Report

by

Working Party on Security Over Moveable Property

March 1986

Scottish Law Commission

FOREWORD

1. In 1968 a Committee appointed under the Chairmanship of Lord Crowther was set up by the Board of Trade[1] to carry out a wide ranging review of the law and practice "governing the provision of credit to individuals for financing purchases of goods and services for personal consumption". The Committee's Report, Consumer Credit, was published in 1971.[2]

2. The Committee's recommendations included proposals, not only for the special protection of consumers in credit transactions,[3] but also among other things for the establishment of a new legal framework for the regulation of security interests in moveable property[4] - a framework which reflected the influence of Article 9 of the Uniform Commercial Code of the United States of America.

3. In 1973 The Government published its intention to implement, for the whole of Great Britain, the Crowther Committee's recommendations relating to consumer

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[1] As from 20 October 1970 the Board of Trade was united with part of the dissolved Ministry of Technology and became the Department of Trade and Industry.

[2] Cmnd. 4596, 1971.

[3] Part Six of the Crowther Report.

[4] Part Five and Appendix III of the Crowther Report.

protection,[1] and thereafter to consult on the Committee's proposals for reforms in the general law of security over moveable property.[2]

4. Concern was expressed in Scottish legal circles that the reforms relating to security over moveable property recommended by the Crowther Committee might be applied to Scotland without regard to the profound differences between English and Scottish security law and the legal concepts involved.

5. Accordingly as a result of these recommended reforms put forward by the Crowther Report we set up, with considerable assistance from the Law Society of Scotland, a Working Party on Security over Moveable Property under the Chairmanship of Professor J M Halliday CBE, which consisted of practising solicitors with wide experience in commercial law, and Professor W A Wilson, Lord President Reid Professor of Law at the University of Edinburgh.

6. The terms of reference of the Working Party were as follows -

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[1]Paragraph 5 of the Government White Paper - "Reform of the Law on Consumer Credit", Cmnd. 5427. The consumer protection proposals were given legislative effect by the Consumer Credit Act 1974. The provisions of that Act were brought into force in stages by Commencement Orders, the last of which, the Consumer Credit Act 1974 (Commencement No. 8) Order 1983 (S.I. 1983/1551) brought into operation the final provisions of the 1974 Act (with the exception of sections 123-125 relating to negotiable instruments).

[2]Paragraph 14 of the Government White Paper.

"To consider the legal and technical problems which would arise or be likely to arise in the creation in Scotland of a system of security over moveable property in relation to all types of loans including consumer loans and to make recommendations in that respect."

7. The Working Party duly completed, and submitted to us, their Report in response to this reference. In formulating proposals for reform of the law in Scotland relating to security over moveables, the Working Party indicated that they had drawn to some extent upon the recommendations in the Crowther Report, and upon the principles adopted in Article 9 of the Uniform Commercial code of the United States of America as well as in the Ontario Personal Property Security Act 1967. They pointed out, however, that their approach to these sources had been selective, "adopting their solutions only to the extent necessary to make good within the field of commercial transactions the acknowledged deficiencies in the existing law".[1]

8. We should like to take this opportunity to express our gratitude to the Working Party for their Report, which puts forward for consideration one possible option for reform, and which, in our view, makes an important contribution to an understanding of the difficult problems associated with our security law.

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[1] Working Party Report, paragraph 22.

9. Following completion of the task of implementing the Crowther Report's recommendations on consumer protection, the Department of Trade and Industry have announced their intention to review for Great Britain the law of security over moveable property, indicating that the natural starting-off point for this project should be the proposals put forward for reform in this area by the Crowther Report.

10. Professor Aubrey Diamond, recently retired Director of the Institute of Advanced Legal Studies, who has lectured and written on the law of security, and is regarded as a leading British authority on Article 9 of the American Uniform Commercial Code, has been appointed by the Department of Trade and Industry to examine the need to reform the law governing securities over moveable property and to make recommendations by the end of 1986 as to the nature of any reforms required. The terms of reference of this review are as follows:-

"(a) to examine the need to reform the law relating to mortgages and charges over and other interests in property other than land, including those arising from hire purchase and sale with retention of title and in Scotland securities over moveables;

(b) to consider the case for a single scheme of registration for such interests and in particular to consider the position of the registration of charges created by companies in the context of such a scheme; and

(c) to make recommendations as to the nature of any reforms required and as to how work in this area might best be carried forward.

In so doing:

(i) to consult the Law Commissions as necessary;

(ii) to take account of the proposals in Part V of the Crowther Report;

(iii) to take account of the desirability to have, so far as practicable, a uniform law throughout Great Britain; and

(iv) to take account of the need to minimise the burden on public resources whilst adequately protecting the interests of lenders, borrowers, creditors and the general public."

11. Mr A J Sim, a recently retired senior member of our legal staff with extensive knowledge of this field of law, has also been appointed by the Department of Trade and Industry to participate in the above review. He will be primarily concerned with the Scots law aspects of this exercise. It is understood that arrangements will be made to set up a panel of experts in Scotland, who will be available for consultation during the course of the review.

12. In order to assist the Review Team in the furtherance of their project we have forwarded to Professor Diamond a copy of the Working Party's Report on Security over Moveable Property. We understand that it is the intention of the Review Team during the course of this year to consult with persons and bodies in Scotland and elsewhere in Great Britain who have an interest in security law. In these circumstances we consider it only right that our Working Party's Report should also be available to the Scottish consultees to assist them in responding to that consultation. With this in mind, we have decided,

with the agreement of Professor Diamond and the Department of Trade and Industry, to publish the Report at this time. We wish to make it clear, however, that the views expressed in the Report are those of the members of the Working Party and do not necessarily represent the views of the Scottish Law Commission. Nevertheless, we hope that the Report will form a useful source of information for those who wish to consider and to respond to the consultation paper which we believe the Review Team propose to issue shortly.

Scottish Law Commission
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REPORT

by

WORKING PARTY ON SECURITY OVER MOVEABLE PROPERTY

To: The Hon Lord Maxwell
Chairman
Scottish Law Commission

We have pleasure in submitting our report on Security over Moveable Property.

In submitting the Report we wish to pay tribute to the late George R H Reid, whose contribution to the creation of the Report was of outstanding value.

We also wish to record our indebtedness to our Secretary, Mr A J Sim, whose examination of source material, guidance on matters of policy and part in framing our Report were of immense assistance.

Signed: John M Halliday, Chairman
R B Jack
T Gardiner
Alex M Hamilton
Richard H Barclay
W A Wilson

A J Sim, Secretary
14 March 1983

REPORT

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WORKING PARTY ON SECURITY OVER MOVEABLE PROPERTY

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SCOTTISH LAW COMMISSION

REPORT

by

WORKING PARTY ON SECURITY OVER MOVEABLE PROPERTY

I. INTRODUCTION

1. We[1] were invited by the Scottish Law Commission after consultation with the Law Society of Scotland to examine the law relating to security over moveable property, our terms of reference being -

> To consider the legal and technical problems which would arise or be likely to arise in the creation in Scotland of a system of security over moveable property in relation to all types of loans including consumer loans and to make recommendations in that respect.

We have now completed our examination of the subject referred to us.

2. The setting up of the Working Party resulted from the recommendations contained in a Report (Cmnd. 4596 published in March 1971) by a Committee appointed under the chairmanship of Lord Crowther to examine the law relating to consumer credit. Those recommendations not only related to the specific protection of consumers in credit transactions but extended to the creation of an entirely new legal framework in connection with all loans secured over moveable property. The recommendations for the protection of the consumer (which are contained

[1] A list of our members is appended to this Report.

in Part Six of the Report) were largely given effect or provided for by the Consumer Credit Act 1974. There is no indication when, if at all, Government will implement the Committee's recommendations (in Part Five of the Report) for the creation of a new system of security over moveable property in relation to loans generally. In 1973 the Government issued a White Paper (Reform of the Law on Consumer Credit, Cmnd. 5427) in which, after accepting the recommendations of the Crowther Committee directed solely at the protection of consumers, they concluded, as regards the law relating to security over moveable property, that there was insufficient evidence "either of a need for such major recasting of existing law on new principles [as recommended by the Crowther Committee] or of general support for the particular solution proposed by the Committee." They therefore intended "to institute consultations with those most closely concerned in the light of the situation existing after passage of the Consumer Credit Bill". It appears unlikely that these consultations will be commenced in the foreseeable future.

3. The uncertainty as to whether the recommendations in the Crowther Report relating to security over moveable property will be implemented is increased by the possibility of intervention by the European law-making bodies, who are anxious that there should be some movement towards uniformity in the laws of the Member States in this field. In 1976 we submitted to the Scottish Law Commission (who, in turn, submitted to the Department of Trade) comments upon a draft directive on the recognition of securities over moveables put forward for consideration by the Commission of the European Communities. Work on that draft

Directive is no longer progressing, but in 1979 the Commission of the Communities issued a draft Directive for the purpose of regulating clauses in contracts for the sale of goods under which the title to the goods is reserved to the seller until the price has been paid. We also commented upon that draft Directive. The need to resolve certain questions of policy subsequently delayed its progress. The present position, as we understand it, is that the question of reservation of title to goods has been the subject of co-operation between the Commission of the Communities and the Council of Europe, and that the latter have issued for consideration a draft Convention on "simple" reservation of title affecting only international transactions. A further complicating factor is the EEC draft Bankruptcy Convention. Article 41 of that draft Convention makes provision as to the validity and effect of clauses of reservation of title to goods in the event of the bankruptcy of the buyer or the seller. It is a measure of the difficulty and controversy surrounding these clauses that Article 41 in its present form contains three variants, one of these being that the Bankruptcy Convention should contain no provisions at all relating to reservation of title clauses.

4. Progress on our work was interrupted by our consideration of the two draft Directives referred to in the foregoing paragraph. Our progress was also significantly delayed by our consideration, in conjunction with certain additional ad hoc members, of a request by the Scottish Law Commission and the Lord Advocate to examine the problem of provision of security in connection with the

financing of North Sea oil and related operations. That request was duly complied with and a special report on the subject was submitted by us to the Scottish Law Commission in September 1981. That report (along with certain observations by the Commission) was thereafter submitted to the Lord Advocate.

