees or time to pay orders. These respectively prevent diligence or freeze diligence and hence limit their liability to diligence expenses, provided the terms of the decree or order are complied with.[309] We turn to consider whether there any special features of inhibition that could justify departing from this general rule.

3.179 In the only reported case[310] the expenses of an inhibition were held not chargeable against the debtor on the grounds that inhibition is merely prohibitory, a diligence of precaution or protection which cannot be carried further so as to become a direct step in enforcing payment. This is correct in legal theory, but nevertheless inhibition is often an effective way of forcing the inhibitee to pay the amount due to the inhibitor. We do not think an inhibition in execution can be regarded as merely a protective diligence, in the same way as an inhibition on the dependence of an action undoubtedly is. The very fact that inhibition is frequently resorted to shows that creditors regard it as an effective diligence for enforcing decree debts.

3.180 Another objection that may be advanced against making the debtor liable for the expenses of inhibition is that it would encourage the use of inhibition, particularly for modest debts. Greater use of inhibition would have an adverse effect on all conveyancing transactions where a search has to be carried out of the personal register in order to ensure that the seller or person disposing of the property is not inhibited. The more inhibitions

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[305] *Inglis v McIntyre* (1862) 24D 541; *Harvie v Luxram Electric Ltd* (1952) 68 Sh Ct Reps 181. For arrestments, earnings arrestments and poindings diligence expenses must now be paid or tendered as well, Debtors (Scotland) Act 1987, s 95(1).
[306] Gretton, p 45.
[307] Graham Stewart, p 567; *Lickley Petr* (1871) 8 S L Rep 624.
[308] Gretton, p 220.
[309] Debtors (Scotland) Act 1987, Part I.
[310] *Clark v Scott and Connell* (1878) Guthrie's Sh Ct Cases 204.

there are, the more troublesome such a search is and the greater the likelihood of errors in matching the names of sellers etc to the names of inhibitees or finding possible matches which have to be investigated. We doubt whether making the expenses of inhibition recoverable from debtors would result in an increase in the number of inhibitions. First, many creditors already recover such expenses in practice. Second, there is some evidence that creditors at present use inhibition for modest debts. Professor Gretton notes that in a particular month there were 18 inhibitions registered for a debt of under £500 of which 3 were for under £200.[311] Our own researches confirm this. We looked at 110 inhibitions in execution registered in a period during September and October 1996. 7% (8) were for a principal sum of less than £500, 15% (17) were for less than £1,000 and 34% (37) for less than £2,000. Third, most inhibitions at present are on the dependence of actions for payment of money where pursuers have an almost unqualified right to obtain a warrant to inhibit. In our Report on *Diligence on the Dependence and Admiralty Arrestments*[312] we recommend changes which should result in a substantial decrease in the number of inhibitions on the dependence. Fourth, the proposed new procedures[313] for executing and registering inhibitions should reduce the expenses of diligence substantially. This would lessen the burden on debtors should they become liable for these expenses. Finally, we provisionally recommend that adjudication in their present form should be replaced by a diligence of land attachment and sale where the expenses would fall on the debtor.[314] Unless the expenses of inhibition were recoverable from debtors there would be an incentive for creditors to use land attachment rather than inhibition.

3.181 A more substantial objection against debtors becoming liable for the expenses of inhibition used against them is that there is no fund out of which such expenses may be claimed. Unlike poinding or arrestment, there is no property which can be sold or fund which can be utilised for payment of the debt and diligence expenses. We are not in favour of permitting creditors to recover inhibition expenses by means of an action for payment. That would multiply legal proceedings, potentially to infinity if the creditor inhibited in order to enforce a decree for payment of the expenses of inhibition in enforcing a previous decree and so on. For this and other reasons section 93 of the Debtors (Scotland) Act 1987 sets out a general rule in relation to the diligences of arrestment, earnings arrestment and poinding that the expenses of a diligence should be "recoverable from the debtor by the diligence concerned but not by any other legal process". But it is not possible to provide that the expenses of inhibition should be recoverable only by the inhibition as there is no fund attached by that diligence. Indirect methods of recovery, other than by a fresh action for payment, would have to be used. The first such method is that an inhibitor should not be obliged to discharge the inhibition unless the diligence expenses were paid as well as the debt. As we have noted[315] this is to some extent the present practice but not the present law. If the creditor refused to grant a discharge on being tendered debt and expenses then the debtor should be entitled to apply to the court for a recall of the inhibition and the inhibitor should be liable for the expenses of the application.[316] The second is that in a sequestration, liquidation or other ranking process the inhibitor should be entitled to rank for both the debt and the diligence expenses. Another method of indirect recovery could be via a land

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[311] P 45.
[312] Scot Law Com No 164 (1998).
[313] See Section D above.
[314] See Part 2, Section B, Proposition 17.
[315] Para 3.177 above.
[316] This is the present law where the creditor refuses a discharge on the amount of the debt being tendered.

attachment. The creditor should be entitled to charge and attach for the expenses of a prior inhibition as well as for the debt and the other expenses of land attachment. The final method could be by way of attachment order which we propose in our forthcoming Discussion Paper *Attachment Orders and Money Attachments*. Attachment orders would be the residual diligence; available in relation to property where no other diligence was competent. The creditor should be entitled out of the proceeds of attachment to the expenses of a prior inhibition provided the property attached had been affected by the inhibition.

3.182 The Debtors (Scotland) Act 1987 also contains a subsidiary rule[317] ascribing payments made by, or on behalf of, the debtor to the creditor while the diligence is in effect; first to the diligence expenses, secondly to interest and finally to the debt itself. We would adopt this for inhibition expenses in order to deal with cases where the payments recovered by the inhibitor were insufficient to meet the debt and expenses in full. There would also have to be rules dealing with multiple inhibitions by the same creditor and inhibitions which were invalid due to some defect in the warrant or their execution.

3.183 In order to elicit views on the issue of the debtor's liability for expenses we ask the following questions:

> **32.(1) Should the expenses of executing an inhibition in execution of a decree (or other document on which inhibition is competent) be recoverable from the inhibitee?**
>
> **(2) It should not be competent for the inhibitor to bring a separate action against the inhibitee or to do other diligence (apart from a land attachment and attachment order) for the recovery of the expenses of the inhibition. If recovery is to be allowed should it be by any of the following methods:**
>
> > **(a) The inhibitor should not be obliged to discharge the inhibition unless the debt and the diligence expenses are tendered;**
> >
> > **(b) The inhibitor should rank in a sequestration, liquidation or other ranking process for the debt and diligence expenses;**
> >
> > **(c) The inhibitor who proceeds to a land attachment should be entitled to charge and attach for the debt and the expenses of the inhibition; or**
> >
> > **(d) The inhibitor who proceeds to an attachment order should be entitled to charge and attach for the debt and expenses of an inhibition which affected the property attached?**

3.184 In our recent Report on *Diligence on the Dependence and Admiralty Arrestments* we recommended that the court should award the pursuer the taxed expenses of obtaining and executing a warrant for arrestment on the dependence, but may modify or refuse them if the pursuer was unreasonable in applying for the warrant or if modification or refusal is reasonable in the circumstances (including the outcome of the action).[318] If debtors are to be

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[317] S 94.
[318] Recommendation 11, para 3.111.

liable for the expenses of inhibition in execution (as they are for the expenses of arrestment in execution) then we think that the rules for the expenses of inhibition on the dependence should be the same as for arrestment on the dependence.

PART 4 ABOLITION OR RETENTION OF INHIBITIONS

Introduction

4.1 In this Part, we seek views on whether the diligence of inhibition should be retained or abolished. It is assumed that land attachment will be introduced in accordance with the scheme set out in Part 2.[1] It is also assumed that, if inhibitions are retained, they would be reformed as proposed in Part 3 above. In our provisional view, some criticisms of the existing law and practice of inhibitions are not fundamental and could be met by appropriate reforms. In this Part we seek views on more fundamental criticisms going to the root of inhibitions. Some may argue that inhibitions should be retained without most or all of the reforms proposed in Part 3 and may make that point in their responses to that Part.

4.2 The diligence of land attachment is to include an attacher's notice of litigiosity which would have to be registered at least 14 days before a notice of land attachment could be registered.[2] This notice of litigiosity, like the subsequent notice of land attachment, would specify the property affected and be registered in the property registers.[3] A registered notice of litigiosity would, like an inhibition, prohibit the debtor from granting future voluntary deeds and render any such deed reducible by the attacher.[4] It would also warn third parties transacting with the debtor on the faith of the registers of the possibility of a notice of land attachment being registered after a mandatory delay of not less than 14 days after registration of the attacher's notice of litigiosity[5] and this delay would give them an opportunity to complete title by registration before the creditor's notice of land attachment can be registered or to insist on the registers being cleared of the notice of litigiosity before the conveyancing transaction is settled and the price or other consideration paid.

4.3 Under our proposals for reform of inhibitions in Part 3, an inhibition would not have any effect against future debts[6] and the inhibitor would no longer obtain a preference in a ranking process by the exclusion of such debts. We also propose changes to deal with the problems caused by an inhibition which is effective but which was not disclosed by a personal search before settlement of a conveyancing transaction with the inhibitee. First, the existence of a registered inhibition would no longer be deemed to be known by everybody.[7] Second, a deed by an inhibitee in favour of a third party would not be affected by an inhibition if at the time of delivery of the deed the third party was justifiably ignorant of the existence of the inhibition.[8] A third party would be treated as justifiably ignorant if he had taken reasonable steps to discover the inhibition, as by obtaining a personal search which did not disclose the inhibition.[9] Third, an inhibitee's deed in favour of a third party violating

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[1] See Part 2, Section B; restated with explanatory notes in Appendix A below.
[2] Part 2, Section B, proposition 6.
[3] *Ibid*, proposition 6(1), (3) and (4).
[4] *Ibid*, proposition 6(3).
[5] *Ibid*, proposition 7(a).
[6] Proposal 4 (para 3.22).
[7] Proposal 13 (para 3.79).
[8] Proposal 15 (para 3.88).
[9] *Idem*.

an inhibition and registered in the Land Register would not be reducible at the instance of the inhibitor unless the Keeper had noted the inhibition when registering the third party's title or the third party had been fraudulent in that he knew of the inhibition at the date of delivery of the deed.[10] The Keeper should have to pay indemnity to the inhibitor for the latter's inability to reduce only if the Keeper had been at fault in failing to discover or note the inhibition.[11]

4.4 The main issue as we see it is whether inhibition is needed as well as an attacher's notice of litigiosity, or whether the existence of two "freeze" procedures against heritable property would make the law unnecessarily complex.

Arguments for retaining inhibitions

4.5 The following seem to be the main arguments for retaining inhibitions. An inhibition:

(1) affects the debtor's whole heritable property, including attachable property which cannot for practical reasons be reached by land attachment;

(2) is easy for creditors to use and inexpensive;

(3) is humane to debtors;

(4) can be used on the dependence of an action and otherwise to give effect to a personal prohibition against transactions with heritable property; and

(5) gives creditors a choice of diligence against heritable property.

4.6 **Affects debtor's whole property.** An inhibition affects the debtor's whole heritable property. There are two aspects to this. The whole property is affected without the need to find out what property the debtor possesses or to specify it.[12] Moreover an inhibition affects not only property to which the debtor has a registered title but also rights which, though registrable in the property registers, are in fact unregistered. Land attachment is designed to attach property which is registered in the property registers and property which could be, but has not yet been, registered there.[13] An example of the second category of attachable property is the right of a purchaser holding a delivered but unregistered disposition. The new diligence of attachment orders which we propose in our forthcoming Discussion Paper on *Attachment Orders and Money Attachments* would enable creditors to attach (among other assets) rights in relation to heritable property which cannot be registered in the property registers,[14] for example, a timeshare, a tenant's interest under a short lease or a purchaser's rights under missives.

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[10] Proposals 19 (para 3.99) and 20 (para 3.111).
[11] Proposal 20(5) (para 3.111).
[12] See paras 2.41 to 4.11.
[13] See Proposition 1(1) in Part 2.
[14] We also propose that a beneficiary's interest under a trust should be arrestable in the hands of the trustees whether the interest is heritable or moveable. A personal right to heritable property acquired by testate or intestate succession is a common example of such an interest, but the interest would

4.7 If inhibition were to be abolished, there would in practice be a gap in diligence in relation to unregistered heritable property which could be registered. In theory such property would be attachable by land attachment, but in practice the creditor may not have access to the relevant information or documents. A search of the property registers will not disclose the debtor's ownership or other attachable and registrable right. We do not think that it would be socially acceptable to force debtors to disclose information or produce unregistered deeds or other links in title for registration by their creditors under pain of punishment for contempt of court. Without such information or deeds, the creditor would not be able to register an attacher's notice of litigiosity or a notice of land attachment because he could not specify the property or the debtor's registrable interest in it or, in Land Register cases, satisfy the Keeper that he was entitled to attach what on the face of the register is another person's property.

4.8 In short, inhibition could be used against heritable property which could not in practice be attached by land attachment or otherwise except by resort to sequestration or liquidation. Inhibitions would therefore still have a distinctive and useful part to play in the machinery of debt enforcement.

4.9 **Ease of use.** The main advantage of inhibition over an attacher's notice of litigiosity is that the creditor can affect the debtor's whole heritable property without knowing its extent or having to specify any of it. All that an inhibition involves is service of a schedule of inhibition on the debtor and registration of documents in the personal register. The creditor does not have to go to the trouble and expense of first finding out from the property registers or otherwise what heritable property the debtor owns.

4.10 By contrast a creditor using the diligence of land attachment would first have to discover, and then specify in the attacher's notice of litigiosity and notice of land attachment, items of heritable property which the debtor owns. A search of all the 33 registration counties in the Register of Sasines and the Land Register would cost at present £231, - £7 for each county. Assuming that the expense of serving and registering an attacher's notice of litigiosity is comparable to that of an inhibition then the notice of litigiosity could be up to £231 more expensive than a general inhibition.

4.11 It is true that a full search of the Sasine and Land registers may not be necessary before a creditor can use land attachment. Indeed the creditor may not require to carry out any search at all. Most creditors will know their debtor's home address and may also be aware if the debtor is an owner rather than a tenant. Creditors of a business will likewise be aware of the whereabouts of the debtor's business premises and the status of these could readily be checked if not already known. Moreover, the Registers of Scotland are developing a direct access system whereby subscribers can obtain on-line access to the computerised records of the property and personal registers. The cost of a full search of the property registers against a debtor using this system may well be considerably less than the

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become attachable by land attachment once the executors had delivered to the beneficiary a docketed certificate of confirmation or a disposition.

figure of £231 mentioned above. Nevertheless, some of the cost and ease of use advantages of inhibitions are likely to remain.

4.12 **Inhibition a humane diligence.** From time to time since the 1970s there has been much criticism by interest groups representing debtors of the harsh operation of diligence. Although the use of inhibitions has increased greatly over the same period, we are not aware of any significant criticism of inhibitions from the standpoint of debtors over that period.[15]

4.13 An inhibition does not by itself deprive debtors of ownership or of possession of their property. They cannot be made homeless through a forced sale of their homes. Inhibition prevents debtors from selling or granting security over their property, but debtors who wish to sell will usually be able to do so by arranging to pay the inhibitor out the proceeds of sale. Inhibition also does not make a debtor "apparently insolvent" as would happen on the expiry of the charge to pay which we propose should be a necessary preliminary to an attacher's notice of litigiosity. Apparent insolvency is a trigger for sequestration[16] and for calling up a standard security.[17] Leases often provide for irritancy in the event of the tenant's apparent insolvency. If inhibition were not available, creditors might resort to other forms of diligence such as poinding, interim attachment of moveables,[18] and arrestment which are more intrusive, and are known to be resented by debtors more than inhibitions, as well as land attachment. Arrestment of a bank account, for example, interrupts cash flow and for companies other than those dealing in heritable property is likely to be more disruptive of trade than an inhibition affecting its premises.

4.14 Citizens Advice Scotland, in responding to our Discussion Paper on *Adjudication for Debt and Related Matters*, preferred that adjudication should be abolished without any replacement so that inhibition should be the sole diligence against heritable property. They were concerned that the introduction of a new diligence against land would lead to more homelessness through forced sale of dwelling houses. It is for consideration whether these fears will turn out to be exaggerated. An attacher's notice of litigiosity, although part of the diligence of land attachment, will not necessarily lead to a sale of the debtor's property by the creditor. The notice is effective for up to five years and during this time operates in the same way as an inhibition in relation to the property specified. The next step in the diligence of land attachment, the notice of land attachment, also has a lifetime of five years. The creditor may utilise these periods to give the debtor time to pay rather than pressing ahead with the diligence by applying for warrant to sell. If the creditor did not give the debtor time to pay voluntarily, the debtor would be entitled to apply to the court for a time to pay order.

4.15 Another counter-argument is that an inhibition is humane because it is not effective. Debtors who do not wish to dispose of, or grant security over, their heritable property can simply ignore an inhibition which may therefore not be an effective compulsitor to payment. Although an attacher's notice on litigiosity also has no direct enforcement effect, it can be

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[15] Criticisms of diligence on the dependence appear to have been directed more to arrestments on the dependence than inhibitions on the dependence, and should be met by the judicial control recommended in our recent Report on *Diligence on the Dependence and Admiralty Arrestments* Scot Law Com No 164 (1998).

[16] Bankruptcy (Scotland) Act 1985, s 7(1)(c)(ii).

[17] Conveyancing and Feudal Reform (Scotland) Act 1970, Sch 3, standard condition 9(2)

[18] Recommended in our recent Report on *Diligence on the Dependence and Admiralty Arrestments* Scot Law Com No 164 (1998), Part 4.

followed up first by a notice of land attachment, which gives the creditor security over the attached property for the debt, and then by a sale of the property.

4.16 **Use on the dependence.** Inhibition is widely used by pursuers on the dependence of actions for payment of money. Although the judicial control over the granting of warrants for arrestment and inhibition on the dependence recommended in our Report on *Diligence on the Dependence and Admiralty Arrestments*[19] may reduce the number of warrants granted, we would expect inhibition on the dependence to continue to be used to a substantial extent. It would be possible to allow an attacher's notice of litigiosity (or even a notice of land attachment) to be registered of the dependence of an action,[20] but the need to specify the property which these notices require might be regarded as a serious disadvantage. At the start of litigation, the pursuer may not have time to ascertain what property the debtor owns but will nevertheless wish to freeze whatever there is so that it will remain available to satisfy any decree obtained. Moreover a relatively inexpensive global diligence, such as inhibition, is especially appropriate for use on the dependence of an action.

4.17 Another possible freeze mechanism to replace inhibition on the dependence would be a personal interdict against disposal along the lines of the *Mareva* injunctions in England and Wales. We think, however, that inhibitions have significant advantages over personal interdicts. First, an inhibition which has been violated by the granting of a subsequent voluntary deed is enforceable by a civil remedy, namely, reduction of the deed for the benefit of the inhibitor, whereas breach of interdict involves the heavy quasi-criminal sanctions of contempt of court. Second, inhibitions are extremely effective in freezing heritable property in the debtor's hands since they are registrable in the personal register which will be searched in the course of any conveyancing transaction. Personal interdicts are not registrable in that register and are likely to be less effective.

4.18 For reasons such as these, in the context of aliment or divorce actions where both remedies are available on the dependence, the Court of Session has affirmed that inhibition should be used in preference to personal interdicts.[21] It would be a retrograde step to replace the effective prohibitory remedy of inhibition and its civil sanction with the more cumbersome and less effective remedy of personal interdict and its quasi-criminal sanction.

4.19 There are other circumstances where, from the standpoint of creditors, inhibition may be preferable to a targeted diligence such as an attacher's notice of litigiosity. An inhibition may be used as an ancillary remedy in aid of a statutory restraint order made in criminal proceedings for confiscating the proceeds of crime or for forfeiting property used in crime.[22] Inhibitions allow prompt and effective action against persons who may be intent on money laundering. We would welcome views from the competent authorities and others on this specialised aspect.

4.20 **A choice of diligence against heritable property**. If land attachments were to be introduced, it is arguable that creditors should be allowed to choose whether to use

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[19] *Ibid*, Parts 2 and 3.

[20] These notices would have to be discharged if the pursuer failed to obtained decree for payment

[21] *Wilson v Wilson* 1981 SLT 101(OH) at pp 102 and 103 per Lord Maxwell, approved in *Pow v Pow* 1987 SLT 127 at p 129. Personal interdicts are used to prevent disposal of goods pending the determination of an action.

[22] Eg Proceeds of Crime (Scotland) Act 1995, ss 32 and 37. See our Report on *Confiscation and Forfeiture* (1994) Scot Law Com No 147, paras 9.33, 9.34 and 9.37. In the year to April 1998, the Crown Office registered inhibitions against 28 persons (unpublished information supplied by the Crown Office).

inhibition, or an attacher's notice of litigiosity leading to land attachment, or both, as seems good to them in the circumstances. On this argument market forces should decide. The argument that creditors are likely in most cases to prefer land attachments may or may not be true; nobody yet knows. But it is not, or at least not yet, an argument for abolition of inhibitions and thereby making them unavailable in cases where they would be useful, or even uniquely valuable, to creditors. Abolition is likely to be irrevocable, and the prudent course would be to retain both diligences for a sufficient period to enable their patterns of use to settle down, and thereafter, if need be, to review their use. Abolition at this stage might be at best premature and at worst unnecessarily destructive.

Arguments for abolishing inhibitions

4.21 We turn now to consider the case for abolishing inhibitions. The main arguments in favour of abolition are:

(1) The connection between an inhibitee and an owner of registered property may not be made, causing problems for third parties and in Land Register cases the Keeper.

(2) Inhibitions make searching the personal register more difficult.

(3) Inhibitions may be ineffective or oppressive.

(4) Retaining inhibitions while introducing attacher's notices of litigiosity results in an unnecessarily complex system.

4.22 **Undisclosed inhibitions and the faith of the registers.** The existing law seeks to strike a balance between the interests of inhibitors and those of third party purchasers or lenders transacting on the faith of the registers by requiring an inhibition to be registered in the personal register before it is effective. Normal procedures in conveyancing transactions involving heritable property include a search in the personal register (a "personal search") against the owner of the property and certain predecessors in title in order to discover whether there is an effective inhibition against those persons.

4.23 The professional searchers (including the Keeper's staff) who search the registers experience difficulty in connecting (a) the names of inhibitees appearing in the personal register with the name of the person being searched against, and (b) persons inhibited in the personal register with the owners of heritable property registered in the property registers. The same person may be described quite properly using a different address in each register and each entry may have a different version of the name, both of which are correct.

4.24 The difficulties are illustrated by the recent case of *Atlas Appointments Ltd v Tinsley*[23] which is discussed in detail in Part 3.[24] It was there held that an inhibition was valid even though it was not discovered by the computer-assisted searching system ordinarily used at that time by the Keeper and professional searchers. As a result there exists a serious gap in the faith of the registers. A bona fide purchaser for value relying on a clear, or ostensibly clear, search may find that his title to his property may be set aside by a reduction on the

[23] 1997 SC 200 (1st Div); 1996 SCLR 476 (OH Lord Penrose); 1994 SC 582 (2nd Div, reversing Lord McCluskey).
[24] See paras 3. 75; 3.78; 3.80 to 3.84; and 3.113.

ground of an undiscovered inhibition. That in itself is bad enough. But worse may follow since it is not even clear that the purchaser will have an effective right to compensation.[25]

4.25 The Keeper is under a statutory duty to enter on the title sheet of an interest in land registered in the Land Register any subsisting entry in the personal register "adverse to the interest".[26] The current practice is for any inhibition against the owner to be entered in the Land Register, not when it is registered in the personal register, but later when registering the title of a third party who has transacted with the owner in breach of the inhibition. The Keeper carries out a thorough search of the personal register against the owner, using the name and designation as in the Land Register and any likely variants. If an inhibition is entered the Keeper will exclude indemnity so allowing the Land Register to be rectified to show the inhibitor's reduction on the ground of inhibition.[27] If no inhibition is entered rectification is allowed only if the third party had been fraudulent (for example he knew of the existence of the inhibition) or careless[28] - both of which are very uncommon. The inhibitor will therefore be entitled to claim indemnity from the Keeper because the Land Register cannot be rectified to give effect to a decree of reduction.[29]

4.26 In Part 3 we put forward proposals to protect third parties and the Keeper from action by inhibitors.[30] These proposed reforms would close the existing gap in the faith of the registers. Conveyancing transactions nevertheless would still involve searching, by a fallible computer-assisted search, a very large number of entries in the personal register in order to find out whether a debtor is inhibited. As we note in the next paragraph, abolition of inhibitions would not make the personal register redundant but it would make search of that register very much easier and more reliable. If inhibitions are retained, the professional corps of searchers, the Keeper and solicitors will spend time and money in considering the output from the computer-assisted searches, eliminating unlikely entries and investigating close but not exact matches.

4.27 The protection we propose for third parties transacting on the faith of the registers and for the Keeper creates a disadvantage for inhibitors who are thereby prevented from reducing deeds granted in breach of their inhibitions. These legal and practical problems are inherent in the present registration system, where two different registers are maintained, the personal register for inhibitions (among other documents creating or discharging litigiosity) and the Register of Sasines or the Land Register for title to property.

4.28 An attacher's notice of litigiosity would avoid many of these inherent problems. This is because it would be "property-specific" and registered in the property registers against the property specified in the notice. Any search of the property register would reveal the notice. There would be no doubt as to whether it applied to the owner of the specified property. The situation which occurred in the *Tinsley* case,[31] where there was an effective but undiscovered inhibition, would not arise. Provided that creditors were able to identify the property owned by the debtor, they would, by using an attacher's notice of litigiosity, have

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[25] See para 3.85
[26] Land Registration (Scotland) Act 1979, s 6(1)(c).
[27] 1979 Act, ss 12(2) and 9(3)(a)(iv).
[28] 1979 Act, s 9(3).
[29] 1979 Act, s 12(1)(b).
[30] These are summarised at para 4.3 above.
[31] *Atlas Appointments Ltd v Tinsley* 1997 SC 200.

an almost foolproof means of preventing its disposal pending registration of a notice of land attachment.

4.29 **Searching the personal register.** It may be said that inhibitions complicate conveyancing transactions unduly by requiring third parties, who have nothing to do with the inhibitee's debt to the inhibitor, to search the personal register. It may be conceded that the personal register would still have to be searched even if inhibition were to be replaced by an attacher's notice of litigiosity registrable in the property registers. The personal register contains other notices, such as an award of sequestration,[32] which affect all the person's property and which could not be made property-specific without losing much of their usefulness. Nevertheless, inhibitions make up the bulk of the entries in the personal register so that their removal would make personal searches for the remaining items easier and more likely to be accurate.

4.30 **Inhibition ineffective or oppressive.** From the point of view of debtors, the fact that a general inhibition affects the whole of their heritable property can be a disadvantage. The property is rendered unmarketable for five years, the prescriptive period.[33] Especially vulnerable are debtors with many conveyancing transactions in hand at any one time; development companies buying large houses for subdivision, builders selling homes they have built, local authorities selling council houses under the "right to buy" legislation and the like. While the inhibition subsists, the debtor will be unable to enter into future sales or disposals.[34]

4.31 The Keeper of the Registers represented to us that an inhibition is highly effective if the inhibitee has heritage and useless if he has not. In the latter instance, he observed, using inhibition clutters up a public register to no purpose and serves only to confuse. The Keeper characterised this as "a scatter-gun approach". Although this criticism was not presented as a ground for abolition,[35] it could be used as an argument for replacing inhibition with the "property-specific" attacher's notice of litigiosity and notice of land attachment. It could be argued that if an inhibition does no harm to a debtor, it is ineffective; that if it does harm to a debtor, it may be oppressive; and that it is sheer chance whether an inhibition is proportionate in its effect to the debt sought to be recovered. On this view, a targeted diligence leading to direct recovery out of the property affected is better than an untargeted freeze diligence especially if it causes problems for third parties.

4.32 **Two heritable diligences unnecessarily complex.** If inhibitions are retained and an inhibitor then decides to use land attachment in order to obtain payment, the resulting system is quite complex. There would then be two forms of diligence with an inhibitory effect; the general inhibition and the attacher's notice of litigiosity. It might be argued that this result is unnecessarily complex. The counter-argument is that each of the two diligences achieves a different effect and serves a different purpose. The law should contain both so

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[32] Bankruptcy (Scotland) Act 1985, s 14.
[33] Conveyancing (Scotland) Act 1924, s 44.
[34] Transactions which the inhibitee is obliged to carry out in terms of a pre-inhibition obligation are not affected by the inhibition.
[35] The Keeper observed that because inhibition is so effective in the right circumstances, creditors should be obliged to ensure that the circumstances are right before using it. In other words the creditor should be obliged to ascertain if the debtor has heritage and the diligence should be targeted on that named heritage, coupled of course, with notice to the debtor.

that creditors can decide for themselves whether to use a general inhibition or a more targeted attacher's notice of litigiosity.

Conclusion

4.33 We have found the issue of abolishing or retaining inhibitions difficult and would prefer not to express a view one way or the other at this stage. We therefore would be grateful for comments on the following question:

> **33. If the new diligence of land attachment, with notices of litigiosity and of land attachment specifying the property affected, is introduced as proposed in Part 2, should the diligence of inhibition be abolished, or be retained and reformed as proposed in Part 3?**

PART 5 LIST OF PROPOSALS AND QUESTIONS

INTRODUCTION OF LAND ATTACHMENT AND RELATED ISSUES (PART 2)

1. Views are invited on the propositions in Part 2, Section B, for introducing land attachments and for making consequential reforms of the law on sequestration and liquidation.

(Paragraph 2.9)

2. We invite views on the following propositions in Part 2, Section B which are specifically designed to protect persons transacting on the faith of the registers from:

land attachments (propositions 3(3) and 7);

sequestration (propositions 27 and 28(3) to (5)); and

liquidation (propositions 29 and 30(1) and (2)).

(Paragraph 2.60)

3. Views are specifically invited on the following propositions in Part 2, Section B, namely:

proposition 26 which proposes that equalisation of adjudications for debt should be abolished and that no similar provision should be made for the equalisation of land attachments; and

propositions 31 and 33 which propose respectively that land attachments registered within 6 months prior to sequestration or liquidation should be ineffectual in a question with the permanent trustee or liquidator.