5. In formulating our proposals we have taken into consideration the Crowther Report, the White Paper on Reform of the Law on Consumer Credit and the two draft Directives and draft Bankruptcy Convention to which we have referred. In the field of comparative law we have studied Article 9 of the Uniform Commercial Code of the United States of America, the Ontario Personal Property Security Act and the First Report of the Contracts and Commercial Law Reform Committee of New Zealand on Chattels Securities. We have also had the benefit of a meeting with Mr Donald E MacKenzie, Vice President, General Counsel and Secretary of the Canadian Acceptance Corporation Limited and of further written advice from Mr MacKenzie.

6. In view of the uncertainty surrounding the implementation of the recommendations in the Crowther Report for the creation of a new system of security over moveable property and because we consider in any event that the creation of such a system in its entirety would be undesirable, we confine ourselves in this Report to setting out the main principles of a scheme that might be adopted to make good certain deficiencies in the law of Scotland. In setting out the principles of our scheme we have attempted to incorporate guidelines for their

application in practice, but we have not sought at this stage to develop the recommendations in detail. Our recommendations are summarised at the conclusion of the Report.

II. THE EXISTING LAW AND ITS DIFFICULTIES

7. The general rule of Scots law is that a fixed security over corporeal moveable property requires possession of the property by the creditor. It is customary to describe this possession in security as a pledge where it is created by agreement between the creditor and the debtor and as a lien where it is created by operation of law. Both common law and statute have admitted exceptions to the general rule but these exceptions are not numerous and do not substantially detract from the general rule.[1] Sellers of goods may safeguard themselves by employing quasi-security devices such as hire-purchase and conditional sale agreements but, although these devices are useful for the limited purpose of securing payment of the price of goods, they are not suitable for the provision of general business finance, for example, where the security offered is a large number of items which are constantly changing, such as stock-in-trade. Moreover, although hire-purchase and conditional sale agreements have obvious convenience for both the sellers and purchasers of individual items such as cars and television sets, statute has introduced special rules for the protection of the purchasers of motor vehicles which owe more to practical expediency than

[1] The main exceptions are certain conventional and legal hypothecs (notably the hypothec of a landlord over the invecta et illata of his tenant) and the facilities for creating securities over stocks of agricultural merchandise, ships and aircraft provided respectively by the Agricultural Credits (Scotland) Act 1929, the Merchant Shipping Act 1894 (ss. 31-46) and the Mortgaging of Aircraft Order 1972.

principle. Thus Part III of the Hire-Purchase Act 1964 confers special protection upon the private purchaser of a motor vehicle that is the subject of a hire-purchase or conditional sale agreement - a protection not given to the purchaser of any other article subject to such an agreement.

8. Some uncertainty has been created recently in the field of commercial contracts by the introduction into commercial contracts for the sale of goods of a clause of reservation of title, now commonly known as a Romalpa type clause, whereby an attempt is made to obtain security for payment of the price by reserving to the seller both the title to the goods and the proceeds from their sale until the seller has received the price.

9. In the leading English case, Aluminium Industrie Vaassen B.V. v. Romalpa Aluminium Ltd,[1] Dutch suppliers of aluminium foil successfully relied upon such a clause as creating a fiduciary relationship which entitled them to claim the unsold foil and the proceeds of sale of unmixed foil in a question with a receiver appointed over the assets of the purchasing company. Subsequent decisions in Borden (U.K.) Ltd v. Scottish Timber Products Ltd[2] and Re Bond Worth Ltd[3] indicate that where the goods supplied have been incorporated in other manufactured

[1] [1976] 1 W.L.R. 676, 2 All E.R. 552.
[2] [1979] 3 W.L.R. 672, 3 All E.R. 961.
[3] [1979] 3 W.L.R. 629, 3 All E.R. 919.

products the sellers are not entitled to invoke a clause of reservation of title to claim a share of the proceeds of sale of the other products.

10. The Scottish courts have been disinclined to recognise that such a clause creates a fiduciary relationship (Clark Taylor and Co. Ltd v. Quality Site Development (Edinburgh) Ltd)[1]. Lord Ross recently decided that a clause of reservation of title which also sought to make the customer (that is, the buyer) a trustee for the suppliers was an ineffective attempt to create a security without possession.[2]

11. Whatever may be the merits of the case for protecting unpaid sellers of goods, it seems clear that any such protection should be provided for them by means of a true security whose method of creation, effect and enforcement procedures are clearly defined.

12. The position under Scots law regarding securities over incorporeal rights is also unsatisfactory. Possession in the literal sense of a debt or of rights under a contract is clearly impossible, and the law requires instead that a secured party have a completed right to demand performance from the debtor. This is constituted

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[1] 1981 S.L.T. 308.

[2] Emerald Stainless Steel Ltd v. South Side Distribution Ltd (16th December 1981). The clause provided that until payment of the price and any other debt owed by the customer to the suppliers "the goods held by the customer and all products into which such items come to be converted or incorporated shall remain the property of the pursuers and shall be held by the customer as trustee for the pursuers". His lordship held that the clause could not be regarded merely as a clause of reservation of title but was truly an ineffectual attempt to create a security without possession by the machinery of a trust.

by assignation by the original creditor followed by intimation to the debtor. The obligation on the debtor thereafter is to render payment or performance to the assignee. This procedure is reasonably satisfactory and straightforward in the case of an assignation of a single debt or other benefit under an executed contract. the procedure has, however, the inherent disadvantage that a third party (for example, another prospective lender) has no independent means of satisfying himself as to the position. Moreover, intimation to the debtor becomes a clumsy and inconvenient procedure where there are a substantial number of individual debtors, as in the case of a sescurity over book debts. Again, assignation followed by intimation is an undeveloped and uncertain method of creating a security over contract rights in an executory contract, for example, the rights of a person who has contracted with a ship-builder to build a ship for him. The difficulty here is that the apparent effect of an assignation of the contract rights followed by intimation would be to divest the cedent and vest the contract rights wholly in the assignee. In that event, the assignee might become liable instead of or in addition to the cedent for the contractual obligations undertaken by him. It might also be to the assignee and not the cedent that the ship-builder would look for any instructions as to the method of proceeding. Accordingly, an assignee is faced with the invidious choice of not intimating the assignation (and so having an imperfect security) or of intimating it and perhaps incurring responsibilities which he would wish to avoid. There is, therefore, a need - as there is in relation to securities over corporeal moveables - for a true security whose method of creation, effect and enforcement procedures are clearly defined.

13. The creation of a floating charge over the assets of the borrower may not be an adequate or even an available solution because -

(a) those debts which in a winding-up must be paid in priority to all other debts also have priority over a floating charge;[1]

(b) fixed securities, even when created subsequently, may also have a priority in ranking;

(c) the borrower may deal with his property without reference to the creditor - so, for example, valuable assets consisting of rights under contracts or agreements may be altered or terminated and their value diminished or destroyed; and

(d) only an incorporated company or a society registered under the Industrial and Provident Societies Act 1965 may create a floating charge.

Although the subsequent creation of fixed securities having prior or pari passu ranking with the charge and dealings with the security assets may be prohibited or restricted in terms of the charge, the complex character of the assets charged may make it difficult to frame prohibitions or restraints upon dealings with the assets which are not unduly restrictive of operations.

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[1] See section 319(5) of Companies Act 1948 and section 19 of Companies (Floating Charges and Receivers) (Scotland) Act 1972.

III. ARTICLE 9 OF THE UNIFORM COMMERCIAL CODE AND THE RECOMMENDATIONS OF THE CROWTHER COMMITTEE

14. The primary questions of policy are whether and, if so, to what extent we should follow one of the major reforms proposed by the Crowther Committee, namely, that there should be introduced a comprehensive new system for the creation of security over all types of moveable property. The recommendations of the Committee (which are contained in Part Five of their Report) are based substantially upon the provisions of Article 9 of the Uniform Commercial Code of the United States of America (hereinafter referred to as Article 9). The Uniform Commercial Code is a comprehensive modernisation of statute law relating to commercial transactions. Uniformity throughout the various jurisdictions of the United States is one of the main objectives of the Code, which is intended to be a model exposition of commercial law. The Code applies in an American State only after it has been expressly enacted with or without amendments by the State legislature, but by 1972 Article 9 had been enacted in fifty-one jurisdictions. The Crowther Committee were greatly attracted to the scheme of Article 9, referring, for example,

> "to the outstanding merits of Article 9, which gave the common law world, for the first time, a comprehensive and rational legal structure for the regulation of security interests in personal property."[1]

The recommendations of the Crowther Committee accordingly embody (with some important variations) the essential

[1] Crowther Report, para. 5.1.5.

features of Article 9 as regards the creation of a filing system for the recording of security interests, the extent of the security afforded to the security holder and the remedies available to him on default by the debtor.

15. The aim of Article 9 is to create uniformity in the rights, remedies and obligations of the secured party and the debtor in contractual securities over moveable property. The scheme of the Article is to permit the parties to a security transaction to use any form of security device they choose, whether it be hire-purchase, conditional sale or a straightforward sale combined with an agreement to create security, but to regulate the rights and remedies of parties according to the true purpose of the transaction. If that purpose is the creation of security, Article 9 applies irrespective of the form of the transaction. Thus it is provided that -

> "the retention or reservation of title by a seller of goods notwithstanding shipment or delivery to the buyer is limited in effect to a reservation of a 'security interest'."[1]

16. Article 9 permits the creation of security interests in moveable property of every kind, corporeal and incorporeal. In order that there may be a security interest enforceable against the debtor - in order that in the terminology of Article 9 the interest may "attach" - there must be a security agreement, value must have been given, and the debtor must have "rights" (the extent of which is not defined) in the security subjects.[2]

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[1] Article 1 of the Uniform Commercial Code, section 1-201(37).

[2] See section 9-203(1) of Article 9.