(Paragraph 2.71)

REFORM OF INHIBITIONS (PART 3)

The effect of inhibitions and ranking

4. (1) An inhibition should continue to prohibit the inhibitee from granting any future voluntary deed relating to the heritable property affected by the inhibition to the prejudice of the inhibitor.

(2) An inhibition should cease to prohibit the inhibitee from incurring debts after the date of the inhibition. Accordingly, the inhibitor should no longer enjoy a preference by exclusion over such debts in a sequestration, liquidation or other ranking process.

(Paragraph 3.22)

5. (1) Where an inhibitee grants a deed in breach of the inhibition, the inhibitor should be entitled to bring an action of reduction on the ground of inhibition and to attach the property affected by the deed in question. A reduction on the ground of inhibition should continue to benefit the inhibitor only.

(2) Should it be competent for an inhibitor to reduce a lease granted by the inhibitee in breach of the inhibition, whatever the terms of the lease?

(3) On commencing an action of reduction on the ground of inhibition, the inhibitor should be entitled to register in the property registers a notice of litigiosity specifying the land in the deed under reduction. An inhibitor who fails to obtain a decree of reduction should be bound to discharge the notice.

(4) It should be made clear that where the inhibitee breaches the inhibition by disposing of property to a third party, then any land attachments by creditors of the third party should be postponed to the reducing inhibitor's land attachment.

(Paragraph 3.30)

Warrants for inhibition in execution of decrees and other documents

6. (1) Warrants of execution contained in extract decrees of the Court of Session, the High Court of Justiciary, the Court of Teinds and the sheriff court and in extract writs registered for execution in the Books of Council and Session or sheriff court books should authorise inhibition as well as authorising arrestment in common form, poinding and arrestment of earnings. Accordingly, it should no longer be competent to obtain a warrant for inhibition in execution of such decrees or writs by way of an application for letters of inhibition.

(2) An inhibition in pursuance of a warrant for execution contained in an extract of a sheriff court decree, or of a writ registered in the books of a sheriff court, should affect the inhibitee's heritable property throughout Scotland, not merely property within the sheriffdom.

(Paragraph 3.39)

7. The warrant for execution contained in the extract of an order imposing a fine or other financial penalty or of a compensation order should authorise inhibition in addition to arrestment of assets other than earnings, poinding and sale, and arrestment of earnings.

(Paragraph 3.46)

8. Where a sheriff has granted a restraint order under section 28 of the Proceeds of Crime (Scotland) Act 1995, that sheriff or another sheriff of that sheriffdom should have power to grant, on application by the procurator-fiscal, warrant for inhibition against any person interdicted by that restraint order or an interdict under section 28(8).

(Paragraph 3.47)

9. Section 38 of the Child Support Act 1991 (liability order by sheriff "apt to found Bill of inhibition") should be amended so that an extract of a liability order would automatically authorise inhibition at the instance of the Secretary of State for Social Security of the person against whom the order was made.

(Paragraph 3.48)

10. Should a summary warrant for arrears of local or central government tax authorise inhibition of the defaulter?

(Paragraph 3.51)

Service and registration of inhibitions

11. Should the present system of service and registration of an inhibition be replaced by a scheme along the following lines?

(a) A solicitor in possession of a warrant to inhibit should be entitled to register on behalf of the inhibitor a schedule of inhibition in the personal register.

(b) It should be competent to serve the schedule of inhibition on the inhibitee by means of hand service by officer of court or, if the place of service is within the British Islands, by registered or recorded delivery post. If postal service was ineffective the schedule should be re-served by officer of court.

(c) The inhibition should become effective on the first moment of the day when the schedule of inhibition was served on the inhibitee or the schedule was registered, whichever is the later. Where the schedule was served by post the date of service should be the date when it was delivered, as established by a document from the Post Office or other evidence. In the absence of such a document or other evidence a letter which was not returned as undelivered should be deemed to have been delivered on the third day after the date of posting.

(d) The inhibitee should be charged only the cost of postal service, unless re-service by officer of court was necessary in which case the inhibitee should be charged for the attempted postal service and the re-service.

(e) The schedule of inhibition and other documents connected with service and registration of inhibitions should be in a form prescribed by the Court of Session by Act of Sederunt. The Act of Sederunt should also contain rules relating to the modes of service of the schedule on the inhibitee.

(Paragraph 3.69)

12. Should it be competent for a solicitor to serve a schedule of inhibition by post or should this task continue to be carried out solely by officers of court?

(Paragraph 3.73)

Inhibitions and the property registers

13. The registration of an inhibition in the personal register should no longer have the effect that every person is deemed to know of its existence, subject however to Proposals 15 to 18 below as to when persons transacting with heritable property should be bound by an inhibition affecting it.

(Paragraph 3.79)

14. Having regard to the protection for persons relying on the faith of the personal register suggested in Proposals 15 to 18 below, no amendment should be made of the existing criterion (affirmed in *Atlas Appointments Limited v Tinsley* 1997 SC 200) for the validity of an inhibition, namely that an inhibition is valid if the designation of the person in the inhibition is such as to make the identity of the person inhibited clear to a third party.

(Paragraph 3.84)

15. An inhibition should not affect a deed violating it if the grantee was justifiably ignorant of its existence at the time of delivery to him of the deed. For this purpose, the grantee's ignorance of the inhibition at that time should be treated as justifiable if he had taken reasonable steps to discover the inhibition before that time.

(Paragraph 3.88)

16. Should the solution for protecting third parties set out in Proposal 15 apply to gratuitous third parties?

(Paragraph 3.91)

17. Where a singular successor deriving right directly from the inhibitee is protected under Proposal 15, that protection should enure for the benefit of every subsequent singular successor even if he was aware of the inhibition.

(Paragraph 3.93)

18. (1) Where:

(a) the grantee in a deed violating an inhibition accepted delivery of the deed in reliance on an erroneous clear personal search and as a result was in justifiable ignorance of the existence of the inhibition; and

(b) the inhibitor is precluded, by legislation following on Proposal 15, from reducing the deed on the ground of inhibition,

should the inhibitor be entitled to claim damages from the person whose fault led to the issue of the erroneous search?

(2) If so, should the right to reparation or cause of action, the classes of persons who owe a duty of care, and the standard of care required, be regulated by statute or (as we would prefer) be left to development by the courts?

(Paragraph 3.96)

19. Section 6(1)(c) of the Land Registration (Scotland) Act 1979 should be replaced, as far as inhibitions are concerned, by a provision directing the Keeper to enter an inhibition on a title sheet only:

> (a) when registering the interest of a third party where the deed conveying or creating that interest was granted by the inhibitee in breach of the inhibition, or
>
> (b) after registration, on an application by the inhibitor under section 9 of the Act

(Paragraph 3.99)

20. (1) A reduction on the ground of inhibition (*ex capite inhibitionis*) should not be competent unless the inhibition was entered on the relevant Land Register title sheet in terms of Proposal 19.

(2) The existence of such a reduction should not be regarded as creating an inaccuracy in the Land Register and accordingly it should not be necessary to rectify the Register before showing the reduction on the title sheet. The Keeper may note such a reduction on the relevant title sheet if aware of it, but should be bound to note it only on an application to that effect by the inhibitor.

(3) A decree of adjudication or a notice of land attachment by the inhibitor following reduction should be entered by the Keeper on the relevant title sheet on an application by the inhibitor for its registration.

(4) Where the Keeper did not enter the inhibition on the title sheet when registering the third party's interest, the inhibitor should be entitled to apply for the Land Register to be rectified by entering the inhibition in accordance with the existing rectification provisions in section 9 of the Land Registration (Scotland) Act 1979.

(5) The Keeper should be required to pay indemnity to an inhibitor who is prevented from reducing and adjudging or using land attachment by the omission of the inhibition from the title sheet only if the omission is due to fault on the part of the Keeper.

(Paragraph 3.111)

21. (1) Carrying out a computer-assisted personal search by means of an appropriate program should be regarded as taking reasonable care to discover the existence of an inhibition for the purpose of Proposals 18 and 20(5).

(2) It is thought that legislation is unnecessary to achieve that result.

(Paragraph 3.115)

22. Where the inhibitee is a company registered in a part of the United Kingdom, use of the correct company number on the inhibition documents registered in the personal register should be mandatory, on pain of invalidity of the inhibition.

(Paragraph 3.116)

Property subject to inhibition and prescription of inhibitions

23. The present rule should remain whereby an inhibition does not affect heritable property belonging to the inhibitee acquired after the date when the inhibition became effective.

(Paragraph 3.120)

24. A person who has entered into a contract to purchase heritable property should be treated as having acquired that property for the purposes of section 157 of the Titles to Land (Consolidation) (Scotland) Act 1868 (inhibition not to affect lands acquired by inhibitee after date of registration of inhibition) at the date when the contract was concluded.

(Paragraph 3.129)

25. Where an inhibitee executes and delivers a deed transferring or creating a real right in or over his heritable property in favour of a third party while the inhibition is in effect, the delivery of the deed (but not the conclusion of the antecedent contract) should be treated as a violation of the inhibition, even if the deed is not registered till after the inhibition is extinguished by prescription.

(Paragraph 3.136)

26. (1) The provisions of section 44(3)(a) of the Conveyancing (Scotland) Act 1924 should be amended to make it clear that an inhibitor's right to reduce a deed in breach of an inhibition does not prescribe at the same time as the inhibition itself (i.e. five years after the date when the inhibition became effective).

(2) If the right to reduce is not to prescribe at that time, should the normal prescriptive period of 20 years apply or should some other period be introduced, in each case running from the date of the breach?

(Paragraph 3.141)

27. Section 44(3)(a) of the Conveyancing (Scotland) Act 1924 should be amended to make it clear that the rules of interruption of negative prescription do not apply to the prescription of inhibitions under that section.

(Paragraph 3.144)

Insolvency and inhibitions

28. (1) A permanent trustee in sequestration should continue to be entitled to sell property free from challenge on the ground of any inhibition against the debtor, but reserving the effect (if any) of such an inhibition in giving the inhibitor priority in ranking over any post-inhibition deed.

(2) Section 37(2) and (3) of the Bankruptcy (Scotland) Act 1985 (inhibitions within 60 days before the date of sequestration to be ineffectual in a question with the permanent trustee) should be amended to make it clear that the permanent trustee

acquires right under those provisions not only to the inhibitor's right of reduction of any deed violating the inhibition but also to the inhibitor's right to attach the property conveyed by such a deed or, as the case may be, the inhibitor's preference over the deed. Further where money is received by the permanent trustee as the result of a reduction of a deed violating an inhibition rendered ineffectual by the provisions of section 37(2) and (3), the inhibitor should not have any preference over the money in the trustee's hands.

(Paragraph 3.149)

29. (1) A liquidator in a creditors' voluntary winding up of a company should be entitled to dispose of the company's heritable property, notwithstanding the existence of an effectual inhibition, but the inhibitor should be entitled to rank on the proceeds of sale.

(2) This change should not be extended to a liquidator in a members' voluntary winding up.

(Paragraph 3.151)

Inhibitions and voluntary securities

30. Where a heritable creditor sells property which is subject to an inhibition registered after the granting of the security, the inhibitor should be entitled to rank on the proceeds of sale along with other diligence creditors only if he has either:

(a) attached the property by land attachment prior to the sale; or

(b) arrested the proceeds of sale in the hands of the heritable creditor or another person who has an obligation to account to the debtor.

(Paragraph 3.164)

Miscellaneous issues

31. An inhibition against the owner of property subject to a judicial factory should be equally effective against the judicial factor.

(Paragraph 3.175)

32. (1) Should the expenses of executing an inhibition in execution of a decree (or other document on which inhibition is competent) be recoverable from the inhibitee?

(2) It should not be competent for the inhibitor to bring a separate action against the inhibitee or to do other diligence (apart from a land attachment and an attachment order) for the recovery of the expenses of the inhibition. If recovery is to be allowed should it be by any of the following methods:

(a) The inhibitor should not be obliged to discharge the inhibition unless the debt and the diligence expenses are tendered;

(b) The inhibitor should rank in a sequestration, liquidation or other ranking process for the debt and diligence expenses;

(c) The inhibitor who proceeds to a land attachment should be entitled to charge and attach for the debt and the expenses of the inhibition; or

(d) The inhibitor who proceeds to an attachment order should be entitled to charge and attach for the debt and expenses of an inhibition which affected the property attached?

(Paragraph 3.183)

ABOLITION OR RETENTION OF INHIBITIONS (PART 4)

33. If the new diligence of land attachment, with notices of litigiosity and of land attachment specifying the property affected, is introduced as proposed in Part 2, should the diligence of inhibition be abolished, or be retained and reformed as proposed in Part 3?

(Paragraph 4.33)

APPENDIX A

PROPOSITIONS ON LAND ATTACHMENTS OF REGISTRABLE HERITABLE PROPERTY ETC. AND COMMENTARY

Note: This Appendix re-states the propositions in Section B of Part 2 of this Discussion Paper, and adds detailed explanatory notes on each proposition.

CONTENTS

CHAPTER I : LAND ATTACHMENT REPLACING ADJUDICATION FOR DEBT OF REGISTRABLE HERITABLE PROPERTY

(1) Introduction of new diligence of land attachment replacing adjudication for debt of registrable heritable property

1.(1) There should be a new diligence, to be known as land attachment and sale (or land attachment, for short) to enforce the payment of debt out of the proceeds of sale of heritable property belonging to a debtor whose title to the property is, at the date of execution of the land attachment, either registered in the property registers or capable of being so registered.

(2) A land attachment should be constituted as a real right attaching property by registration in the property registers of a document in a prescribed form, to be known as a notice of land attachment, and should be completed by a sale under the sheriff's warrant or by decree of foreclosure.

(3) In these propositions, the expression "attacher's notice of litigiosity" has reference to a document registrable in the property registers introduced by proposition 6 below.

(4) Adjudication for debt should:

(a) no longer be competent in cases where land attachment is competent; and

(b) should be abolished when attachment of property not registrable in the property registers is introduced as mentioned in our forthcoming Discussion Paper No 108 on Attachment Orders and Money Attachments*.*

Comment

1. This proposes the introduction in Scots law of the new diligence of land attachment and sale (or land attachment, for brevity) applying to property registrable in the Land Register or Register of Sasines (paragraph (1)). A land attachment would be constituted as a real right by registration of a notice of land attachment in the property registers (paragraph (2)). Registration would impose a nexus encumbering the attached property. As such it would be an inchoate diligence having effect for ranking purposes but requiring to be completed by a warrant sale or by foreclosure in default of sale. There is an analogy with poinding and sale or arrestment and sale.

2. Paragraph (3) introduces the expression "attacher's notice of litigiosity".

3. The new diligence would replace adjudication for debt of registrable property.

Right conferred on creditor by land attachment

2. *The registration of a notice of land attachment should, as from the date of the registration, confer on the creditor a subordinate real right over the heritable property specified in the notice for securing payment to him of:*

(a) the amount of the debt specified in the notice;

(b) accruing interest; and

(c) the expenses of the diligence in so far as chargeable against the debtor,
but subject to the claims of other creditors to be ranked and preferred as by law competent.

Comment

This proposition reinforces the point that a land attachment is a subordinate real right in security of the debt subject to the general law of ranking, see *Stair Memorial Encyclopaedia* vol 18 para 5. It would be an "effectually executed diligence" on property for the purpose of the floating charges legislation: Companies Act 1985, s 463(1); Insolvency Act 1986, s 55(3).

(2) Property attachable

3.(1) Heritable property attachable by land attachment should include a claim secured by a subordinate real right in security.

(2) The subordinate real rights attachable by land attachment should include:

(a) a lease registered in the property registers under the Registration of Leases (Scotland) Act 1857 or the Land Registration (Scotland) Act 1979; and

(b) an assignation in security of such a lease, but should not include:

(i) a lease which, though registrable in the property registers under that Act, has not been so registered or an assignation in security of an unregistered lease;

(ii) a lease where assignation is excluded expressly or by implication;

(iii) a lease where assignation is excluded except with the landlord's consent, but we invite views on whether a clause providing that the landlord's consent should not be unreasonably withheld should betreated as excluding or permitting land attachment.

(3) For avoidance of doubt, a land attachment should be treated as attaching property of the debtor where at the date of registration of the notice of land attachment:

(a) the debtor had previously granted and delivered a deed transferring the property to a third party; but

(b) the third party's title to the property has not been completed as a real right by registration of the deed in the property registers,

and accordingly in any competition between the attaching creditor and the third party, the debtor should not be treated as having been divested of his attachable right to the property by virtue of his delivery of the deed to the third party.

In this paragraph, a deed includes a disposition, an assignation, a translation of an assignation and any other divestitive deed.

(4) A land attachment enforcing a debt due by the debtor in his personal capacity should not attach property held by him in a different capacity, for example as trustee for any other person, and conversely a land attachment should not attach property held by the debtor in a personal capacity if it enforces a debt due by him in a different capacity.

Comment

1. Paragraphs (1) and (2) make it clear that, as in the case of adjudication for debt, it is not only the primary real right of ownership or the property itself which is attachable but also subordinate real rights to which the debtor is entitled.

2. A registered lease, being a subordinate real right, should be attachable but for practical reasons a registrable lease which has not been registered or an assignation in security of an unregistered lease should not be attachable by land attachment. The proposed new residual diligence of attachment order provisionally proposed in our forthcoming Discussion Paper on *Attachment Orders and Money Attachments* could however apply.

3. The background to paragraph (3) is discussed in Part 2, Section C of the Discussion Paper: see especially paragraph 2.55.

4. Paragraph (4) is partly modelled on the Bankruptcy (Scotland) Act 1985, section 33(1)(a), but expanded to cover the converse case where the debt is due in a fiduciary capacity and the property held in a personal capacity

(3) Attachment

Warrant for land attachment

4. *A warrant for diligence in an extract of:*

> *(a) a decree for the payment of money of the ordinary courts of law (Court of Session, High Court of Justiciary, Court of Teinds or a sheriff court);*
>
> *(b) a document of debt registered for execution;*
>
> *(c) an order of a court or tribunal deemed to have the same effect as a decree or extract registered writ;*
>
> *(d) an order of a criminal court imposing a fine or other financial penalty or making a compensation order; or*
>
> *(e) a liability order under the Child Support Act 1991,*

should have the effect of authorising the creditor, among other things:

> *(i) to charge the debtor to pay the debt, interest and expenses within the days of charge on pain of attachment of land;*

(ii) after expiry of the days of charge without payment to register in the property registers an attacher's notice of litigiosity specifying the debtor's land affected by the litigiosity; and

(iii) after the expiry of 14 days from the date of registration of the notice of litigiosity to register in the property registers a notice of land attachment over any land specified in the notice of litigiosity.

Comment

1. The charge would be a general one so that the creditor could proceed to poind and arrest earnings as well. The charge would be in prescribed form and be served on the debtor in accordance with the existing rules for service of charges. Consequential amendments will be required to section 87 of the Debtors (Scotland) Act 1987, section 3 of the Writs Execution (Scotland) Act 1877 and section 7 of the Sheriff Courts (Scotland) Extracts Act 1892 which set out the effect of a warrant for execution. A warrant contained in an extract of a sheriff court decree or a writ registered in the books of a sheriff court would authorise attachment of land situated in any sheriffdom in Scotland.

2. The days of charge are 14 or 28 depending on the debtor's circumstances, see section 90(3) of the Debtors (Scotland) Act 1987. Poinding and arrestment of earnings are not competent more than two years after the service of a charge: section 90(5). This rule should be applied to land attachment. The charge should be served on the debtor in accordance with the normal rules for service set out in the Ordinary Cause Rules 1993.

3. A warrant for attachment would also be available in relation to orders of other courts or tribunals which are enforceable by virtue of various enactments as if they were decrees or registered writs. Orders for payment of fines, penalties, sums due under compensation orders (Criminal Procedure (Scotland) Act 1995, s 221) and a liability order for arrears of child maintenance (c.f. Child Support Act 1991, s 38, providing that the Secretary of State may adjudge on the basis of a liability order) should also contain warrants authorising attachment as well as the other diligences presently authorised. Summary warrants for rates, taxes and other local or central government debts should not authorise attachment. These would continue to be enforceable by arrestment, earnings arrestment and the special poinding procedure set out in Schedule 5 to the Debtors (Scotland) Act 1987.

4. A creditor, if so advised, could enforce more than one debt due to him in the same capacity by the same debtor against the same land by means of a single notice of land attachment. One charge may be served for one debt or two or more debts. The notice of land attachment should itemise all the debts being enforced thereby.

Time to pay and preventing or freezing attachments

5.(1) An application for a time to pay order under the Debtors (Scotland) Act 1987 should be competent at any time after the service of a charge until the creditor's application for warrant to sell the attached land is granted. An interim order sisting diligence (section 6(3)) should prevent the creditor from taking further steps in the diligence, other than registering an attacher's notice of litigiosity, an inhibition or a notice of land attachment, and it should be incompetent for the court to grant a warrant to sell attached land and any pending application for warrant should fall.

(2) The making of a time to pay order should preclude the creditor from thereafter registering a notice of land attachment (but not an attacher's notice of litigiosity or an inhibition). If the creditor had registered a notice of land attachment before the sheriff made a time to pay order, the sheriff should be required to make an ancillary order prohibiting the creditor from taking any further steps in the diligence.

(3) While a time order under section 129 of the Consumer Credit Act 1974 is in effect, it should be incompetent to commence or continue diligence (other than registering an inhibition or an attacher's notice of litigiosity) against the individual concerned.

Comment

1. This proposition adapts the provisions of the Debtors (Scotland) Act 1987 on the effect of time to pay directions in court decrees and on time to pay orders to deal with the new diligence of land attachment.

2. A time to pay direction in a decree precludes the service of a charge (section 2(1)(a)), so preventing any registration of a notice of land attachment. The reference to an adjudication for debt in section 2(1)(b)(iv) should be repealed. Other references to adjudications in section 8(1)(d), the effect of an interim order on adjudication, and section 9(2)(c), prohibiting taking further steps in adjudication when making a time to pay order, should be retained to deal with pre-commencement adjudications which are depending at commencement, but removing any reference to commencing an action of adjudication.

3. If the time to pay direction or order lapsed on the debtor's default, the creditor would become entitled to pursue diligence.

4. Section 11(3) as read with section 10(5) of the Insolvency Act 1986 provides that while an administration order is in force no diligence or other legal process may be commenced or continued against the property of the company concerned. This provision requires no amendment for land attachment.

5. The inter-relation between diligence and time orders under section 129 of the Consumer Credit Act 1974 is not clear. The problem was mentioned in our *Report on Diligence and Debtor Protection*, paragraph 3.126, but no legislation followed. Proposition 4(3) proposes a simple provision (going beyond land attachment), along the lines of section 11(3) of the Insolvency Act 1986, to the 1974 Act.

Attacher's notice of litigiosity

6.(1) After the days of charge have expired without payment, the creditor should be entitled to register in the property registers a document in a prescribed form to be known as an attacher's notice of litigiosity.

(2) An attacher's notice of litigiosity should:

(a) set out the names and designations of the creditor and debtor;

(b) narrate the charge and its expiry without payment; and

(c) specify the items of heritable property which the creditor proposes to attach by land attachment.

(3) An attacher's notice of litigiosity should render litigious only those items and, subject to the reforms of inhibitions proposed in Part 3 of this Discussion Paper, should have the same effect as an inhibition restricted to those items.

(4) Unlike notices of litigiosity under the present law, an attacher's notice of litigiosity would not be registrable in the personal register.

(5) The attacher's notice of litigiosity should:

(a) be served on the debtor by an officer of court (messenger-at-arms or sheriff officer) before or after the date of registration of the notice; and

(b) take effect on the date of such registration, but if a certificate by the officer of court of service of the notice on the debtor has not been not registered in the property registers within three weeks after that date, the notice should thereafter be deemed to be, and always to have been, void.

Comment

1. The nature and role of an attacher's notice of litigiosity are explained in paras 2.41 - 2.45 of the Discussion Paper.

2. An attacher's notice of litigiosity should, like a notice of summons of adjudication (Gretton, page 211), have the effect of an inhibition but only in relation to the land specified in the notice. It would not strike at deeds which the debtor was under an existing obligation to grant. Section 159 of the Titles to Land Consolidation (Scotland) Act 1868 should be amended to include an attacher's notice of litigiosity, and section 44(3)(a) of the Conveyancing (Scotland) Act 1924 would be amended to provide that a notice of litigiosity would prescribe five years after registration.

Mandatory delay between notice of litigiosity and registration of land attachment

7. The registration of a notice of land attachment in the property registers should be effectual only if at the date of such registration:

(a) an attacher's notice of litigiosity specifying the attached property has been registered in the property registers at least 14 days before that date; and

(b) a certificate of service of the notice of litigiosity on the debtor is registered in the property registers, in accordance with proposition 6(5)(b) above, on or before that date.

Comment

As regards para (a), the need for the mandatory delay is discussed at paras 2.53 and 2.54 of the Discussion Paper. Para (b) provides a sanction to ensure that a certificate of service of a

notice of litigiosity is duly registered in the property registers, in accordance with proposition 6(5)(b).

Notice of land attachment

8.(1) The notice of land attachment should set out the names and designations of the creditor and debtor and specify:

(a) the decree or other document constituting the debt and containing the warrant for the diligence;

(b) the amount of the debt secured by the land attachment (principal sum, interest to date, the expenses of its registration and the preceding attacher's notice of litigiosity and of executing the prior charge, less payments to account); and

(c) the item or items of heritable property attached thereby, being all or part of the property specified in the notice of litigiosity.

(2) (a) At the same time as registering the notice of land attachment, the creditor should post a copy of the notice to the debtor at his last known address.

(b) The creditor's failure to post a copy should not invalidate the registration of the notice but, on such a failure, he should:

(i) not be entitled to recover his expenses of executing the diligence from the debtor except in so far as the court, on the creditor's application, otherwise orders; and

(ii) be liable to compensate the debtor for any patrimonial loss suffered by him as a direct and proximate consequence of the failure.

Comment

1. In the Land Register, the creditor would apply for registration on a form to be prescribed by the Secretary of State under section 27 of the 1979 Act. The Keeper would enter details of the attachment in the Charges section of the Title Sheet and issue the creditor with a Charge Certificate containing details of the attachment and any heritable securities ranking prior to, and *pari passu* with, it.

2. Section 2(2) of the 1979 Act provides that registration of a heritable security is not to induce a first registration of the debtor's land situated in an operational area. The security would be registered in the Sasine Register. This should also be the position for land attachment. Section 2(3) requires a heritable security to be registered in the Land Register if the land is registered. This provision should be extended to land attachment, but would have to be amended because, unlike a heritable security or an adjudication, a land attachment is created by the registration of a notice of land attachment and not by an antecedent deed or decree.

3. Subsections (1)(a),(b) and(3) of section 5 and section 6(1)(d) of the 1979 Act and rule 6 of the Land Registration (Scotland) Rules 1980 set out how heritable securities are entered on title sheets. These provisions should apply to a land attachment as they apply to a heritable security.

4. Section 12(3)(o) of the 1979 Act excludes indemnity in respect of the amount due under a heritable security. Land attachments should be in the same position.

5. The definition of heritable security in section 28(1) of the 1979 Act includes an adjudication, see Gretton, p 213, but would not include a land attachment. It is for consideration whether the definition should be extended or the various provisions dealing with heritable securities should be individually amended.

6. Where the debtor is the unregistered proprietor of heritable property, the notice of land attachment in the Sasine Register should specify the links in title connecting the debtor to the last registered proprietor. The Keeper would be entitled under section 4(1) of the 1979 Act to refuse to enter the attachment in the Land Register unless satisfied by documents or other evidence that the debtor owned heritable property in relation to the land in the relevant title sheet and might exclude indemnity in relation to the validity of the links. Creditors who were unable to find out about, or to specify, these links would not be able to use land attachment. They would have to use some other diligence or to sequestrate. If the debtor's title was incomplete in that some steps had to be taken in order to obtain a link in title, the creditor should not be entitled to take the required steps in place of the debtor. Thus, for example, a creditor would not be able to attach the tenancy-land of a tenant-at-will because he should not be entitled to acquire on behalf of the debtor the land from the landlord under sections 20 and 21 of the 1979 Act on payment of compensation to the landlord, register the disposition and then register a notice of land attachment.

Other effects of land attachment

9. (1) After the notice of land attachment is registered, the sheriff on the creditor's application should be have power to grant:

> *(a) authority to inspect the property attached, make any buildings safe or carry out emergency repairs;*
>
> *(b) a warrant to eject any person occupying the property without title; and*
>
> *(c) an order requiring the debtor's tenants of the attached property to pay their rents to the attaching creditor.*

(2) A notice of land attachment should be deemed to contain an assignation to the creditor of titles, searches and unregistered conveyances.

(3) Registration of a notice of land attachment in respect of a moveable debt should not convert that debt into a heritable debt.

Comment

1. The creditor's title to apply to the sheriff for an order requiring the tenants of attached land to pay their rent to the attaching creditor could be useful where the land is let and cannot be sold immediately. A standard security holder has an analogous entitlement under standard condition 10(3) in Schedule 3 to the 1970 Act.

2. Paragraph (2) is modelled on section 10(4) of the 1970 Act which deems a standard security to contain the same provisions for assignation of prior writs relating to the debtor's title.

3. Registration of a notice of land attachment should not constitute apparent insolvency. The debtor would have been made apparently insolvent already by the expiry of the preceding charge without payment. Section 7(1)(c)(iv) of the Bankruptcy (Scotland) Act 1985 provides that the granting of a decree of adjudication constitutes apparent insolvency. This provision should be retained to deal with existing decrees and decrees granted in actions pending at commencement.

(4) The Sale
Application for warrant of sale

10.*(1) A creditor should not be entitled to sell the attached property unless a sheriff having jurisdiction over the place where any item or part of the attached heritable property is situated grants a warrant of sale. The sheriff clerk should fix a date for the hearing of the creditor's application at which the debtor, the creditor and other interested parties should be entitled to be heard.*

(2) Where the attached property is a pro indiviso *share, the creditor should have a title to raise an action of division and sale which should be combined with proceedings in the diligence in a manner to be prescribed by rules of court, and the provisions on applications for warrant of sale proposed below should apply subject to those rules.*

Comment

1. The warrant for land attachment would not by itself authorise a sale by the creditor. The creditor would have to obtain a sheriff's warrant authorising the sale. There should be some judicial control over the use of the diligence and the most appropriate stage for the court to exercise this control is the period following the registration of the notice of land attachment. Adjudications, arrestments and poindings all involve court proceedings. The creditor should not be entitled to advertise the land for sale until a warrant has been granted.