"Perfection" or completion of the security interest so that it is valid in a question with third parties normally requires a further element - either possession of the security subjects by the creditor or the filing in the appropriate records office of a "financing statement" based upon the security agreement. Attachment may precede possession or filing or vice versa, but there must be both attachment and possession or filing before there can be perfection. An Article 9 security interest over moveable property that has been perfected by filing of a financing statement does not give the security holder the complete protection that is enjoyed by a creditor in possession of the security subjects. Thus, a "buyer in ordinary course of business" or a person with a lien over goods will generally be preferred to the holder of a filed security interest in the goods. In some cases, notably goods, perfection can be achieved either by filing or by possession (although the former has obvious conveniences for the granter of the security), whereas in the case of certain incorporeals (such as book debts) that are not normally evidenced by any writing - what the Crowther Committee call "pure intangibles" - perfection must necessarily be by filing. By contrast, only possession of the relevant document is available for the perfection of security interests in incorporeal items such as negotiable instruments and shares of incorporated companies.[1]

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[1] See Article 9, section 9-304(1). The Crowther Committee would, however, allow the option of filing in such a case - Crowther Report, paras. 5.7.45 and 5.7.76.

17. The classification of moveable property under Article 9 requires explanation. Corporeal moveables are divided into four groups or classes - "consumer goods", "equipment", "farm products" and "inventory".[1] Except in the case of "farm products", this classification is related not to the intrinsic nature of the goods but to their use or intended use by the buyer. Accordingly, the purchase by a dealer of television sets or washing machines is a purcahse of "inventory" (goods being classified as such if they are held by a person for the purpose of sale or lease). But when the dealer thereafter sells an individual television set or washing machine to a customer, the sale is a sale of "consumer goods" (goods being classified as such if they are used or bought for use primarily for personal, family or household purposes). Goods are classified as "equipment" if they are used or bought for use primarily in business or if they do not fall within another classification. Accordingly, the sale of typewriters or a photocopying machine to a firm of solicitors would be classified as a sale of "equipment". The reason for classification in the manner indicated is that the effect of the creation of a security interest in goods depends in a variety of situations upon the class or category to which the goods belong. The Crowther Committee would allow the filing of a security interest in "inventory" or "equipment" but not of a security interest in "consumer goods".

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[1] These expressions are defined in section 9-109 of Article 9.

18. Incorporeal moveables are subdivided into what the Crowther Report refers to as "documentary intangibles" and "pure intangibles".[1] A documentary intangible is an incorporeal moveable right whose existence is evidenced by a document which confers a title to the right upon the possessor or a specified person as, for example, a cheque, a stock or share certificate or a life insurance policy. In such a case Article 9 requires perfection of a security interest by possession of the document, and filing as a means of perfection is not available.[2] Pure intangibles consist of those incorporeal moveable rights where the existence of the right and the entitlement to it are not normally evidenced by any document (for example, book debts or copyright). In any such case possession is not a practical possibility and in consequence filing is the only available means of perfection.

19. Where Article 9 applies to a transaction (and, generally speaking, it applies to any transaction regardless of its form which is intended to create a security interest in personal property) the Article regulates the extent of the sescurity interest, the rights and obligations of the parties inter se and the effect of the security interest in a question with the competing interests of other creditors and purchasers. For example,

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[1] Crowther Report, Appendix III, Vol. 2 at p.575.

[2] The Crowther Committee would, however, allow the option of filing in such a case - see para. 16 above.

a "buyer in ordinary course of business" is unaffected by a security interest created by his seller.[1] Accordingly, a purchaser of a television set from a dealer who has created a secsurity interest over the goods in his shop (his "inventory") would not be affected by that interest. It would be unfair and impracticable to expect the purchaser to search the record of security interests. But the purchaser of what has been "equipment" (for example, a person who buys typewriters from a firm of solicitors who no longer require them) would not be a buyer in ordinary course of business (as the seller is not in the business of selling typewriters), and would take the typewriters subject to any security interest in them created by the solicitors. Accordingly, a prudent purchaser would search the record of security interests before buying the typewriters.

20. While the Crowther committee largely adopt the scheme of Article 9, they depart from the Article in a number of important respects. Perhaps the most important departure is that whereas Article 9 permits the filing of a security interest in consumer goods, the Crowther Committee would not allow the filing of such a security interest except where the item concerned is a motor vehicle, caravan, boat or something of a like nature. An unfiled security interest in consumer goods would, under the Crowther proposals -

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[1] See section 9-307(1).

> "be subordinated to the rights of a bona fide buyer for value (including a subsequent encumbrancer) but should be effective against the debtor's general creditors in a bankruptcy or winding-up."[1]

Accordingly, under the proposals of the Crowther Committee any bona fide purchaser of goods from a consumer would take them free of any security interest created by the consumer in the goods. In practical terms, this means that the purchaser of (say) a second-hand television set from a householder would not be affected by any security interest in the set created by the householder. The Crowther Committee also go further than Article 9 in proposing protection for any buyer of consumer goods against any filed security interest - protection against a filed security interest being available under Article 9 only where the buyer buys the encumbered goods "from a person selling in the ordinary course of business", and even in that event only against a filed security interest created by the seller. The Committee sum up their proposals for protection of the consumer as follows -

> "We have previously expressed the view (paragraph 5.7.21) that it would not be reasonable to expect a bona fide buyer of consumer goods to search a public file for the existence of a security interest affecting the goods. It will be borne in mind that whilst a security interest could not, under the rules previously formulated, have been filed in relation to the goods as consumer goods (see paragraph 5.7.21), a security interest might well have been taken and filed in relation to the goods as inventory. If they subsequently became consumer goods as a result of a consumer sale, the buyer

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[1] Crowther Report, para. 5.7.27.

> ought not to be affected by the filed financing statement. It follows that such a buyer should take free from a security interest granted by his seller or by a prior party, even if filed, unless he had actual knowledge that the disposition by the seller was in breach of the security agreement."[1]

The Crowther Committee also recommended that filing should not be available in relation to what they called "small-cost transactions", that is, transactions where the secured sum did not exceed £300[2] (a minimum amount that is no longer realistic).

21. The Crowther Committee recommended that the new security system should not at present apply where a special regime for the creation of security already exists:[3] the obvious examples are the creation of mortgages over ships and aircraft for which provision is made by the Merchant Shipping Act 1894 and the Mortgaging of Aircraft Order 1972 respectively. But those exceptions apart, the creation, effect and enforceability of any security interest in moveable property under a contract (whether a purely commercial contract or one to which a consumer was a party) would be governed by the new rules proposed by the Crowther Committee.

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[1] Crowther Report, para. 5.7.71.

[2] Crowther Report, para. 5.7.26.

[3] Crowther Report, para. 5.7.43.

IV. THE WORKING PARTY'S APPROACH TO REFORM

The general approach

22. In considering our proposals for reform we have taken into account the policy of the Government as stated in the White Paper on Reform of the Law on Consumer Credit (Cmnd. 5427) and subsequent legislation and in particular the Consumer Credit Act 1974. We have concluded that, without affecting the law relating to transactions involving consumers, there is a need for the introduction, within the field of commercial transactions, of a modern law of security over moveables without possession by the creditor, which would remedy the principal deficiencies of the existing law. Our proposals in that respect are based on a system of notice filing and in their formulation we have drawn to some extent upon the recommendations in the Crowther Report and also upon the principles adopted in Article 9 and in the Ontario Personal Property Security Act. In several important respects, however, our proposals differ significantly from the solutions propounded in the Crowther Report and from the systems operating in the United States of America and in Ontario. Our approach to these sources has been selective, adopting their solutions only to the extent necessary to make good within the field of commercial transactions the acknowledged deficiencies in the existing law, and we have avoided recommendations for the wholesale introduction into Scots law of concepts which are alien to its tradition and which might well be productive of confusion rather than conducive to commercial convenience.

The Government's policy

23. The White Paper (Cmnd. 5427) stated that the Department of Trade were not convinced that there was sufficient evidence of the need to reshape the law as proposed by the Crowther Committee or of general support for their proposals. They therefore intended to institute consultations in due course "with those most closely concerned". The Department also stated that there might be social disadvantages for some consumers if it became easier for them to give security by "chattel mortgage", the descriptive term of English law for a security over moveable property which remains in the debtor's possession. The White Paper also stated that it was proposed to retain in law the concept of hire-purchase and not, as the Crowther Committee recommended, to treat a hire-purchase transaction as though it were an immediate sale of goods financed by a loan secured over the goods. These expressions of Departmental opinion suggest that there is little probability of the introduction in the United Kingdom of a comprehensive scheme for the creation of security over moveable property incorporating a register of security interests as proposed in the Crowther Report.

24. We accept that, in the area of consumer transactions, there are grounds for misgiving as to the introduction of a facility for loans to consumers which might make such transactions easier to the ultimate detriment of some consumers, and that the comparatively recent detailed legislative provisions for hire-purchase and consumer credit should continue in operation at least until experience has demonstrated their utility or disclosed any serious deficiencies. In the area of commercial

transactions, however, the situation, especially in Scotland, is substantially different. We have already rehearsed in Part II of this Report the difficulties under existing law in relation to the creation of securities over moveables. The practical position in England may not be significantly different as regards the creation of securities over corporeal moveables[1] but in Scotland there are no facilities such as exist in England for the creation of equitable securities, notably by agreement coupled with possession of a document evidencing the right assigned in security. The absence of a comprehensive and satisfactory method of creating fixed securities over valuable moveable assets without the requirement of delivery to the creditor (or its equivalent) makes it difficult to obtain loans for commercial purposes on the most favourable terms. The remedy in our view lies not in the adoption of the equitable security, which is based on a concept of English law which is foreign to the principles of the law of Scotland, but rather in the introduction of the system outlined in the following paragraph.

Outline of proposals

25. We recommend the introduction of a system for creating security over moveable property based upon the establishment of a register of security interests with

[1] Securities over corporeal moveables without possession can be created in England under the provisions of the Bills of Sale Acts 1878 and 1882, but it is understood that in practice these Acts are not widely used.

notice filing. Details of the scheme and our reasons for them are set out in Part V but it is convenient to indicate here its principal features.

(1) There would be no requirement of possession of the security subjects by the creditor. Certain categories of transactions (as described below)[1] would be excluded from the scheme. Securities in the excluded sector would continue to be regulated by the existing law.

(2) Within the sphere of its application the scheme would be mandatory for the creation by agreement of a valid security save that it would remain competent to create security over corporeal moveables by way of pledge.[2]

(3) Rules would be provided under the scheme with regard to the form and content of a loan agreement and the requirements for the security to "attach" to the security subjects so as to be valid as between the creditor and the debtor and for it to be "perfected" so as to be valid also in questions with third parties.

(4) Provision would be made for the establishment of a register of security interests and for filing

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[1] See paras. 29 to 31.

[2] "Pledge" should be taken to include both the case where there is actual physical delivery of the security subjects and the case where constructive or symbolical delivery is effected by the transfer of documents of title to the subjects. Where documents of title are transferred, the result may be to give a right of property (and not merely a right of pledge) to the secured party - see "Pledge of Bills of Lading in Scots Law" by Dr Alan Rodger 1971 Juridical Review 193 and cases therein mentioned.

of notice of the creation of a security, this being an essential element of perfection of a security under the scheme.

(5) The extent and effect in law of a security under the scheme would be defined.

(6) Provision would be made for regulating the priority of the security in questions between the creditor and third parties.

(7) Provision would also be made for the enforcement, transfer and discharge of the security.

Comparison with the proposals of the Crowther Report and with Article 9

26. The fundamental features of the scheme which we propose are based upon the scheme recommended in the Crowther Report, which in turn adopted to a large extent Article 9, but our proposals differ from both in certain important respects. These divergences, and the reasons for them, are noticed and explained in the relevant paragraphs in Part V of this Report, but it may be useful to mention some of the most material differences here. These are:

(1) The restrictions and exclusions proposed by us (particularly the proposed exclusion of transactions relating to consumer goods) would in effect restrict the application of our scheme to major commercial transactions with security over moveables.

(2) We disagree with the proposal that the parties should be free to use any form of agreement they choose but that the effect of the agreement should be regulated by statute irrespective of

the form used. We suggest that a specimen form of agreement should be provided but that any form of agreement which contains certain essential particulars should be effective.

(3) We do not consider that it should be competent to create a security interest in incorporeal moveable property by agreement coupled with possession of a non-negotiable document evidencing the debtor's right such as a share certificate or policy of assurance.[1] Nor would we recommend that filing in the register of security interests should supersede existing methods of completing a security interest in incorporeal moveable property except where an existing method is clearly cumbersome or inappropriate, for example, intimation of an assignation of multiple book debts or of certain rights under contracts. Filing involves formalities and has a number of disadvantages, notably that it is effective to perfect a security only for a defined period, the period which we recommend being five years.[2]

(4) We do not adopt in their entirety the complex proposals of the Crowther Committee and Article 9 in relation to tracing a security interest through to proceeds.

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[1] This is, of course, the concept of the equitable mortgage - see para. 39 below.

[2] Renewal for successive periods of five years would be competent - see para. 56 below.

(5) We agree with the Crowther Committee that any person who buys goods from a person selling in the ordinary course of business should be protected not only against a security interest created by the seller but also against a sescurity interest created by any prior party. (Under Article 9 a buyer in ordinary course of business is protected only against a security interest created by the seller.) On the other hand, we do not consider that a buyer of consumer goods who does not purchase them in the ordinary course of the seller's business should receive greater protection against filed security interests than any other buyer of goods. (Under the Crowther Committee proposals any buyer of consumer goods would be protected against a filed security interest created by the seller or by any prior party.)

V. THE WORKING PARTY'S PROPOSALS

27. From the experience of the operation of Article 9 in the United States of America and the fact that it has been adopted by almost all States in that country, and from the arguments in favour of a similar system contained in the Crowther Report, we accept that the introduction in Scotland of a scheme for the creation of security over moveable property on broadly similar lines would be advantageous. The scheme which we suggest, however, is not of universal application but restricted to the areas where reform of the existing law of Scotland is most required.

A. FIELD OF APPLICATION

Scope of scheme

28. Our objective in proposing the new scheme is to make provision for the creation of securities over moveables in areas where the existing law of Scotland is unsatisfactory. Primarily that is the field of commercial transations where security is required over specific corporeal moveables which it would be impracticable to deliver to the creditor seeking security or to leave in his possession, changing stock-in-trade, book debts, rights under contracts or other valuable assets of the debtor. It would be difficult to define satisfactorily the great variety of commercial lending transactions for which a more satisfactory form of security over moveable property is desirable, and so we have proceeded by way of making the scheme generally applicable to transactions for the creation of security over moveable property, subject to the exclusion of specified categories of transactions[1] for which, for reasons of policy or

[1] See para. 31 below.

because existing forms of security are adequate, we do not propose change in the existing law.

29. We envisage that in the field of securities over corporeal moveables, the subjects of security would generally be "inventory" or "equipment" within the meaning given to these expressions in section 9-109 of Article 9.[1] We propose, however, that, where the subjects of security are "equipment", there should be excluded from the scheme transactions where the amount of the secured loan (excluding interest) does not exceed such amount as may be prescribed by order made by statutory instrument.[2] The prescribed amount might, we suggest, be fixed initially at £5,000.[3] The reason for the recommended exclusion is that we wish to prevent, so far as possible, the proposed register of security interests being over-burdened with relatively small transactions.[4] We do not propose, however, that the exclusion should apply where the subjects of security are "inventory", because the changing nature of the security subjects could often

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[1] See para. 17 above for an explanation of the meaning of the expressions "inventory" and "equipment". We consider that the formula "used or acquired for use" is preferable to the formula "used or bought for use" employed in the Article 9 definition of "equipment" - see Crowther Report, para. 5.7.25.

[2] The exclusion should not apply where the amount of the loan is indefinite.

[3] This is the present credit limit under a consumer credit agreement to which the Consumer Credit Act 1974 applies.

[4] In the majority of excluded cases, hire-purchase or conditional sale would accommodate the borrower's needs.

result in an initial loan of an amount which happened to be less than the prescribed amount being increased to an amount that exceeded the prescribed amount. An increase of the amount of the secured loan might, of course, also occur where the subjects of security are "equipment", but it is likely to happen less frequently.

30. In the field of securities over incorporeal moveables we envisage that the proposed scheme should apply primarily to debts and rights of all kinds under commercial contracts or agreements, that is, any right to payment or performance or other entitlement or interest under such a contract or agreement. In this area we do not propose to restrict the scope of the scheme by a requirement of any minimum amount of loan, since it would be undesirable to deny the benefit of the new form of security to any transactions relating to security over book debts (where the existing forms of security are not satisfactory). As regards advances on the security of rights under continuing contracts, the exclusion could create unjustified inconvenience where an initial loan was increased as the contract progressed and the value of the borrower's rights under it became enhanced.

Excluded transactions

31. We have already mentioned[1] that certain categories of transactions should be excluded from the scheme. The categories of transactions which should be excluded

[1] See paras. 25 and 28 above.

would require to be adjusted after consultation with appropriate organisations such as banks and other commercial lenders but provisionally we suggest the following -

(1) Transactions involving the creation of security interests in consumer goods. Article 9 and the Crowther Report classify goods as "consumer goods" where they are used or acquired for use primarily for personal, family or household purposes.[1] Article 9 permits a security interest in consumer goods to be filed in the register of security interests, but the Crowther Committee would not permit filing of such an interest.[2] A security interest for which filing is not available has only a restricted effect.[3] We think it preferable that security (or quasi-security) transactions relating to consumer goods should be excluded from the scheme (as its function is to cater for commercial transactions) and continue to be effected by hire-purchase, conditional sale or other method regulated by the existing law.

(2) Transactions where the security subjects are equipment and the amount of the secured loan does not exceed a prescribed amount. The reason for this proposed exclusion has already been explained.[4]

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[1] See section 9-109 of Article 9 and Crowther Report, paras. 5.7.24 and 5.7.25, also para. 17 above.

[2] Crowther Report, para. 5.7.22.

[3] See para. 20 above and Crowther Report, para. 5.7.27.

[4] See para. 29 above.

(3) Securities over subjects for which adequate statutory facilities involving special registers already exist. These would include mortgages over ships registered under the Merchant Shipping Act 1894, aircraft mortgages under the Mortgaging of Aircraft Order 1972, agricultural credits under the Agricultural Credits (Scotland) Act 1929, securities over patents under the Patents Act 1977 and securities by way of assignment of trade marks under the Trade Marks Act 1938.

(4) Corporate securities. We do not favour proposals on the lines indicated in paragraphs 5.7.44 to 5.7.46 of the Crowther Report for inclusion within the filing system of corporate securities such as stocks and shares of incorporated companies or securities of government of public or local authorities. Such securities can be created satisfactorily by existing methods based upon the registers of the companies or authorities concerned.

(5) Commercial paper. We should exclude from the ambit of the proposed scheme negotiable instruments and rights under bills of lading, delivery orders, warehouse receipts and other documents where delivery of the document (with or without any necessary endorsements) effects a transfer of rights in the goods represented by the document.

(6) Securities over assets not normally used in commercial transactions. Examples are securities over life assurance policies and interests in trust estates which can be created satisfactorily by assignation and intimation under the existing law and are normally used in relation to borrowing for private or personal purposes.

The proposed scheme relates to the creation of fixed securities. Floating charges are outwith its scope and nothing in the new scheme would affect the operation of the Companies (Floating Charges and Receivers) (Scotland) Act 1972.

Book debts

32. The application of the proposed scheme to securities over book debts requires special consideration. These debts may be unsecured or may be secured over moveable property such as debts under hire-purchase agreements and conditional sale agreements. Because of the difficulty in distinguishing between assignations of book debts in security and sales of book debts (which may often be qualified by recourse arrangements or warranties which make them virtually security transactions), Article 9 applies to "any sale of accounts or chattel paper"[1] subject to a number of detailed exceptions.[2] The Crowther Committee agree with the scheme

[1] Section 9-102(1)(b).

[2] See section 9-104(f).

of Article 9 in that matter and have explained its rational basis.[1] The Ontario Personal Property Security Act applies to every assignment of book debts intended as security and also to every assignment of book debts not intended as security other than an assignment for the general benefit of creditors.[2] We are in broad agreement with the reasoning which underlies those provisions, but we favour a rather simpler arrangement. We recommend that our proposed scheme should apply to any transfer in security or on sale of book debts other than a sale of book debts as part of a sale of a business.