2. The sheriff, on the debtor's application, should be empowered to include in the warrant of sale land situated outwith the sheriffdom. This would enable all the debtor's land to be dealt with in a single application. Rules of court should require the creditor to produce the certificate of execution of the charge and evidence of registration of the notice of land attachment to the sheriff clerk before the clerk grants a warrant for intimation. If the debtor has agreed to shorten the period in paragraph (2), evidence of this should also be submitted.

3. A copy of the application and the date set for the hearing should be intimated to the debtor, all other attaching or heritably secured creditors, the landlord where the debtor is a tenant and the tenant where the debtor is a landlord, and a non-entitled spouse of the debtor. If the whereabouts of the debtor are not known intimation should be made to the Extractor of the Court of Session, see section 19(6) of the 1970 Act which makes similar provision in relation to notices calling up standard securities. Where the application is combined with an action of division and sale at the instance of the attaching creditor, the action would be intimated to all the other co-owners as well.

Court's powers in an application for warrant of sale

11.(1) The sheriff should have power to refuse to grant a warrant of sale of his own accord or on an objection by any interested person on the ground that:

(a) the attachment is invalid or has ceased to have effect;

(b) the debt is disproportionately small in relation to the value of the attached land; and

(c) the net free proceeds of sale receivable by the attaching creditor are unlikely to exceed the expenses of sale.

(2) The sheriff should have power to refuse to grant a warrant of sale on an objection by the debtor's spouse if satisfied that the diligence was designed to defeat the spouse's occupancy rights under the Matrimonial Homes (Family Protection) (Scotland) Act 1981.

(3) The sheriff should have power, on an objection by any interested person, to refuse to grant a warrant of sale or postpone the grant for a specified period not exceeding 12 months on the ground that a sale of the attached land would be unduly harsh in the circumstances.

(4) The sheriff should have power, on an objection by any interested person, to postpone the grant of a warrant of sale:

(a) for up to 12 months, where the property attached comprises or includes the principal or only residence of the debtor and one or more close relatives of the debtor. The expression "close relative" has reference to a spouse, a child of the debtor or his spouse, or a child treated by the debtor as such a child; or, as the case may be,

(b) for up to 6 months, where the property attached comprises or includes the principal or only residence of one or more individuals except where they occupy under a right (such as a lease or liferent) binding on the creditor.

(5) The sheriff should have power to refuse or to sist the application where another creditor has already been granted a warrant of sale, or intends to exercise a power of sale, of the attached land.

Comment

1. The powers set out in this proposition constitute, together with the delay for residential property, the main protections for debtors. The powers in paragraph (1)(b) and (c) protect debtors against their homes or other land being sold for modest debts. This is a more flexible approach than a minimum monetary limit for the debt. Another way of avoiding a sale would be for the debtor to apply for a time to pay order. Paragraph (1)(c)

prevents a creditor from selling where that would confer no financial advantage. Creditors may threaten to sell in such circumstances in order to put pressure on the debtor in question and their other debtors generally.

2. A forced sale of land is harsh so that undue harshness means something more. Possible examples of undue harshness might be the debtor or a family member being seriously ill or children being at a critical stage in their schooling. These would normally justify a postponement rather than a refusal. The 12 month limit to postponement is taken from section 40 of the Bankruptcy (Scotland) Act 1985.

3. The sheriff should not of his own accord refuse or postpone granting a warrant without giving the creditor and other parties an opportunity to be heard, and should not dispose of an application which has been opposed without giving all parties an opportunity to be heard.

4. A refusal of a warrant of sale under paragraph (1)(a) would resemble a declarator of invalidity and a refusal under paragraph (2) would result in the attachment ceasing to have effect. The debtor should be entitled to register in the Register of Sasines a notice in a prescribed form to this effect, or to apply to the Keeper for the attachment to be deleted from the Land Register. The creditor may be entitled to re-charge or register a fresh notice of land attachment, or another diligence may be used. A refusal on the other grounds would leave the attachment in place so that the creditor's debt would remain secured and could be recovered if the land was sold by a creditor in a standard security or a permanent trustee in sequestration. The sheriff clerk should notify the debtor of any postponement or refusal of warrant.

5. The sheriff's powers on a creditor's application for warrant of sale are set out in the following table:

Ground	**Result**	**When exerciseable**
Attachment invalid or ceased to have effect	Refusal of warrant	Of own accord or objection by any interested person
Debt disproportionately small in relation to value of attached land	Refusal or grant of warrant	Of own accord or objection by any interested person
Diligence designed to defeat occupancy rights of non-entitled spouse	Refusal of warrant	Objection by spouse
Other heritable or attaching creditor wishing to sell	Sist or grant of application	Objection by other creditor
Creditor unlikely to recover expenses of sale	Refusal or grant of warrant	Of own accord or objection by any interested person
Sale would be unduly harsh	Refusal or grant of warrant or postponement of granting for up to 12 months	Objection by any interested person

The warrant of sale

12.(1) Unless the sheriff otherwise directs, the grant of a warrant of sale should terminate the debtor's right to occupy the attached heritable property.

(2) The sheriff on granting warrant of sale should have power:

(a) to authorise the creditor to sell the attached property in lots or to sell part of the property and sist the application as regards the remainder;

(b) to grant a warrant for ejection on a 14 days notice of the debtor and any other occupiers (except those whose rights of occupation are effective against singular successors of the debtor) from the attached property; and

(c) to grant ancillary orders in relation to the sale.

Comment

1. Unless the sheriff otherwise directs, the debtor and persons deriving right from him should have no right to occupy after the grant of a warrant of sale. This would enable the creditor to sell with vacant possession and facilitate the sale to get the best price possible. Any other solution is likely to be unworkable in practice. The creditor may of course allow the debtor to stay, but the permission could be withdrawn at any time. The creditor may apply for a warrant of ejection in the application for warrant of sale or later if the debtor refuses to remove voluntarily.

2. The creditor should, like heritable creditors under section 40(2) and (3) of the Conveyancing (Scotland) Act 1924, be entitled to apportion existing monetary burdens (so far as not redeemed) and create rights and obligations in relation to the lots or parts (by deed of declaration of conditions under section 32 of the Conveyancing (Scotland) Act 1874 or otherwise).

Conduct of the sale and the purchaser's title

13.(1) A creditor should be entitled, unless the sheriff orders otherwise, to sell the attached heritable property by private bargain or public auction after due advertisement. The creditor should be under a general duty to take all reasonable steps to ensure that the sale price is the best that can reasonably be obtained.

(2) An attachment and sale should be valid notwithstanding that the debtor and any other person to whom intimation has to be made is in nonage or under legal disability.

(3) The creditor should have a title, by virtue of the sheriff's warrant, to grant a disposition in favour of the purchaser in implement of the contract of sale. The disposition should be deemed to include an assignation by the debtor to the purchaser of all obligations of warrandice owed to the debtor and an obligation by the creditor of warrandice from his own facts and deeds. The creditor's right to the writs under proposition 9 would be assigned under the Land Registration (Scotland) Act 1979, s 16.

(4) A disposition by the creditor in favour of the purchaser, which bears to be in implement of the warrant of sale, should not be reducible on the ground of any latent error or irregularity in the diligence, provided that the warrant of sale and evidence of due advertisement were produced and were apparently in order.

Comment

1. Paragraph (1) derives from section 25 of the 1970 Act. What amounts to due advertisement would depend on the situation and nature of the land. The advertisement should not reveal the name of the debtor or disclose that it is a sale by an attaching creditor.

2. Paragraph (2) follows section 41(1) of the Conveyancing (Scotland) Act 1924. In terms of section 16 of the 1979 Act a deed conveying an interest in land is deemed to include an assignation of writs. This statutory assignation would be imported into the disposition granted by the creditor to the purchaser, see paragraph (3).

3. As regards paragraph (4), the purchaser should not have to investigate whether irregularities occurred in the diligence before the granting of the warrant of sale. The sheriff clerk would have checked that the charge and the notice of land attachment, which are to accompany the application for warrant of sale, were in order. The purchaser should also be protected against the land attachment having ceased to have effect, by payment of the debt or otherwise, prior to delivery of the disposition, unless this fact was apparent from the property registers or the purchaser was aware of it at that time, see section 41(2) of the Conveyancing (Scotland) Act 1924. These provisions protecting the purchaser should not affect the right of the debtor or any other interested person to claim damages against the creditor for wrongful execution of the diligence.

Disburdenment of purchaser's title and ranking on proceeds of sale

14.(1) Registration of the purchaser's disposition in the property registers should have the effect of disburdening the heritable property disponed of the selling creditor's land attachment and all other diligences and heritable securities ranking pari passu *with or postponed to that attachment, but not of any real right or preference ranking prior to it.*

(2) The proceeds of sale should be applied to meet the following debts in the following order:

(a) the creditor's expenses in connection with the sale and any attempted sale incurred after the granting of the warrant of sale;

(b) the sums due to the creditors holding prior securities, attachments or diligences, except the amount due under a prior security which is not redeemed;

(c) the amount due to the attaching creditor (less the expenses in (a)), or where there are pari passu *attachments, diligences and securities the sums due to the attaching creditor and the others in their due proportions; and*

(d) the sums due to creditors with attachments, diligences or securities postponed to that of the attaching creditor, in accordance with their rankings.

Comment

1. The creditor should be bound to discharge all prior attachments and diligences and should be entitled to redeem any prior security, even if the debtor was not so entitled. The ranking of inhibitors is to be left until the responses to the proposals in Parts 3 and 4 of the Discussion Paper have been evaluated. Any net surplus proceeds of sale arising after satisfying creditors' claims should be paid to the debtor. The debtor should remain personally liable for any balance of the debt still due to the creditor after completion of the sale process.

2. If the creditor is unable to obtain a discharge for any of the above sums, the sum should be consigned in the sheriff court which granted the warrant of sale. The sheriff clerk's receipt should be equivalent to a discharge. Where the consigned sum relates to a prior security or attachment which the creditor is redeeming, the creditor should register a notice in prescribed form in the Property Registers which would have the effect of disburdening the land sold of that prior security or attachment.

3. A land attachment should be regarded as a security for the purposes of section 27 of the 1970 Act (application of proceeds of sale carried out by a standard security holder).

Report of sale

15.(1) The creditor executing a warrant of sale should be required to submit to the sheriff a report on sale and diligence expenses in prescribed form within 28 days of the date of settlement of the sale.

(2) The sheriff should have power to make an order imposing on a creditor, who makes a report late without reasonable excuse or refuses to make a report, liability in whole or in part for the expenses of attachment otherwise chargeable against the debtor.

(3) The report of sale should be remitted by the sheriff to the auditor of court who should:

(a) tax the expenses chargeable against the debtor;

(b) certify the balance due to or by the debtor; and

(c) report to the sheriff,

after giving interested persons an opportunity to make representations on any alteration of the expenses or balance.

(4) On receiving the auditor's report, the sheriff, after giving interested persons an opportunity to be heard, should have power:

(a) to declare the above-mentioned balance to be due to or by the debtor, with or without modifications; or

(b) if the sheriff is satisfied that there has been a substantial irregularity in the diligence to declare the diligence to be void and make consequential orders.

Comment

1. It is considered that, unlike a sale carried out by a standard security holder, there should be judicial scrutiny of the sale procedure and an auditing of the payments made to other creditors and the diligence expenses. This proposal is modelled on the provisions on the report of sale of poinded goods in section 39 of the Debtors (Scotland) Act 1987. The report of sale should include the following information:

(a) any land sold and the amounts for which it has been sold;

(b) any land remaining unsold and the price at which it was last exposed for sale;

(c) the expenses chargeable against the debtor incurred in executing the diligence;

(d) the amounts of any prior, *pari passu* or postponed debts ranking on the proceeds of sale;

(e) any surplus paid to the debtor; and

(f) any balance of the proceeds of sale due to the debtor or any balance of the debt due by the debtor to the creditor.

There should be no fee chargeable for lodging a report of sale and the cost of the auditor of court's audit should be met out of public funds. Requiring the debtor to pay would increase the expenses of the diligence. The report of sale and auditor's report should be available for inspection by the public for a prescribed period on payment of a prescribed fee.

2. A declarator by the sheriff that the diligence was void should not affect the title of a purchaser which is protected in terms of proposition 13(4) above.

Foreclosure

16.(1) A creditor who fails to sell the attached heritable property by public auction, or parts by private bargain and the rest by public auction, for sufficient to pay off the debt and prior and pari passu *creditors' securities and diligences, should be entitled to apply to the sheriff court which granted the warrant of sale for a decree of foreclosure.*

(2) The sheriff, after ordering such intimation and enquiry as seems fit and giving the applicant, the debtor and other creditors an opportunity to be heard, should have power:

(a) to sist the application for up to 3 months;

(b) to order the unsold property to be auctioned with a reserve price, or to be re-advertised for sale at that fixed price and if still unsold auctioned at that reserve price. The creditor should be entitled to bid and buy at the auction; and

(c) to grant decree of foreclosure, either immediately or in the event that the property remains unsold.

(3) Registration of the decree in the property registers should:

(a) extinguish the debtor's right to bring the attachment to an end by paying the debt;

(b) vest the creditor in the heritable property described at the upset price at which it was last auctioned; and

(c) disburden the property of the creditor's attachment and all postponed securities and diligences.

Comment

1. These proposals on foreclosure are modelled on the provisions for standard securities in section 28 of the 1970 Act. Foreclosure by standard security holders is very uncommon and seems unlikely to be any more common in land attachments. Before applying for decree of foreclosure, the creditor must have attempted to sell the land, or the remainder of the land (having sold part by private bargain), by public auction for at least the sum mentioned in paragraph (2).

2. Rules of court should provide that the creditor's application should be intimated to the debtor, other creditors holding securities or attachments on the land and other persons with an interest. The application should state the amount due to the various creditors and if part of the land had been sold a report of the sale should be submitted.

3. The sheriff should have power to appoint a valuer to value the unsold land if the land is to re-exposed for sale at a reserve price.

4. The decree of foreclosure should be in prescribed form and contain a sufficient conveyancing description of the unsold land. The creditor should have the right to redeem prior and *pari passu* securities, even if the debtor had no such right. The debtor would remain liable for the balance due to the creditor and sums due under postponed securities and attachments, which would have been discharged as mentioned in paragraph (3).

5. The creditor's title should not be challengeable on the ground of any irregularity in the diligence or foreclosure proceedings, without prejudice to the debtor's right to claim damages for wrongful diligence.

(5) Liability for diligence expenses

17.(1) The expenses properly incurred by a creditor in executing the diligence of land attachment should be chargeable against the debtor. The expenses should, unless paid by the debtor, be recoverable from the proceeds of the attachment concerned but (apart from the expenses of the charge) not by any other legal process except supervening insolvency processes or processes of ranking creditors' claims on the attached land.

(2) Any expenses not recovered by the time when the diligence is completed or ceases to have effect should cease to be chargeable against the debtor, except as aforesaid.