After-acquired property

33. Both the system of security in moveable property created by Article 9 and that recommended by the Crowther Committee permit the creation of a true fixed security (as where the security subjects are specific items of property) or a security that is akin to a floating charge (as where the security subjects are existing and future property of a specified kind or are wholly future property). Section 9-204(1) of Article 9 provides that -

> "... a security agreement may provide that any or all obligations covered by the security agreement are to be secured by after-acquired collateral."

This provision is complemented by section 9-108 of Article 9, which provides that when certain conditions are satisfied, "after-acquired collateral" is not to be regarded as security for an antecedent debt.

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[1] Crowther Report, Appendix III, Vol. 2 at p.576.

[2] See section 2.

Section 9-108 is as follows -

> "Where a secured party makes an advance, incurs an obligation, releases a perfected security interest, or otherwise gives new value which is to be secured in whole or in part by after-acquired property his security interest in the after-acquired collateral shall be deemed to be taken for new value and not as security for an antecedent debt if the debtor acquires his rights in such collateral either in the ordinary course of his business or under a contract of purchase made pursuant to the security agreement within a reasonable time after new value is given."

34. The Crowther Committee comment that "it is vital to provide a form of security which will attach automatically to after-acquired property", pointing out that the equitable assignment makes this possible at present under English law.[1] The floating charge is, of course, a species of equitable assignment, and the principle that a creditor may take a security interest in after-acquired property has thus been conceded in Scots law. We recommend, therefore, that it should be competent for a secured party to take a security interest not only in the existing property of the debtor but also in property which the debtor may acquire in the future. A security interest in after-acquired property would inevitably constitute security for a pre-existing debt and as such be vulnerable to challenge as an illegal preference, particularly if the bankruptcy or winding-up of the borrower occurred within six months after the acquisition by him or it of the after-acquired property. We think it reasonable that the lender should be protected against this hazard where he does in fact give "new value" for a security interest in property which consists in whole or in part of after-acquired property. We accordingly

[1] Crowther Report, para. 5.6.5.

recommend that a security interest in after-acquired property should not be regarded as security for a pre-existing debt (a) where the secured creditor has given value for the security provided in whole or in part by the after-acquired property, and (b) the after-acquired property is acquired by the debtor in the ordinary course of his business. It would also be necessary for the security agreement and financing statement (in addition to containing a specific or generic description of the property involved) to show that the security subjects consisted of, or included, after-acquired property.[1]

35. There is one special case that should be mentioned. Creditor A may lend money to debtor B on the security of his existing and after-acquired property of a certain description (which will usually be, but will not necessarily be, inventory). Suppose, however, that creditor C thereafter lends money to debtor B to purchase an additional quantity of property of that description, the loan by C being secured by a security interest in that additional property. In these circumstances it would be unfair that the security interst of creditor A in all property of the kind described in his financing

[1] After-acquired property is to be distinguished from "proceeds", which represent the continuation of the security subjects in some other form (for example, the debts resulting from a sale of the subjects). After-acquired property is available as security only if it is acquired in the ordinary course of the debtor's business, but there is no necessity for it to be derived from previous security subjects: it is sufficient that the debtor has acquired the property and that it falls within a descriptive category in the security agreement and financing statement.

statement should be enlarged at the expense of creditor C. Accordingly, the security interest of C in the additional property purchased with the money supplied by C (and in the proceeds of that property) will take precedence over the security interest in the property enjoyed by A, provided that certain conditions are fulfilled. We discuss the matter further below.[1]

Demarcation

36. We propose that, within the field of its application, the foregoing method of creating a security over moveable property should be the only permissible way of creating a security by agreement, apart from pledge of corporeal moveable property. We consider that such a provision is desirable in the interests of clarity and uniformity. Conversely, in the case of transactions excluded from the scheme, the procedures under the scheme and filing in the proposed register of security interests would be incompetent and the methods permitted or required by the existing law would be appropriate. In a case where a hire-purchase or other reservation of title agreement was employed in a transaction to which the new scheme applied (i) it would be unenforceable and the agreement would have effect (notwithstanding its terms) as an immediate sale of the goods to the debtor, (ii) the debtor's personal obligation to make payment would remain in force in accordance with the terms of the agreement, e.g. by the instalments stated in the hire-purchase document, and (iii) the creditor could require the debtor to enter into a valid security agreement in appropriate form which would receive appropriate

[1] See para. 61(4). See also Crowther Report, paras. 5.7.73 and 5.7.74.

effect only when the requirements for attachment or perfection under the proposed new scheme were satisfied. Conversely, where the parties to a transaction excluded from the scope of the proposed new scheme purported to create a security in the form prescribed in the new scheme it should not be accepted for filing in the proposed register of security interests. The personal obligation of the debtor would not be prejudiced by the inept security.

37. Where there was a security agreement which related partly to things which were within the scope of the new scheme and partly to things excluded from it, e.g. where the security subjects were expressed as including equipment of a business and also ships, filing would be effective in creating a valid security over the equipment but not over the ships. If a creditor wished to obtain an effective security over the "excluded" items he would require to do so by the appropriate method.

B. THE CREATION UNDER THE SCHEME OF A SECURITY INTEREST AND THE REGISTER OF SECURITY INTERESTS

Introductory

38. Having indicated in broad outline the nature of the scheme which we propose and the field of its application, we now develop in more detail the method of creation under the scheme of a security interest (that is, its documentation and the rules for its attachment and for its completion or "perfection" by attachment conjoined with filing of a financing statement) and the structure and operation of the filing system.

Documentation

39. The Crowther Committee recommended that a security interest should not be enforceable against the debtor or a third party unless -

> "i. the creation of the security interest is evidenced by a memorandum in writing which reasonably identifies the security and which is signed by or on behalf of the debtor; or
>
> ii. the secured party has by agreement of the debtor taken possession of the security or of documents representing it."[1]

The Crowther Committee explained that "if a security interest is created by deposit of the security or documents representing it - as where life assurance policies or hire-purchase agreements are deposited with a bank by way of security - no written instrument is necessary, since possession is given to the secured party."[2] This reference to the deposit of documents is, of course, a reference to the equitable mortgage, which (as the Crowther Committee recognise) does not extend to Scotland. Under English law the deposit must be supported by an agreement that it was in fact made for the purpose of creating security, but this agreement may be oral or simply inferred from the circumstances. The equitable mortgage is binding upon any subsequent purchaser or mortgagee who knows or ought to know of its existence. Our view is that to introduce this concept into Scots law would be to create uncertainty. In our view the only method of creating the new security[3] should

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[1] Crowther Report, para. 5.6.1.

[2] Ib., para. 5.6.2.

[3] We use the expressions "new security" and "new security interest" for the convenient description of a security under our proposed scheme.

be by an agreement in writing between the parties. It would, as we have already mentioned,[1] remain competent to create a security over corporeal moveables by the existing method of the creditor taking delivery (actual, constructive or symbolical) of the security subjects, but in the area where the new security applies a written agreement would be essential for creating security without possession by the creditor.

40. The Crowther Committee (adopting in this respect the scheme of Article 9) recommended that the parties to a transaction which was intended to create a security interest in moveable property should be free to use whatever method they might care to employ, whether it took the form of hire-purchase or conditional sale agreement or expressly bore to be a security agreement. But whatever the form used, the rights, obligations and remedies available to the parties would be regulated in the same way if the purpose of the transaction was to create a security interest in moveable property. The approach is explained thus in the Crowther Report -

> "The assimilation of the various forms of security interest in personal property is in no way intended to force parties into selecting a particular form of financing instrument. On the contrary, it should be the aim of the law (except as modified by a consumer protection statute) to allow the parties the widest freedom and informality in entering into contractual relationships. The purpose of the new law here proposed is thus not to impose any particular form of agreement on a party but simply to ensure that, whatever form the parties select, the rights and duties of the parties will be regulated according to the purpose and substance

[1] See para. 25 above.

> of the transaction. Hence the parties would be free, if they were used to the hire-purchase agreement, to continue employing that form of agreement instead of a chattel mortgage. But the law would nonetheless view the transaction as a security transaction and regulate the rights of the parties on this basis in just the same way as if they had used a chattel mortgage."[1]

We find this approach unattractive. There is a certain contradiction in stating that the parties may enjoy "the widest freedom and informality in entering into contractual relationships" and then to stipulate that if the true purpose of a contract is the creation of a security interest in moveable property, the rights and obligations of the parties will be regulated by statutory rules external to the contract. We accept that it would be undesirable to prescribe a form of agreement which would be strictly mandatory and that there should be flexibility to accommodate commercial security transactions in varying forms appropriate to differing circumstances. On the other hand we consider that it would be of help to practitioners, and would facilitate uniformity, if a specimen ~~form of loan agreement~~ with security were prescribed, but that any form of agreement which contained the essential particulars stated in paragraph 41 should be permissible.

41. We suggest that the loan agreement should be executed by the creditor and the debtor and that the specimen form of agreement should contain the following essential elements: (a) identification of the creditor and debtor,

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[1] Crowther Report, para. 5.2.15.

(b) a description of the debt secured (which could be a specific or fluctuating amount or comprehensive of all moneys due or to become due under the agreement, and could be ascertained by reference to a separate document where that course was convenient), (c) an identifying description of the security subjects (which could be changing subjects such as inventory), (d) a clear indication that the purpose of the document was the creation of security over these subjects, and (e) the date (or dates) of execution of the agreement. Any written agreement which contained these essential particulars would be effective, notwithstanding that it did not conform precisely to the specimen form prescribed.

42. The legal effect of the use by parties of an inappropriate document has already been considered in paragraph 36 above.

43. Our proposals apply only to security transactions within the field to which the new scheme applies. They would not affect the validity of, for example, a genuine leasing agreement which was not employed as a device to evade the rules governing the creation of securities.

Attachment

44. The concept of Article 9 and the Crowther Committee is that the mere existence of a security agreement should not make the security interest effective against the debtor or "fasten on" to an identified asset. Before there can be "attachment" (to use the Article 9 expression) there must also be value given by the creditor to the

debtor and the debtor must have acquired "rights" in the security subjects.[1] Neither Article 9 nor the Crowther Report specifies the nature of the rights which must have been acquired, but we envisage that it should suffice that the debtor has a right of any kind that he could dispose of for value. In general, the creditor could claim no higher right than that enjoyed by the debtor. The creditor should, however, enjoy the benefit of the various statutory provisions which give protection to a good faith acquirer for value. This is important in the context of the legislation relating to the sale goods and the powers of mercantile agents. For example, where a person who has sold goods continues in possession of the goods or of the documents of title to them, "the delivery or transfer by that person, or by a mercantile agent acting for him, of the goods or documents of title under any sale, pledge or other disposition thereof, to any person receiving the same in good faith and without notice of the previous sale" is as effective as a delivery or transfer by the true owner.[2] Similar provision is made for the converse case of a sale, pledge or other disposition by a buyer who is in possession of the goods or documents of title with the consent of the seller.[3] Provisions of a similar kind are also found in the Factors Act 1889 as applied to Scotland by the Factors (Scotland)

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[1] See Article 9, section 9-203(1) and Crowther Report, Appendix III, Vol. 2 at p.578.

[2] Sale of Goods Act 1979, section 24.

[3] Ib., section 25.

Act 1890. We consider that where (as in the instances mentioned above) a person in possession of goods or of the documents of title to them can create an effective pledge thereof, any new security interest in the goods created by that person should likewise be effective. Subject to the foregoing comment upon the requirement that the debtor must have acquired rights in the security subjects, we agree with the recommendation by the Crowther Committee that there cannot be attachment without value given by the creditor and the debtor having rights in the security subjects. The question whether there has been attachment may well be important both as regards the determination of priority as between two unfiled security interests and also as regards a competition between a filed security interest and the interest of a third party (such as a purchaser for value or trustee in bankruptcy). The reason is that there must be both attachment and filing of a new security interest before there can be "perfection" (that is, completion) of the security interest so as to make it effective not only against the debtor but also against third parties. In a case where the filing precedes attachment (which is permissible under both Article 9 and the recommendations in the Crowther Report) it could be of vital importance in a competition between the creditor in the filed security interest and a third party to determine whether there had also been attachment at the date when the debtor (say) disposed of the agreed security subjects to a purchaser or became bankrupt. Attachment (but not, of course, filing) is also necessary to give the creditor the right to exercise his remedies in relation to the security subjects on default by the debtor. Our proposals

in connection with these remedies are set out later in this Report.[1]

Perfection by filing of a financing statement

45. The distinctive feature of Article 9 and of the scheme recommended by the Crowther Committee is that it enables a creditor who does not have possession of moveable property to perfect a security right by public notice through the filing of a "financing statement" giving particulars of the security in a public register of security interests. This has the additional advantage of enabling third parties to know what security interests a debtor or prospective borrower has already created over his assets generally or any particular asset. Moreover, it enables the security to embrace, to the extent which we suggest in paragraph 62(2), proceeds of sale of goods covered by the security. As we have already indicated, we consider that there is a need for the introduction of such a system in Scotland to the limited extent already indicated.

The structure and operation of the register of security interests

46. The Crowther Committee recommended that the register of security interests in which financing statements would be filed should be administered by the Consumer Credit Commissioner.[2] "The Consumer Credit Commissioner" was the name given by the Crowther Committee to the official

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[1] See paras. 64 to 79 below.

[2] Crowther Report, paras. 7.4.8 to 7.4.10.

to be appointed to administer the new system of consumer credit proposed by them.[1] The Committee recognised that there was a slight anomaly in their recommendation in respect that the administration of the register was, under their proposals, a function that lay partly in and partly outside the field of consumer credit. But the Commissioner's various duties would bring him into contact with the great majority of the secured parties (that is, the financial institutions of the country) and the anomaly would exist, in the opinion of the Committee, "more in the realm of logic than of practice".

47. Since the system of filing of financing statements must cater for filing in relation to both specific items of moveable property and groups of items identified by type and location, particularly "inventory", a description in the financing statement of individual items of moveable property would not always be practicable. It must therefore be permissible to specify individually or to describe generically in a financing statement the item or items forming the security subjects. This leads to the conclusion that the proposed register of security interests cannot incorporate an index of security subjects themselves but must be operated by reference to the name of the debtor by whom the security interest is created. This has the disadvantage that, unless a person who inspects the register of security interests is prepared

[1] The Consumer Credit Act 1974, which made provision for a system of consumer credit on the lines recommended by the Crowther Committee, entrusted the administration of the system to the Director General of Fair Trading appointed under the Fair Trading Act 1973.

to put himself to a great deal of trouble, he will discover only the existence or otherwise of security interests created by the owner of the subjects with whom he is negotiating. The position is summed up as follows in the Crowther Report:

> "We therefore conclude that title registration is impracticable and that a registration or filing system must be limited to security interests. The registration of such interests is effected not against the security but against the name of the debtor by whom the security interest is granted. The corollary is, of course, that the system does not give such complete protection to a subsequent buyer or encumbrancer as a title registration system, since security registration can only show whether a prior security interest has been granted by the person who is disposing of or charging the goods; it will not reveal security given over the goods by a prior owner. The same limitation applies to dealings in unregistered land. A prospective purchaser has no way of discovering the existence of undisclosed land charges created prior to the root of title, since he does not know the names against which to search. In practice however this limitation does not usually give rise to any serious problems; and we think that registration of security interests in personal property would be both useful and practicable, provided that certain classes of transaction were excluded."[1]

The problem then becomes how one identifies with certainty the debtor because many people have the same name and it is also possible that two people having the same name could be located at the same address. Apart from this, there is the obvious risk of fraud by the creation of assumed identities. Accordingly, an individual proposing to create a security interest should be required to specify, in addition to his name and address, his national insurance number (if any) and his date of birth. Each individual debtor would be given a registration number.

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[1] Crowther Report, para. 5.7.20.

48. The register of security interests should, in our opinion, be a new independent register consisting only of filed financing statements and related documents and necessary indices etc. (It is no doubt for consideration whether, in the case of a new security created by an incorporated company, registration under section 106A of the Companies Act 1948 should also be required.[1]) It is implicit in the recommendation of the Crowther Committee that the proposed register of security interests should be operative throughout Great Britain. The Committee do not, however, discuss the question of the location (or locations) of the register or the rules for determining the proper place for the filing of a financing statement or the applicable law for the perfection of a security interest containing both English and Scottish elements. The Committee may have thought that these questions were either matters for subsequent decision or of secondary importance if the law for the creation of security interests in moveable property were the same throughout Great Britain. We accept that the questions cannot be profitably considered until there is a policy decision as to the geographical extent and the substance of the proposed legislation. We do no more, therefore, than make some comments of a general nature on the questions.

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[1] A standard security created by a company must be registered in both the Register of Sasines (or Land Register) and the Register of Charges, and it might appear consistent to impose a similar requirement for double registration in the case of a new security created by a company. But the list of securities for which registration under section 106A of the 1948 Act is at present required is incomplete and does not have any obvious systematic basis.

49. The law of Scotland relating to the creation of security over moveable property is so fundamentally different from that of England, and the scheme recommended in this Report is so preoccupied with overcoming the problems associated with the creation of such security under Scots law, that a register of security interests to accommodate the requirements of our scheme would probably be inappropriate in the context of any other legal system. The register of security interests envisaged by the Crowther Committee would, for example, accommodate the filing of security interests in many instances where filing would not be available under our scheme.[1] But in view of the general uncertainty surrounding the implementation of the recommendations in the Crowther Report[2] we cannot usefully say anything more at this stage. Our provisional view is that the most acceptable system for Scotland would be one based on a central register in Edinburgh but with facilities for the filing of financing statements and related documents, and for the obtaining of information about filed security interests, in Glasgow and other principal centres of business in Scotland. Computer linkage should enable the filing arrangements at the various filing offices to be co-ordinated and for full information about all filed security interests to be available at each of these offices. In order that the register may be kept up-to-date we recommend that there should be a duty, sanctioned if appropriate by a monetary penalty,

[1] See paras. 16, 18 and 31 above. For example, the Crowther Committee would allow the filing of a security interest in company shares or in a cheque.

[2] See paras. 1 to 6 above.

upon both the debtor and the creditor in a filed security interest to notify the keeper of the register of any change of name or address.

50. Transactions relating to moveable property which involve or result in the involvement of more than one system of law inevitably give rise to difficult questions of choice of law in the event of a competition between the interested parties.[1] Competitions involving a conflict of laws are likely to be more rather than less numerous if the new system of security over moveable property proposed by us is introduced. Article 9 recognises the desirability of creating rules relating to the perfection of security interests in what it calls multiple state transactions.[2] Perfection and the effect of perfection of a security interest in goods (other than goods covered by a certificate of title and mobile goods) are governed by the law of the state where the goods are situated "when the last event occurs on which is based the assertion that the security interest is

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[1] See e.g. Mitchell v. Burnet and Mouat (1746) Mor. 4468; Cammell v. Sewell (1858) 3 H. & N. 617 and (1860) 5 H. & N. 728; Todd v. Armour (1882) 9 R. 901 (corporeal moveable property): Dinwoodie v. Wright (1894) 23 R. 234; Forbes v. Official Receiver in Bankruptcy 1924 S.L.T. 522; Pender v. Commercial Bank of Scotland Ltd 1940 S.L.T. 306; Stirling's Trustees v. Legal and General Assurance Society Ltd 1957 S.L.T. 73 (incorporeal moveable property).

[2] See Article 9, section 9-103.

perfected". In the case of accounts, general intangibles[1] and "goods which are mobile and which are of a type normally used in more than one jurisdiction", it is provided that "the law (including the conflict of laws rules) of the jurisdiction in which the debtor is located governs the perfection and the effect of perfection ... of the security interest." A debtor is located "at his place of business if he has one, at his chief executive office if he has more than one place of business, otherwise at his residence." Provision is made for the case where the debtor is not located within the United States. These rules will no doubt operate most satisfactorily where the states involved are both or all Code states. Even in those circumstances, however, the rules will almost certainly not provide an answer to all the difficult questions that can arise. But they do at least give a degree of certainty. Professor Gilmore points out some of the difficulties that can arise in the application of the Article 9 rules but concludes "that the handling of these problems under common law rules, which were vague, inconsistent and even contradictory, was even less satisfactory".[2] Likewise, the Official

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[1] The expression "general intangibles" is defined in section 9-106 of Article 9 as meaning "any personal property (including things in action) other than goods, accounts, chattel paper, documents, instruments and money". The expression is a definitional safety-net which brings within the scope of the Article all types of personal property (for example, goodwill, copyright and miscellaneous contractual rights) not expressly defined or referred to in the Uniform Commercial Code.