(3) Each party should bear his own expenses in relation to incidental court applications, but the debtor should be liable for the expenses of an application for warrant to sell on the basis that it was unopposed and the court should be empowered to award expenses not exceeding a prescribed sum if an application or an objection was frivolous.

Comment

These proposals on expenses of attachment are modelled on sections 92 to 95 of the Debtors (Scotland) Act 1987 which deal with the expenses of diligence against moveables, especially those relating to poinding. At present an adjudging creditor is not entitled to charge the debtor with any of the expenses of adjudication, except that the debtor is liable for the extra expense occasioned by unsuccessful opposition. The rule for adjudications has to be viewed against the background that the adjudger will, if the debt remains unpaid, eventually become owner of the land, however valuable it is in relation to the debt.

(6) Transmission and Termination of Land Attachments

Assignation of debt

18. An assignation of the debt should carry with it the benefit of steps in the diligence of land attachment already taken by the cedent in relation to that debt.

Comment

At common law, the assignation of a debt automatically carries with it, by operation of law, any diligence securing the debt. If the cedent had not already registered a notice of land attachment the assignee would have to apply to the sheriff clerk under section 88 of the Debtors (Scotland) Act 1987 for a warrant to register a notice of land attachment (and to charge and register an attacher's notice of litigiosity where this had not already been done) in his own name. The warrant would also authorise arrestment, earnings arrestment and poinding by the assignee to enforce the debt assigned. Where the cedent had already registered a notice of land attachment the assignee would acquire the benefit of steps already taken by the cedent and be entitled to complete the diligence. The assignee should be entitled to register a notice in the Sasine Register, or apply to the Keeper for the Land Register to be amended, so as to show the assignee as the new creditor. Rules of court should provide that the assignee must produce the assignation, notice, or amended Land Register charge certificate when applying for warrant of sale or lodging the report of sale. The proposition does not cover the case where the land attachment is assigned but not the principal debt which it secures because there is authority that an assignation of a security does not by implication assign the principal debt which it secures: *Watson v Bogue* 1998 GWD 18-930 (Sheriff Principal Nicholson).

Duration of land attachment

19.(1) A notice of land attachment should cease to have effect on the expiry of a period of five years after the date of its registration.

(2) The creditor should be entitled not earlier than two months before the end of this period to extend the period for a further five years by registering a document in a prescribed form to be known as a notice of extension. More than one extension should be competent.

Comment

The creditor would be entitled to extend the attachment period provided that the debt remains enforceable. The notice of extension of a registered land attachment in the Sasine Register should be in a prescribed form as should the form of application for registering an extension in the Land Register. The fact that the period of attachment is "extended" (as distinct from "renewed") means that the creditor continues to rank as from the date of registration of the original notice.

Termination of attachment by payment

20. The debtor should be entitled, at any time up to the conclusion of the contract of sale or the registration of a decree of foreclosure, to bring a land attachment to an end by paying or tendering the full amount (including expenses chargeable against the debtor) due to the creditor.

Comment

This would apply to land attachments the rule in section 95 of the Debtors (Scotland) Act 1987 for poindings and arrestments. Proposition 17 details the expenses chargeable against the debtor.

Discharge, recall and restriction

21.(1) A land attachment may be discharged or restricted by the creditor.

(2) A land attachment may be recalled or restricted by the sheriff on the ground that:

(a) the warrant is invalid in whole or in part;

(b) the execution of the diligence is irregular or incompetent; or

(c) the diligence has ceased to have effect.

Comment

1. If the debt is satisfied otherwise than by sale of all of the attached land (e.g. by payment, or sale of part of the land, or other diligence), the creditor should be under a duty to grant a discharge of the land attachment. The debtor should be liable for the whole expenses of preparing and registering any discharge or restriction granted by the creditor.

2. The debtor or any other person having an interest should be entitled to apply to the sheriff for a land attachment to be recalled or restricted. The debtor may wish to do this if the creditor refuses to grant a discharge when obliged to do so. The expenses should be left to the sheriff's discretion.

3. The discharge, recall or restriction should be in a prescribed form and be registrable in the property registers.

Debtor's death before registration of land attachment

22.(1) A notice of land attachment registered after the death of the debtor in pursuance of a warrant contained in an extract of a decree or registered writ against the debtor should be ineffectual.

(2) Where an executor has confirmed to the estate of a deceased debtor, a creditor of the deceased should constitute his debt by decree for payment against the executor as under the present law and be entitled to do diligence under the decree against the executry estate in the normal way.

(3) Where no executor has confirmed to the estate of a deceased debtor, it should cease to be competent for the deceased's creditor to confirm as executor-creditor to the deceased debtor's heritable property, and land attachment should be competent as mentioned in the following paragraphs.

(4) Where on the expiry of six months after a debtor's death, the succession to his estate is vacant (i.e. no executor has confirmed to his estate and either no person has succeeded to the deceased's heritable property by virtue of a special destination or such a person has renounced his succession), a creditor of the deceased should be entitled to raise an action in the sheriff court of constitution of the debt and declarator of the extent of the debt due by the deceased to the pursuer (traditionally known as an action of constitution cognitionis causa tantum). *Decree in the action should grant warrant for land attachment in place of an action of adjudication for debt* contra haereditatem jacentem *(attaching the heritable property in the vacant succession by adjudication) which should cease to be competent. Provision should be made by rules of court adapting the statutory procedure in land attachment to the case of a vacant succession, including provision conferring powers on the sheriff to make ancillary orders dispensing with or modifying steps in that procedure.*

(5) With respect to special destinations, we confirm the two following recommendations made in a previous report.[1]

> *(a) A person who succeeds to heritable property by virtue of a special destination should be personally liable for the debts of the previous owner, unless the person renounces the succession. This liability should be limited to the value of the property at the date of the previous owner's death.*[2]
>
> *(b) A destination in an assignation of a lease where assignation is permitted without the consent of the landlord should, so far as the rights of creditors of the assignees are concerned, have the same effect as the same destination in a disposition of feudal property.*[3] *This paragraph is subject to proposition 3(2) above.*

A creditor of the deceased should raise an action of declarator of the value of the property passing under the special destination and constitute his debt by decree for payment against the person succeeding under the special destination and be entitled to do diligence under the decree against the person's attachable property in the normal way.

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[1] Report on *Succession* (1990) Scot Law Com No 124.
[2] *Ibid*., recommendation 29 (para 6.16).
[3] *Ibid*, recommendation 33 (para 6.29).

(6) A land attachment which is:

(a) used by the creditor of a deceased against the deceased's heritable property passing under a special destination; and

(b) registered within one year of the debtor's death,

should have priority in ranking over a land attachment against the property previously registered by a creditor of the person succeeding under the special destination.

Comment

1. This proposition deals with cases where the debtor has died before the registration of a notice of land attachment. There are three categories of case, namely: (1) where an executor is confirmed to the estate of the deceased debtor; (2) where the succession is vacant, (a phrase explained in proposition 22(4)); and (3) where a person succeeds to heritable property of the deceased under a special destination in a disposition or assignation of a lease (such a person being traditionally called an "heir of provision").

2. The effect of proposition 22(1) is that where the debtor has died before the registration of a notice of land attachment, the diligence (including a charge to pay and attacher's notice of litigiosity) would lapse. The steps to be taken by the creditor differ in each of the three categories.

3. Proposition 22(2) covers the first (and usual) case where an executor confirms to the deceased's estate. No change to the existing law is proposed except that a decree against the executry estate would authorise land attachment as mentioned in proposition 4.

4. Proposition 22(3) and (4) deal with cases of vacant succession. Proposition 22(3) proposes that a confirmation as executor-creditor should not be competent to attach heritable property. That form of diligence was introduced by the Succession (Scotland) Act 1964 by a side-wind: see Discussion Paper No 78, vol 2, para 7.23. The remedy proposed in proposition 22(4) is simpler than adapting confirmation as executor-creditor to heritable property by building in safeguards and new procedures.

5. In place of confirmation as executor-creditor, proposition 22(4) proposes to deal with vacant succession cases by a new statutory version of the combined common law actions of constitution *cognitionis causa tantum* and adjudication for debt *contra haereditatem jacentem* (i.e. against the vacant succession). These were available before 1964 in the sheriff court as well as the Court of Session and may possibly still be competent though that is not clear (see Discussion Paper No 78, vol 2, pp 196,197). In the former action the court granted a decree "declaring or cognoscing the extent of the debt due by the deceased, that adjudication might proceed upon it against the lands" (Erskine, *Institute* II,12,47) but not implying personal liability on the part of any one nor itself granting warrant for diligence. Instead of adjudication for debt *contra haereditatem jacentem*, however, the court will grant warrant for land attachment against heritable property in the vacant succession. Since *ex hypothesi* there is no identifiable surviving debtor, the procedure in land attachment should be adapted by rules of court and the sheriff's orders for use against a vacant succession.

6. Proposition 22(5) and (6) deal with the third category, where property passes to an heir of provision under a special destination. Proposition 22(5) confirms two

recommendations in our Report designed to reverse the decision in *Barclays Bank Ltd v McGreish* 1983 SLT 344(OH).

7. Proposition 22(6) applies in modernised form to heirs of provision the general principle underlying the limited preference of the creditors of a deceased over the creditors of his heirs and successors at common law and under the Act Anent Apparent Heirs 1661 (now repealed) and the Confirmation Act 1695: see Discussion Paper No 78, vol 2, paras 7.44 - 7.49. The principle is well explained in Bell, *Commentaries* vol 1, pp 764,765, and is still valid.

Debtor's death after registration of land attachment

23. A creditor who had registered a notice of land attachment prior to the debtor's death should be entitled to proceed with the diligence. Provision should be made by rules of court adapting the statutory procedure in the diligence to that case, including provision conferring powers on the sheriff to make ancillary orders dispensing with or modifying steps in that procedure.

Comment

Rules of court might provide that the deceased debtor's executor or heir of provision (if any) would stand in place of the deceased debtor with regard to receiving intimations, making or opposing applications etc. If the succession is vacant, provision might be made for intimation to the Lord Advocate, as in notices calling up a standard security under section 19 of the 1970 Act.

(7) Miscellaneous

Ascription of payments to account during land attachment

24. Sums paid while a land attachment is in effect and the proceeds of an attachment should be ascribed first to expenses, secondly to interest accrued to the date of registration of the notice of land attachment and lastly to the principal sum together with any further interest.

Comment

This proposition is modelled on the Debtors (Scotland) Act 1987 which makes similar provision for poindings and arrestments.

Transitional provisions

25.(1) An extract of a decree or other writ bearing a warrant for execution should be deemed to include a warrant for land attachment whether the extract was issued before or after commencement.

(2) It should be incompetent after commencement to bring an action of adjudication for debt. Actions of adjudication which are pending at commencement should proceed according to the existing

law. The existing law should also continue to apply to decrees of adjudication granted prior to commencement.

(3) Adjudications which had been equalised before commencement should remain equalised, but an adjudication granted after commencement should not be equalised with any pre-commencement adjudication. Attachments should not be equalised with adjudications.

(4) An adjudication registered within 6 months before a post-commencement sequestration or liquidation should be ineffective to create a preference for the adjudger, whether the adjudication was registered before or after commencement.

Comment

1. Creditors could abandon pending actions of adjudication or existing adjudications and enforce their debts by the new diligence of land attachment instead. The new diligence would enable them to realise the sums due to them more quickly, but they would lose any preference arising out of the adjudication.

2. Section 1(3) of the Prescription and Limitation (Scotland) Act 1973, dealing with positive prescription where the foundation writ is a decree of adjudication, should remain in force for adjudications but should not be extended to land attachments.

CHAPTER II: ABOLITION OF EQUALISATION OF HERITABLE DILIGENCES

26.(1) The following statutory provisions should be repealed, namely:

(a) the Diligence Act 1661 (which makes provision for the pari passu ranking of adjudications led within a year and a day of the first effectual adjudication); and

(b) in the Bankruptcy (Scotland) Act 1985, s 37(1), paragraph (a) (which provides that in relation to diligence the order awarding sequestration has the effect of a decree of adjudication for debt duly recorded in the personal register).

(2) No similar provision should be made for the equalisation of land attachments.

Comment

The reasons for this proposition are fully discussed at paras 2.61-2.71 of the Discussion Paper. The proposition assumes that equalisation will replaced by provisions on the cutting down of land attachments executed within six months before sequestration or liquidation in terms of propositions 31 and 33.

CHAPTER III: CONSEQUENTIAL AMENDMENTS OF LAW ON SEQUESTRATION AND LIQUIDATION

(1) Protection of faith of registers from sequestration and liquidation

Sequestration: litigiosity and certified copy of first order

27.(1) The Bankruptcy (Scotland) Act 1985, section 14(2), should continue to provide that the recording in the personal register under section 14(1)(a) of a certified copy of the first order (i.e. the relevant court order within the meaning of that section awarding sequestration or granting warrant for citation of the debtor under section 12(2)) should have the effect, as from the date of sequestration, of an inhibition at the instance of the creditors who subsequently have claims in the sequestration accepted under section 49.

(2) The reference in section 14(2) to a citation in an adjudication of the debtor's heritable estate at the instance of those creditors should be repealed.

Comment

1. The need for paragraph (1) is explained in para 2.46.

2. Paragraph (2) is a consequential of the abolition of adjudications for debt.

Sequestration: vesting of estate in permanent trustee and protection of the faith of the registers

28.(1) Subject to amendments proposed below, the Bankruptcy (Scotland) Act 1985, section 31(1), should continue to provide that the whole estate of the debtor shall vest in the permanent trustee as at the date of sequestration for the benefit of the creditors, and that:

> *(a) the estate should so vest by virtue of the act and warrant issued on confirmation of the permanent trustee's appointment; and*
>
> *(b) the act and warrant should, in respect of the debtor's heritable estate in Scotland, have the same effect as if a decree of adjudication in implement of sale had been pronounced in favour of the permanent trustee.*

(2) The reference in section 31(1)(b) of the 1985 Act to the act and warrant having effect also as if "a decree of adjudication for payment and in security of debt, subject to no legal reversion" had been pronounced, should be repealed.

(3) For avoidance of doubt, the 1985 Act should be amended to make it clear that the expression "the whole estate of the debtor" occurring in section 31(1) includes property of the debtor where at the date of sequestration :

> *(a) the debtor had previously granted and delivered a deed transferring or assigning the property to a third party ; but*
>
> *(b) the third party's title to the property has not been completed as a real right by registration of the deed in the property registers,*

and accordingly in any competition between the permanent trustee in the sequestration and the third party, the debtor should not be treated as having been divested of his attachable right to the property by virtue of his delivery of the deed to the third party.

(4) The registration in the property registers of any notice of title or other deed by which the permanent trustee :

> *(a) completes title to heritable property of the debtor in Scotland in his own name or in the name of the debtor for the benefit of the creditors in the sequestration; or*
>
> *(b) conveys such property to another person,*

before the expiry of a period of 14 days after the date of recording in the personal register of the first order under section 14(1)(a) of the 1985 Act should be treated as ineffectual.

(5) The 1985 Act, section 32(9)(b) should be amended to ensure that section 32(8) (bar against dealing of debtor relating to his estate when vested in the permanent trustee) does not render ineffectual in a question with the permanent trustee any dealing, after the date of sequestration and before the registration under section 14(1)(a) of the first order in the personal register, by which the debtor delivers a deed transferring or assigning heritable property to a purchaser for value who at the time of delivery is unaware of the sequestration and had at that time no reason to believe that the debtor's estate was sequestrated or was the subject of sequestration proceedings.