[2] Gilmore, Security Interests in Personal Property at p.323.

Comment on section 9-103 of Article 9 records that "this case law [relating to the situs of incorporeal moveables] is in the highest degree confused, contradictory and uncertain: it affords no base on which to build a statutory rule."[1] Broadly speaking, we agree with these conclusions and recommend the formulation of rules for the guidance of the transacting parties, the keeper of the register of security interests and the courts in relation to transactions where more than one system of law may be involved. The rules cannot be devised until a decision has been taken as to the content and geographical extent of the legislation which creates the new security system: a set of rules appropriate for legislation applying to Scotland only might be quite unsuitable for legislation applying to Great Britain as a whole or throughout the United Kingdom.

The financing statement

51. The Crowther Committee concluded that filing of copies of security instruments would be inconvenient and that filing of a financing statement on the model of Article 9 was to be preferred.[2] We agree. We also agree that a short standard form of financing statement should be prescribed. The form should (i) be signed by the creditor and the debtor, (ii)contain the names and addresses of the parties, (iii) specify the date (or dates) of the security agreement, (iv) contain a

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[1] Official Comment on section 9-103 of Article 9 at para. 5(a). See also Anton, Private International Law at p.407 et seq.

[2] See Crowther Report, paras. 5.7.49 to 5.7.53.

description of the security subjects which reasonably identifies them, specifying the types or describing the items, and (v) set out such other information as may be prescribed for facilitating the operation of the filing system. The creditor might, if he wished, specify the amount of the secured debt but it should not be mandatory upon him to do so. The keeper of the register of security interests would mark each statement received and accepted by him with a file number and with the place, date and time of filing and index the statement by reference to the designation and (where appropriate) the registration number of the debtor. The person presenting a financing statement for filing would be entitled to submit to the keeper an additional copy of the statement which the keeper would stamp to show the place, date and time of filing and return to the presenter.

52. There is always the possibility of error in the preparation of a financing statement with a resultant discrepancy between it and the security agreement on which it is based. It seems reasonable that an error in the financing statement should not be permitted to enlarge the amount of the secured debt or the extent of the security subjects, or to create security for which there is no provision in the security agreement. But what should be the position where the financing statement understates the amount of the secured debt or the extent of the security subjects? It should, we think, be permissible for the creditor to file an amending statement, but unless and until he does so his security should be restricted as regards both the amount of the secured debt (in a case where that is disclosed) and the extent of the security subjects to the particulars thereof as

shown on the defective statement.[1] Any other result would be inconsistent with one of the main features of our scheme, namely, that filing of a financing statement is an esential element in the perfection of a security interest. It follows from this that any interests acquired in or securities created over the security subjects, or any preferences in the subjects obtained by the use of diligence, after the filing of the defective statement but before the filing of the amending statement should be unaffected by the filing of the later statement. "Securities" in this context would include any floating charge which, although it had not attached to the property of the debtor company concerned, contained provisions prohibiting or restricting the creation of any fixed security having priority over, or ranking pari passu with, the floating charge.[2]

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[1] We note that English law produces a different result where there is a mistake in registration of a charge under the provisions of the Companies Acts. The English cases regard the certificate of registration of the charge issued by the registrar of companies as conclusive evidence that the formalities of registration have been complied with, but not as evidence of the extent of the charge. That must be obtained from the instrument of charge itself. So, for example, the creditor in a charge has not been prejudiced by the omission from the particulars lodged with the registrar of a reference (a) to the inclusion of chattels within a mortgage (National Provincial and Union Bank of England v. Charnley [1924] 1 K.B. 431), or (b) to interest and certain additional moneys which were secured by the charge (Re Mechanisations (Eaglescliffe) Ltd [1966] Ch. 20).

[2] See Companies (Floating Charges and Receivers) (Scotland) Act 1972, section 5(1).

53. Corporeal security subjects in the field of commercial transactions to which our scheme applies would normally be either types or groups of assets or particular specified items classified as "inventory" or "equipment". "Inventory" is, by its nature, a variable collection of goods. It should suffice that the financing statement contains a generic description of the class or group to which the goods belong, as for example, "all the private cars in the showroom at 1450 Sauchiehall Street, Glasgow". Where, however, the security subjects are not "inventory" but "equipment" and consist of an individual item or individual items, a more specific description would be necessary.

Time of filing of financing statement

54. The Crowther Committee recommended that it should be permissible to file a financing statement before any security agreement had come into existence.[1] This follows the scheme of Article 9 and the Ontario Personal Property Security Act. We disagree with the recommendation that filing should be permissible before a security agreement is in existence. Such a concession might open the way to unjustified or speculative filing. On the other hand we consider that it would be unduly restrictive to stipulate that attachment (which requires that value should have been given and the debtor have acquired rights in the security subjects) must precede filing, particularly as that would create obvious difficulties in relation to after-acquired property. We therefore propose that a prerequisite of the filing of a financing statement should be a written agreement executed by both the creditor and the debtor in respect of advances made

[1] See Crowther Report, paras. 5.7.49 to 5.7.53.

or to be made by the creditor. The security subjects might be corporeal or incorporeal moveable property in which the debtor already had rights or in which he acquired rights after the date of execution of the agreement.

Period allowed for filing

55. The Crowther Committee recommended that there should be no limit of time after execution of a security agreement within which a financing statement would require to be filed, since "subsequent encumbrancers are adequately protected by the rule giving them priority over a previous unregistered interest."[1] The Committee considered, however, that a security interest filed more than 21 days after execution of the security agreement should be void against the debtor's trustee in bankruptcy or liquidator in the event of the debtor becoming bankrupt or going into winding-up within three months after the filing, so that a secured creditor could not gain advantage over other creditors by deferring filing until the eve of bankruptcy or winding-up.[2] In this matter we differ from the Crowther Committee, who appear to consider only subsequent security holders. Their views do not take into account the fact that the proposed register of security interests, if it contained a reasonably up-to-date record of securities granted by a debtor, could be of significant value to trade creditors generally. Moreover, the law of Scotland does not favour the keeping of valuable rights in retentis.

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[1] Crowther Report, para. 5.7.54.

[2] Ib., para. 5.7.55.

We propose that in order to be effective the filing of a financing statement must take place within 21 days after the execution by the debtor of the security agreement. It would, however, be competent to effect late filing where the court granted authority in that respect. We envisage a provision on the lines of section 106G of the Companies Act 1948 (which empowers the court to extend the period within which a registrable charge must be registered).

Duration of filing

56. Both the Crowther Report and Article 9 stipulate that filing of a security interest should be effective only for five years (with which we agree) but should be renewable for successive periods of five years conditional upon the filing of a renewal notice before the expiry of the relevant five-year period.[1] The Ontario Personal Property Security Act permits renewal either before or after the expiration of the period but in the case of renewal after the expiration of the period subject to certain conditions.[2] We appreciate that the Crowther Report and Article 9 approach has the merit of ensuring that perfection will be continued only where it is uninterrupted but we consider that it might operate harshly against a creditor who omits to effect renewal timeously. We propose that in general it should be permissible to file a renewal statement within the period of 30 days immediately preceding the expiration of the relevant five-year period or, in a case where that period

[1] See Article 9, section 9-403 and Crowther Report, para. 5.7.56.

[2] See sections 52 and 53.

has expired without the filing of a renewal statement, within the period of six months after the date of expiry of the period. The consequences of the filing of a renewal statement after the expiry of the relevant five year period are discussed further below.[1]

Provision of information

57. An enquirer, on payment of a prescribed charge, should be entitled to obtain from the keeper of the register of security interests either a certificate as to information contained in a filed financing statement or any other filed document or a copy of any such document. An enquirer should be protected through a State insurance scheme against loss resulting from any error of the keeper. Any claim for loss caused by error, whether in the filing of a financing statement or other document or in the notification of information, would require to be submitted within the period of one year from the date when the claimant had suffered loss. In a case where the loss was not immediately ascertainable, the one year period should run from the date when the claimant discovered, or could with reasonable diligence have discovered, that he had suffered loss.

58. The information available at any time from the register of security interests might not meet the needs of all interested parties. For example, the register might not show the amount of the indebtedness or it might be out of date in some respect. Therefore, the secured creditor should be obliged to supply to the debtor or any

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[1] See paras. 93 to 95.

other interested person requesting the information,[1] on his making payment to the creditor of a prescribed fee, any information regarding the amount of the outstanding indebtedness, the security subjects, or the parties having rights or obligations under the security agreement.

C. THE EFFECTIVENESS OF A FILED SECURITY INTEREST IN COMPETITION WITH OTHER INTERESTS, AND RULES OF PRIORITY

Introductory

59. The object of our proposals is to enable a security over moveable property to be created within the field of commercial transactions without possession of the security subjects by the creditor. Since the security subjects remain in the possession of the debtor, he will continue to be free to deal with them in the ordinary course of business, e.g. by sale of items included in a security over "inventory", in which event the security attaches (to the extent which we later explain) to the proceeds.[2] The debtor's freedom to transact with the security subjects may result in the creation of interests (such as those of a pledgee or lienholder) which conflict with the interest of the holder of the security interest. Problems of competing priority will arise in such cases. It is necessary also to consider the effectiveness of a security created by filing of a financing statement in

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[1] Cf. Article 9, section 9-208 and Ontario Personal Property Security Act, section 20.

[2] The security interest would cease to affect the security subjects in such a case, on the assumption that the buyer is a buyer in the ordinary course of business. In the absence of special provision to the contrary, the security interest would continue in the original security subjects as well as in the proceeds of sale.

a competition with creditors who have executed diligence and in the situation where the estate of the debtor is subsequently sequestrated or where the debtor is an incorporated company which is wound-up or placed in receivership. We consider those problems in relation to (a) competition with rights created by diligence or upon insolvency of the debtor, (b) competition with other securities, (c) sale and competing claims to proceeds, and (d) competition with the rights of holders of documents of title to corporeal moveables. For convenience we refer to a security created by filing of a financing statement as a "filed security interest".