(6) As under the existing law, the heritable property of the debtor should vest in the permanent trustee tantum et tale *as it stood vested in the debtor on the date of sequestration.*

Comment

1. Proposition 28(1) saves the provisions in section 31(1) of the Bankruptcy (Scotland) Act 1985 for vesting the debtor's estate in the permanent trustee subject to minor modifications. As a consequential of the abolition of adjudications for debt, proposition 28(1) and (2) propose the repeal of the reference in section 31(1)(b) of the 1985 Act to that form of diligence. However section 31(1)(b) would continue to provide that the act and warrant should, in respect of the debtor's heritable estate in Scotland, have the same effect as if a decree of adjudication in implement of sale had been pronounced in favour of the permanent trustee. Such a decree only confers a personal right and the permanent trustee would require to run a race to the register against competing real rights.

2. The reasons for proposition 28(3) are explained in para 2.56 of the Discussion Paper.

3. The background to proposition 28(4) - which proposes a mandatory delay of at least 14 days between registration creating litigiosity in the personal register and completion of title by the permanent trustee in property registers - is explained in paras 2.53 and 2.54 of the Discussion Paper.

4. The reason for proposition 28(5) is explained in para 2.47 of the Discussion Paper.

5. Proposition 28(6) proposes retention of the common law doctrine of vesting *tantum et tale* which already applies to vesting in sequestrations.

Publication of statutory avoidance of disposition of heritable property in winding up of company by the court

29.(1) Section 127 of the Insolvency Act 1986 (which provides that a disposition of a company's property made after the commencement of its winding up is void unless the court orders otherwise) should be amended to provide that any disposition (within the meaning of section 127) of a company's heritable property in Scotland is void under the section only if it is made after the date when the fact of the commencement of the winding up first appears in the register of companies.

(2) Unless the court otherwise directs, the first order in a petition to the Court of Session or a sheriff court for the winding up of a company should include a direction to the clerk of the court forthwith to give notice in the prescribed form to the registrar of companies of the presentation of the petition.

Comment

The reasons for this proposition are explained in paras 2.48 - 2.52 of the Discussion Paper.

Liquidation and protection of the faith of the registers

30.(1) The registration in the property registers of any notice of title or other deed by which the liquidator:

> *(a) completes title to heritable property of the company in Scotland in his own name or in the name of the company; or*
>
> *(b) conveys such property to another person,*

before the expiry of a period of 14 days after the date when the fact of the commencement of the winding up first appears in the register of companies should be treated as ineffectual.

(2) It should be made clear by statute that, in the case of a winding up by the court, the property of the company, over which the functions of the liquidator under the Insolvency Act 1986, sections 143(1), 144, 145 and Schedule 4 are exercisable, includes property which the company has disponed to a third party by a delivered deed but of which the company has not been divested by registration of the deed in the property registers. The liquidator's functions include getting in and realising the company's assets; taking property into his custody or under his control; obtaining a court order vesting property belonging to the company in him; recovery of property; powers of sale; and powers to execute deeds.

(3) A liquidator's powers over the company's property should be subject to the same qualifications as are imposed by the principle of tantum et tale *on the company's right on the date of the commencement of the winding up.*

Comment

1. Proposition 30(1) gives effect to the policy of a mandatory period delay of 14 days before the liquidator completes title. In this case, the period begins to run from the date when the fact of the commencement of the winding up first appears in the register of

companies (not the personal register). In practice, liquidators will very rarely transact with heritable property for several months after that date. The need for the proposition - which corresponds to proposition 28(4) in sequestrations - is explained at paras 2.53 and 2.54.

2. The proposal takes account of certain differences between a permanent trustee in sequestration and a liquidator. There is no enactment providing for the automatic vesting in the liquidator of the property of the company corresponding to the provisions on the vesting in a trustee in a sequestration in terms of section 31(1) of the Bankruptcy (Scotland) Act 1985. For the purpose of vesting, the winding-up order or the order appointing the liquidator does not operate as a deemed adjudication in implement of sale or as a deemed adjudication for debt or in security without reversion. This accords with the general theory that the liquidator is merely an administrator of the property which remains vested in the company.

3. Section 37(1)(a) of the Bankruptcy (Scotland) Act 1985, as applied to liquidations Insolvency Act 1986, s 185(1), makes the winding-up order a deemed adjudication for debt only for the limited purpose of the equalisation of adjudications under the Diligence Act 1661, and not for vesting purposes. Section 37(1)(a) replaces section 327(1)(b) of the Companies Act 1948, which was in different terms and could support an argument that the liquidation operated to vest the property in the liquidator, though that was not the generally accepted view. (See Gretton "The Title of a Liquidator" (1984) 29 JLSS 357 at p 358). Proposition 26 proposes that equalisation of adjudications should be abolished and that section 37(1)(a) should be repealed.

4. There are, however, two rarely used provisions under which the liquidator may acquire a title to the company's property in his own name, namely by recording a notice of title or notarial instrument in the property registers (Titles to Land Consolidation (Scotland) Act 1868, s 25), or by obtaining a vesting order of the court (Insolvency Act 1986, s 145(1): winding up by court, applied to voluntary winding up by 1986 Act, s 112(1)). Neither provision deems the property to vest as if the notice of title, notarial instrument or order were an adjudication for debt. The rights of "secured creditors" (including adjudgers) which are preferable to the rights of the liquidator are expressly preserved: Insolvency (Scotland) Rules 1986, rule 4.66(6)(a); definition of "security" in Insolvency Act 1986, s 248(b).

5. Proposition 30(2) is explained by para 2.57.

6. Proposition 30(3) proposes that it should be made clear that the doctrine of *tantum et tale* should qualify the liquidator's powers over the company's property. Because there is no automatic statutory transfer of the company's property from the company to the liquidator, it has been said that the doctrine of *tantum et tale* does not apply in liquidations: *Bank of Scotland v Liquidators of Hutchison, Main and Co Ltd* 1914 SC (HL) 1 at pp 5,6. It may be that the precise formulation of the doctrine must be different. However the general principle is established that the rights of creditors are the same in liquidations as in sequestrations. Therefore in so far as that doctrine affects competitions in ranking (e.g. by letting in the rule that fraud passes against creditors), it must apply in liquidations.

(2) Cutting down, stoppage and ranking of land attachment on debtor's sequestration or liquidation

Cutting down and stoppage of land attachment on sequestration of debtor's estate

31.(1) No land attachment of a debtor's property registered:

(a) within the period of 6 months before the date of sequestration and whether or not subsisting at that date; or

(b) on or after that date,

should be effectual to create preference for the attaching creditor (in a question with the permanent trustee).

(2) A creditor whose land attachment is registered within the above-mentioned period of 6 months should be entitled to payment, out of the proceeds of sale of the attached property, of the expenses incurred:

(a) in obtaining the extract of the decree or other document containing the warrant for land attachment;

(b) in executing a charge to pay and steps in the diligence of land attachment; and

(c) in taking any further necessary action in respect of the land attachment.

Comment

1. At present, there is no provision rendering ineffectual prior adjudications led within a statutory period before the date of sequestration comparable to section 37(4) and (5) of the Bankruptcy (Scotland) Act 1985, which renders ineffectual poindings and arrestments executed within 60 days before the date of sequestration. *Pari passu* ranking of the general creditors with prior adjudications is achieved by equalisation under the Diligence Act 1661 which we propose should be repealed and not replaced: proposition 26. This proposition follows up a proposal in our Discussion Paper No 79 to the effect that if equalisation of adjudications were to be abolished, new provision should be made, on the model of section 37(4) and (5) of the Bankruptcy (Scotland) Act 1985 on the lines set out in this proposition: Discussion Paper No 79, Proposition 2 (para 2.31).

2. In this proposition, the statutory period is 6 months which contrasts with the 60 days period for arrestments and poindings. The longer period was selected in response to representations by the Joint Committee on our earlier Discussion Papers 78 and 79 to the effect that reformed adjudications might be unfair to competing creditors. The period of 6 months is the same as the period in the 1985 Act, section 36, for the reduction of unfair preferences and represents a compromise between 60 days and the one year period for the equalisation of adjudications.

3. The words "whether or not subsisting at that date" were inserted in the 1985 Act, s 37(4)(a) to reverse the decision in *Johnston v Cluny Trustees* 1957 SC 184 which had held that the provision rendering ineffectual a prior arrestment executed within the 60 days pre-sequestration period applied only to an arrestment actually subsisting at the date of

sequestration and therefore had no application where arrestment had been superseded by payment and was no longer subsisting at that date: see our Bankruptcy Report, para 13.12. So a creditor whose land attachment is extinguished by payment of the debt should be required to surrender the payment to the trustee for the benefit of the general body of creditors if sequestration supervenes within six months after the registration of the notice of land attachment.

4. The words "effectual to create a preference for the attaching creditor" in the bankruptcy legislation mean "effectual to secure a preference for the arrester or poinder in a question with the trustee": *Dow & Co v Union Bank* (1875) 2 R 459 at p 462 (the trustee succeeds to the benefit of an arrestment in a question with the arrestee); *Allan v Fyfe* (1835) 14 S 80; Bankruptcy Report, p 195, n 13. Thus for example a land attachment within the statutory "suspect" period would not be reduced or annulled for all purposes by operation of law at the date of sequestration but rather the permanent trustee would succeed to the benefit of any preference it may have obtained.

Further provision: exceptions to stoppage of land attachment on sequestration

32.(1) On or after the date of sequestration of a debtor's estate, it should not be competent for a creditor:

(a) to register a notice of land attachment in the property registers; or

(b) to proceed with a diligence of land attachment already begun unless a contract of sale of the subjects has been concluded in exercise of the attaching creditor's power of sale or unless decree of foreclosure has been granted.

Section 37(8) of the Bankruptcy (Scotland) Act 1985 should be amended accordingly.

(2) On the date of sequestration of a debtor's estate, property belonging to the debtor which has been attached by land attachment should not vest in the permanent trustee if before that date:

(a) the property has been sold by the attaching creditor in implement of his power of sale and the debtor has been divested by the purchaser completing title by registration in the property registers; or

(b) decree of foreclosure has been granted in favour of the attaching creditor.

(3) (a) Where the attaching creditor, in exercise of his power of sale, has concluded a contract of sale of attached subjects which thereafter vest in the permanent trustee at the date of sequestration, the permanent trustee should be bound to concur in or to ratify the attaching creditor's disposition implementing the sale.

(b) Where the land attachment was registered before the commencement of the period of 6 months prior to the date of sequestration (and is thus not rendered ineffectual in a question with the permanent trustee in terms of proposition 31), the attaching creditor should be bound to account for and pay to the permanent trustee the net free proceeds of the sale after satisfying his own debt and diligence expenses, and any prior or pari passu debt and expenses.

(c) Where the land attachment was registered within the period of 6 months prior to the date of sequestration (and is thus ineffectual in a question with the permanent trustee in terms of proposition 31), the attaching creditor should be bound to pay the whole proceeds of sale to the permanent trustee, under deduction of his diligence expenses.

(4) If the contract of sale is terminated before the attaching creditor's disposition is delivered to the purchaser, the permanent trustee should have power to sell the attached subjects with the attaching creditor's consent or, failing such consent, the authority of the court.

Comment

1. Under the present law, the rule that adjudged property vests in the trustee on the date of sequestration (Bankruptcy (Scotland) Act 1985, s 31(1)) is complemented by a rule that it is incompetent for a creditor to raise or insist in an adjudication on or after the date of sequestration. (*Ibid*, s 37(7)). Although bankruptcy legislation defines "securities" in such a way as to include (except where the context otherwise requires) unsecured creditors' diligences as well as voluntary securities, the case law construing that legislation makes it clear that diligences and voluntary securities are not always treated in exactly the same way.

2. The vesting provision in section 31(1) of the 1985 Act is expressly made subject to section 33(3) which provides that section 31 is "without prejudice to the right of any secured creditor which is preferable to the rights of the permanent trustee". The word "security" is widely defined (1985 Act , s 73(1)) to include diligences (Goudy, p 187) and would include land attachment. The effect of this saving for "preferable securities" is, however, merely to preserve the right of a creditor executing land attachment or other diligence to claim a preference in the sequestration and not to exclude the attached property from vesting in the trustee, or his right to take possession and dispose of it: Graham Stewart, p 186; Goudy, p 254; *Lord Advocate v Royal Bank of Scotland* 1977 SC 155 at p 171. This interpretation is consistent with the provision that an adjudger cannot insist in his adjudication: Goudy, pp 319-320; 505-506. See now 1985 Act, Sch 1, para 5(2). Likewise an attaching creditor should not be entitled to insist in his land attachment.

3. By contrast, creditors in voluntary heritable securities have always been entitled to realise the security subjects and rank for any deficiency, subject to the right of the trustee in certain circumstances to take over the security subjects at the valuation specified by the creditor if he lodges a claim before realisation. Under a new provision in section 39(4) of the 1985 Act, the secured creditor may sell the security subjects only if he intimates to the trustee his intention to sell before the trustee intimates to the secured creditor his intention to sell. These provisions clearly do not apply to adjudgers (who under the present law have no power of sale). It is proposed that generally a creditor executing a land attachment, who has neither concluded missives of sale of the attached subjects nor obtained decree of foreclosure before the date of sequestration, should not be entitled to proceed with the land attachment.

4. Conversely where the attaching creditor has concluded missives of sale of the attached subjects, but the debtor has not yet been divested of the subjects by the purchaser's infeftment, a personal right to the subjects should be vested in the trustee (in case the sale transaction is not completed) and the trustee should be bound to concur in or to ratify the disposition implementing the sale. Normally the attaching creditor should be bound to account for and pay to the trustee the free proceeds of sale after deducting his debt, any prior or *pari passu* debt, and his diligence expenses.

5. Where the land attachment was registered within 6 months before the date of sequestration, it should be ineffectual to secure a preference in a question with the trustee in terms of the previous proposal. If a land attachment were to be both registered and followed by missives of sale within the 6 months, the attaching creditor should pay the whole proceeds of sale, under deduction of diligence expenses, to the trustee. If for any reason the contract of sale is terminated (e.g. by rescission or repudiation) before the delivery of the disposition at settlement, the trustee should have power to sell the property with the attaching creditor's consent or, in default of such consent, the authority of the court. Where the attaching creditor has obtained decree of foreclosure before the date of sequestration, the attached subjects should not vest in the trustee whether or not the decree of foreclosure has been registered in the property registers.

Cutting down and stoppage of land attachment on liquidation

33.(1) No land attachment of the property of a company registered:

(a) within the period of 6 months before the date of the court order for winding up of the company and whether or not subsisting at that date; or

(b) on or after that date,

should be effectual to create a preference for the attaching creditor (in a question with the liquidator).

(2) A creditor whose land attachment is registered within the above-mentioned period of 6 months should be entitled to payment, out of the attached property or the proceeds of its sale, of the expenses incurred:

(a) in obtaining the extract of the decree or other document containing the warrant for land attachment;

(b) in executing a charge to pay and steps in the diligence of land attachment; and

(c) in taking any further necessary action in respect of the land attachment.

Comment

1. It is proposed that (on the analogy of sequestration) any land attachment executed within 6 months prior to the date of the commencement of the winding up of the company or on or after that date should be ineffectual in a question with the liquidator: compare proposition 31. Further under proposition 34, it should not be competent for a creditor to commence a diligence of land attachment or proceed with one already begun subject to certain exceptions.

2. As a general rule, the rights of competing creditors in the liquidation of a company under the Companies Acts are governed by the same rules as regulate the rights of creditors in a sequestrated estate under the Bankruptcy Acts: *Bank of Scotland v Liquidators of Hutchison, Main and Co Ltd* 1914 SC (HL) 1 at p 3 per Lord Kinnear. The general object of the statutes is to preserve as far as possible all rights and interests in the position in which they

stood immediately before the date of sequestration or commencement of the winding up, subject *inter alia* to rules on the rendering ineffectual of prior diligences.

3. Through an apparent legislative oversight, however, there is no provision expressly prohibiting adjudications of a company's heritable property, or rendering them ineffectual, as from the commencement of the winding up of the company. Thus while the Insolvency Act 1986, section 185, applies the provisions of the Bankruptcy (Scotland) Act 1985, section 37(1) to (6) (effect of sequestration on diligence), to liquidations, it does not apply that part of section 37(8) which makes it incompetent for a creditor to raise or insist in an adjudication. Nor is there any provision for Scotland equivalent to the Insolvency Act 1986, section 128(1) which provides: "Where a company registered in England and Wales is being wound up by the court, any attachment, sequestration, distress or execution put in force against the estate or effects of the company after the commencement of the winding up is void". This derives ultimately from the Companies Act 1862, s 163, which was in very similar terms but was not expressly confined to companies registered in England and Wales, and was, despite the English legal terminology, held at one time to be applicable in Scotland: *Allan v Cowan* (1892) 20 R 36; Graham Stewart, p 191. Scottish companies were however excluded from the provision on its consolidation in 1908 for reasons which are now obscure: Companies (Consolidation) Act 1908, s 211. Section 128(1) would seem to apply however to diligence in Scotland against a debtor company registered in England and Wales. Section 126 of the Insolvency Act 1986, which confers on the court power to stay or restrain proceedings against a company, does not apply to diligence. This provision fills an apparent gap in the law.

Further provision: exceptions to stoppage of land attachment on liquidation

34.(1) On or after the date of commencement of winding up of the company, it should not be competent for a creditor:

(a) to register a notice of land attachment in the property registers; or

(b) to proceed with a diligence of land attachment already begun unless a contract of sale of the attached subjects has been concluded in implement of the attaching creditor's power of sale or unless decree of foreclosure had been granted.

Section 185 of the Insolvency Act 1986 should be amended accordingly.

(2) On the date of commencement of the winding up of a company, property belonging to the company which has been attached by land attachment should not be subject to the powers of the liquidator if before that date:

(a) the property has been sold by the attaching creditor in implement of his power of sale and the company has been divested by the purchaser completing title by registration in the property registers; or

(b) decree of foreclosure has been granted in favour of the attaching creditor.

(3) Where the attaching creditor has concluded a contract of sale of the attached subjects before the date of commencement of the winding up, proposition 32(3) above should apply with any necessary modifications.

(4) If the contract of sale is terminated before the attaching creditor's disposition is delivered to the purchaser, the liquidator should have power to sell the attached subjects with the attaching creditor's consent or, failing such consent, the authority of the court.

Comment

1. Paragraph (1) proposes that it should not be competent for a creditor to register a notice of land attachment after the date of the commencement of the winding up of the company.

2. Paragraph (2) is in the same terms as proposition 32(2) (relating to sequestrations) but adapted to take account of the rule that the company's property does not vest in the liquidator by operation of law.

3. Paragraph (3) applies proposition 32(3) to liquidations.

4. Paragraph (4) is in similar terms to proposition 32(4).

APPENDIX B

EXAMPLES ILLUSTRATING THE RANKING OF INHIBITIONS AND COMPARISON WITH AMERICAN RULES ON CIRCLES OF PRIORITIES

1. In this Appendix we give, at paragraphs 2 - 7 below, some worked examples of the ranking of inhibitions in order to illustrate the complex operation of Bell's canons of ranking (which are quoted in the Discussion Paper, paragraph 3.14, above).[1] By way of comparison, we also describe at paragraph 8 below the rules generally applied in the United States of America for ranking subordination agreements. These perform broadly the same function as Bell's canons since both sets of rules provide for multiple-round ranking on an insolvent estate involving similar types of circles of priorities of creditors' claims, i.e. where A has priority over B, who has priority over C, who has priority over A. Paragraph 9 below shows, through worked examples, that the American rules reach the same results as the Scottish canons of ranking.

Example 1

2. In a sequestration the inhibitee's heritable property is sold for £30,000. The inhibitee has no moveable property. There are three creditors: A (pre-inhibition) claiming £20,000, B (the inhibitor) claiming £20,000 and C (post-inhibition) claiming £20,000. Applying Canon 1 all creditors rank equally and get a dividend of 50 pence in the pound.

Round 1

A	£10,000
B	£10,000
C	£10,000
	£30,000

Canons 2 and 3 are then applied so as to give the inhibitor B the same dividend as he would have got if C's debt had not existed. A and B would then have got a dividend of 75 pence in the pound, each receiving £15,000.

A is neither benefited nor prejudiced by the inhibition and so continues to receive a dividend of 50 pence. B's extra £5,000 over the first round ranking of £10,000 is taken exclusively from C. The result is:

A	£10,000
B	£15,000
C	£ 5,000
	£30,000

[1] The leading study is Professor Grettons's monograph *The Law of Inhibition and Adjudication* (2d edn; 1996) especially at chapter 7 to which we are greatly indebted.

Example 2

3. As in Example 1 but C has adjudged more than a year and a day before the sequestration (so that the adjudication is not equalised with the trustee's deemed adjudication under the Diligence Act 1661).

Round 1

A	£ 5,000
B	£ 5,000
C	£20,000
	£30.000

Since C has a judicial security, he receives the full amount of the debt on the first round. The balance is shared equally between A and B. In round 2, B would have been entitled to £15,000 if C's debt had not existed. The extra £10,000 is drawn back from C. The result is:

A	£ 5,000
B	£15,000
C	£10,000
	£30,000

Example 3

4. In a sequestration the inhibitee's heritage realises £35,000 and there are four creditors. A (pre-inhibition) claims £20,000, B (the inhibitor) claims £20,000, C (post-inhibition) claims £20,000 and D (also post-inhibition) claims £10,000.

Round 1

All creditors rank equally obtaining a dividend of 50 pence in the pound.

A	£10,000
B	£10,000
C	£10,000
D	£ 5,000
	£35,000

Had C and D's debts not existed B would have obtained £17,500 i.e. £20,000 x 35/40. In terms of the Fourth Canon the extra £7,500 is drawn from C and D rateably in proportion to their debts as they rank equally between themselves. The result is:

A	£10,000
B	£17,500
C	£ 5,000
D	£ 2,500
	£35,000

Example 4

5. In many sequestrations, in addition to property affected by an inhibition (hereafter called "inhibited property"), there will also be property of the debtor which is not so affected

(e.g. heritable property acquired by the debtor after the inhibition, and moveable property). The following example illustrates how the rules are applied in such a case.

The inhibited property is £30,000; the non-inhibited property is £10,000. There are three creditors: A (pre-inhibition) claims £20,000; B (the inhibitor) claims £20,000; C (post-inhibition) claims £20,000. Each creditor's debt is allocated against the inhibited property and the non-inhibited property rateably i.e. 3/4 to the inhibited property and 1/4 to the non-inhibited property. As far as the inhibited property is concerned there are debts totalling £45,000 against property of £30,000, so each creditor is entitled to a first round dividend of 2/3. The same dividend applies to the non-inhibited property.

	Inhibited Property	**Non-inhibited Property**
A	£10,000	£ 3,333
B	£10,000	£ 3,333
C	£10,000	£ 3,333
	£30,000	£10,000

As regards the inhibited property, if C's debt had not existed, A's and B's debts allocated against the inhibited property would total £30,000 so that each would be paid £15,000. The inhibitor B thus receives an extra £5,000 which is drawn back from C. The ranking on the non-inhibited property is unaffected by the inhibition.

	Inhibited Property	**Non-inhibited Property**
A	£10,000	£ 3,333
B	£15,000	£ 3,333
C	£ 5,000	£ 3,333
	£30,000	£ 10,000

There is however an alternative solution to the non-inhibited property if B's drawback against the inhibited property is deemed to be a security. If B's drawback is a security then B has no claim against the non-inhibited property. The drawback exactly matches the amount of B's debt allocated against the non-inhibited property (£5,000). The £10,000 non-inhibited property is therefore split equally between A and C. The result is:

	Inhibited Property	**Non-inhibited Property**
A	£10,000	£ 5,000
B	£15,000	£ -
C	£ 5,000	£ 5,000
	£30,000	£10,000

There is no clear authority as to which approach is correct.

6. The examples so far have concerned a single inhibition. But in many insolvencies there will be more than one inhibiting creditor.

Example 5

Creditors A and B each claim £20,000. After A inhibited, the inhibitee incurred a debt to C of £40,000. Then B inhibited and after that a debt to D of £20,000 was incurred. The inhibitee's heritable property realised £40,000.

In the first round each creditor receives a dividend of 40 pence in the pound.

A	£ 8,000
B	£ 8,000
C	£16,000
D	£ 8,000
	£40,000

A now draws back from C and D the extra amount A would have drawn had their debts not existed. In that case there would have been debts of £40,000 and a fund of £40,000 so A would have been paid £20,000 (i.e. in full). This extra £12,000 is drawn rateably from C and D, i.e. £8,000 from C and £4,000 from D. The result is:

Round 2

A	£20,000
B	£ 8,000
C	£ 8,000
D	£ 4,000
	£40,000

B now draws back from D the extra amount B would have drawn had D's debt not existed. The dividend would be 50 pence in the pound (a £40,000 fund with £80,000 of debts) giving B £10,000. This extra £2,000 is deducted from D's second round ranking. The final result is:

Round 3

A	£20,000
B	£10,000
C	£ 8,000
D	£ 2,000
	£40,000

7. In Example 5 it does not matter whether one applies A's inhibition first then B's or the other way round; the results are the same. However it is possible to have situations where this is not the case.

Example 6

The inhibitee's heritage is sold by the holder of a standard security and the proceeds of sale after deduction of the secured debt are £18,000. A whose debt is £6,000 inhibited and A's debt predates B's inhibition. B whose debt is £6,000 also inhibited and B's debt predates A's inhibition. C's debt which post-dates A's inhibition but not B's is £12,000, D's debt which post-dates A's and B's inhibitions is £6,000. The four creditors all arrest the £18,000 in the secured creditor's hands in the following order: C, D, B and finally A.

Round 1

A	-	
B	-	
C	£12,000	(since C arrested first)
D	£ 6,000	(since D arrested second)
	£18,000	

C's and D's first round rankings exhaust the fund leaving nothing for A and B.

Round 2

(a) **Applying A's inhibition first then B's**. A's inhibition strikes at the debts of C and D so A is entitled to the same ranking as if they didn't exist. A would be paid in full (£6,000) and this sum would be taken from D in terms of the Fourth Canon (drawback against least preferred creditor first and so on). B's inhibition strikes at D only, so B gets the same as if D's debt did not exist. But D is left with nothing after A's inhibition has taken effect, so that there is nothing from which to enhance B's share. The result is:

A	£ 6,000
B	£ -
C	£12,000
D	£ -
	£18,000

(b) **Applying B's inhibition first then A's**. In the absence of D, B would get £6,000 (the balance of £6,000 after satisfying C the first arrester, since B is preferred to A by virtue of having arrested earlier than A). This £6,000 is drawn back from D.

Round 2

A	£ -
B	£ 6,000
C	£12,000
D	£ -
	£18,000

In the absence of C and D, A would get £6,000 since there would be sufficient to satisfy both A and B in full. This sum is drawn back from C because D has nothing from which to draw back, although D is liable to satisfy A's drawback first. The end result is:

A	£ 6,000
B	£ 6,000
C	£ 6,000
D	£ -
	£18,000

USA Subordination Agreement Rules

8. In Scotland an inhibition creates a preference for the inhibitor by exclusion of post-inhibition debts. A similar exclusionary preference may be created by agreement between

creditors and in the USA rules exist to rank the creditors in such situations. Suppose A, B and C are secured creditors ranking on an inadequate fund. They are entitled to priority in that order but A has subordinated his claim to C's. The generally agreed method of distribution is:[2]

> "1. Set aside from the fund the amount of A's claim.
> 2. Pay the amount so set aside to
> a) C, to the amount of his claim;
> b) A, to the extent of any balance remaining after C's claim is satisfied.
> 3. Pay B the amount of the fund remaining after A's claim has been set aside.
> 4. If any balance remains in the fund after A's claim has been set aside and B's claim has been satisfied, distribute the balance to
> a) C,
> b) A."

9. **Example 1**

Suppose there are three creditors (A, B and C) ranking in their alphabetical order on a fund of £120,000. The debts are A £50,000; B £100,000; and C £10,000. A's claim is subject to a preference by exclusion (or subordination agreement) in favour of C.

American system

	A	B	C
1. Set aside the amount of A's claim (£50,000)			
2. Pay the amount so set aside to			
(a) C to the amount of C's claim			£10,000
(b) A to the extent of any balance remaining after C's claim has been satisfied	£40,000		
3. Pay B the amount of the fund after A's claim has been set aside		£70,000	
4. If any balance remains for distribution, pay to			
a) C,			nil
b) A	nil		
	£40,000	£70,000	£10,000

[2]G Gilmore, *Security Interests in Personal Property*, vol 2 (1965), p 1021.

Scottish system

Round 1		Round 2
A draws	£50,000	£40,000
B draws	£70,000	£70,000
C draws nil		£10,000
	£120,000	£120,000

B carries the Round 1 draft into Round 2. If A's debt had not existed, C would have drawn £10.000. Therefore in Round 2 C draws back from A the difference between £10,000 and the dividend in Round 1 (nil), i.e. £10,000. The final division is the same as in the American formula.

Example 2

Suppose the three creditors (A, B and C) again rank in their alphabetical order on a fund of £120,000, but the debts this time are A £40,000; B £50,000; and C £50,000. A's claim is again subject to a preference by exclusion (or subordination agreement) in favour of C.

American system

	A	B	C
1. Set aside the amount of A's claim (£40,000)			
2. Pay the amount so set aside to			
a) C to the amount of C's claim			£40,000
b) A to the extent of any balance remaining after C's claim has been satisfied	Nil		
3. Pay B the amount of the fund after A's claim has been set aside		£50,000	
4. If any balance remains for distribution, pay to			
a) C;			£10,000
b) A	£20,000		
	£20,000	£50,000	£50,000

Scottish system

Round 1		Round 2
A draws	£40,000	£20,000
B draws	£50,000	£50,000
C draws	£30,000	£50,000
	£120,000	£120,000

B carries the Round 1 dividend into Round 2. If A's debt had not existed, C would have drawn £50,000. Therefore in Round 2, C draws back from A the difference between that amount and the lower amount (£30,000) of the dividend in Round 1, i.e. £20,000. The final division is the same as in the American system.