Competition with diligence or upon insolvency

60. The ultimate test of the value of a security is its effectiveness against challenge by other creditors using diligence against the debtor or by the debtor's trustee in sequestration, liquidator on a winding-up or receiver. The rights of the creditor in a filed security interest in a question with those parties should be as follows -

(1) Creditors using diligence against debtor

We suggest that the holder of a filed security interest should be preferred in competition with an arrester or poinder unless the arrestment has been executed or the schedule of poinding delivered to the debtor before the date of perfection of the filed security interest. Where an arrestment is executed or a schedule of poinding delivered to the debtor after a filed security interest has been perfected and written notice of such execution or delivery has been given to the creditor in the filed security interest, the preference of the latter in a

question with the person giving the notice should be restricted to advances already made or future advances which the creditor is obliged to make in terms of the security agreement, with interest on the sums secured in each case. This is similar to the provision in section 9-301(4) of Article 9 and, in relation to heritable securities, in sections 13 and 42 of the Conveyancing and Feudal Reform (Scotland) Act 1970.

(2) Debtor's trustee in sequestration or liquidator

In the event of sequestration of the estate of the debtor or, if an incorporated company, its liquidation, the holder of a filed security interest that has been perfected before the date of sequestration or commencement of winding-up and is not an illegal preference should be preferred to the debtor's trustee or liquidator. The security right would otherwise be of little value.

(3) Floating charge

The holder of a filed security interest should be preferred to the creditor under a floating charge which has crystallised on the appointment of a receiver or on liquidation of the debtor company, where crystallisation occurred subsequent to perfection of the filed security interest, subject, however, to any conventional ranking arrangements.

Competition with other securities over the security subjects

61. We next consider the cases a where there is a competition between the holder of a filed security interest and the holders of other forms of security, both conventional and legal. In general it would be

competent for the holder of a filed security interest to enter into an agreement with the holder of any other form of security over the same security subjects to regulate their respective priorities in the security subjects, and the principles outlined below in this paragraph would be subject to the terms of any such agreement where a question arises between the parties to that agreement.

(1) Other filed security interests and pledge

As a preliminary to considering the rights of a holder of a filed security interest in competition with those of other holders of filed security interests and those of pledgees we refer again to the inter-relationship of attachment and filing. Before a security interest under our proposed scheme is perfected there must be both attachment and filing. There can be no filing until there is a security agreement in existence but, provided that such an agreement does exist, it is immaterial for the purposes of perfection whether attachment precedes filing or vice versa. Attachment requires (to quote Crowther) that:

"(i) there is a security agreement;

(ii) value is given;

(iii) the [debtor] has rights in the security."[1]

The date of filing can, however, be of great significance where filing of a security interest precedes attachment and it happens that a competing security interest, whether created by filing or pledge, is completed in the interval

[1] Crowther Report, Appendix III, Vol. 2 at p.578.

between the date of filing of the first-mentioned security interest and its date of attachment. In such a case both Article 9[1] and the Crowther Committee[2] agree that it should be the date of filing of the first-mentioned security interest (and not the date of perfection of that interest by the subsequent attachment) that should determine its priority in relation to the competing security interest. The Crowther Committee sum up the reason for this rule as follows:

> "It is ... fair that filing should confer priority against an interest subsequently perfected, even if perfected before the filed interest, since the perfecting party had notice of the prior filed interest before his own became perfected."

We agree with the approach of Article 9 and the Crowther Committee and recommend accordingly.

(2) Lien

Disagreeing in this respect with the decision in Lamonby v Foulds,[3] we recommend that a lien of a kind that the law recognises should take precedence over a filed security interest even where it has been perfected before the creation of the lien except where the holder of the lien has actual knowledge that the deposit of the goods is in breach of the security agreement.[4]

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[1] See section 9-312(5)(a).

[2] Crowther Report, para. 5.7.68.

[3] 1928 S.C. 89.

[4] See also Crowther Report, para. 5.7.75.

(3) Landlord's Hypothec

We have found it difficult to decide whether preference should be accorded to a filed security interest or to a landlord's hypothec when the two come into conflict but, while we are in general agreement with the sentiments of paragraph 49 of the Scottish Law Commission's Memorandum No. 27 (Corporeal Moveables, Protection of the Onerous Bona Fide Acquirer of Another's Property, 31 August 1976), we recommend -

(a) that so long as the law remains unchanged (and goods belonging to third parties, e.g. goods held by the tenant on hire-purchase, are attachable), there is no justification for excluding from attachability goods belonging to the tenant himself even although subject to a filed security interest that has been perfected, and

(b) that if the law should be changed so that only goods actually belonging to the tenant are attachable, we favour according priority to a security holder whose interest has been perfected before the landlord exercises his right of hypothec.

(4) After-acquired property and purchase-money security interests

We have already referred to the possibility of a competition between the holder of a filed security interest in after-acquired property of a specified kind and a person who has subsequently lent money to the debtor for the purchase of property or additional property of

that kind.[1] If the subsequent loan is secured by a security interest in the purchased property (a purchase-money security interest), that security interest and the security interest in after-acquired property will compete with each other. On the normal rule that priority of filing regulates preferences the security interest in after-acquired property would take priority over the purchase-money security interest. This would be unfair to the holder of the purchase-money security interest.[2] On the other hand, it would be unfair to take away the priority of the first lender if he made further advances on the security of the purchased property in ignorance of the existence of the purchase-money security interest. We recommend therefore that the purchase-money security interest in the purchased property and the proceeds thereof should take priority over the security interest in after-acquired property provided that (a) the purchase-money security interest is perfected at the time the debtor receives possession of the purchased property, and (b) the holder of the purchase-money security interest gives notice of his interest (with a sufficient description of the property affected by the interest) to the holder of the security interest in after-acquired property not later than the date when the debtor receives possession of the purchased property.[3]

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[1] See para. 35 above. The person lending the money for the purchase of the property may be either the seller of the property or a third party lender such as a bank.

[2] See para. 35 above and Crowther Report, para. 5.7.73.

[3] Cf. Crowther Report, para. 5.7.74.

(5) Limitation upon preference

It may happen that the creditor in a filed security interest for all moneys including future advances will receive written notice of the creation of a subsequent security from the holder of that subsequent security. In those circumstances the preference of the creditor receiving the notice should be restricted in a competition with the giver of the notice to advances made at the date of receipt of the notice and to advances which the creditor is under an obligation to make together with interest on all such advances.[1]

Competition with other interests arising on sale of the security subjects

62. There may also be a competition resulting from a sale by the debtor of goods which are subject to a filed security interest.

(1) Buyer in ordinary course of business

Since goods which are the subjects of a filed security interest remain in the possession of the debtor and it would clearly be undesirable that a buyer in the ordinary course of the debtor's business should require to search the register of security interests before making a purchase, the principle should be that a buyer in the ordinary course of the debtor's business should always be preferred to the holder of a filed security interest. We suggest that the rule might be stated thus -

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[1] Cf. Conveyancing and Feudal Reform (Scotland) Act 1970, sections 13 and 42.

A person who acquires a title to goods from a seller who has sold them in the ordinary course of his business takes them free from any security interest therein created by the seller or by any prior party even though it is perfected and the acquirer actually knows of it unless he knows that the sale to him violates the ownership rights or security interest of a third party in the goods. Protection should be extended to an acquirer who exchanges or trades in other property in or towards satisfaction of the price of the goods acquired by him.

(2) Proceeds of sale

When the subjects of a filed sescurity interest are sold the general principle is that the security interest continues in the security subjects (except where there is provision to the contrary) and the proceeds of sale so far as identifiable also fall within the security. The application of that principle, however, involves problems, particularly as regards (a) the identification of proceeds, and (b) competition between the creditor in the filed security interest and other persons claiming an interest in proceeds. These problems are not considered in detail in the Crowther Report, which refers to the established principles of tracing proceeds in English law but recognises that it is desirable that those principles should be spelled out in detail.[1] Section 9-306 of Article 9 sets out more fully the rules which govern the rights of the holder of a filed security interest in proceeds. The rules are complex and would require careful consideration before any legislation was promulgated but it may be helpful to record our views

[1] See paras. 5.7.63 and 5.7.64.

on certain main issues.

(a) "Proceeds" should include whatever results from or is received upon the sale or other disposal of the security subjects, for example, book debts, cash proceeds and cheques, and goods received in exchange for items covered by the filed security interest.

(b) Whether proceeds are identifiable must be a practical question but uncashed cheques which are still in the hands of the debtor and sums owed to the debtor by the purchaser of any goods would plainly be included in identifiable proceeds.

(c) Moneys or cheques received by the debtor which have been lodged in bank would be subject to the bank's right of set off, but funds at credit of the debtor's bank account(s) which are identifiable proceeds of sale of the security subjects would be included within the security.

(d) Where proceeds comprise other articles received in exchange for any of the security subjects, whether by direct exchange or by way of cash sale of the security subjects and investment in other goods, then, so long as the other goods so acquired are within the description of the security subjects in the financing statement relative to the filed security interest, the replacement goods would be covered by the security.

(e) Where two or more creditors have perfected filed security interests in different items of inventory, and proceeds which are identifiable as resulting from a disposal of such items have been commingled in one account so that the proportion referable to the item or items covered by each of the filed

security interests is not ascertainable, each of the security holders would have an interest in the total proceeds pro rata to the amount of principal (excluding interest) remaining due to him under his security after deduction of the value of other proceeds and unsold goods which are identifiable as covered by his security.

(f) The right of the holder of a filed security interest to proceeds in the form of money or a negotiable instrument would, of course, be cut off if the money or instrument passed into the hands of a third party in the ordinary course of business.[1] Any other rule would be contrary to law and practice and commercially unacceptable.

(g) Where the proceeds take the form of an unsecured debt or the creditor's interest under a hire-purchase agreement or conditional sale agreement, an acquirer for value in the ordinary course of business would usually be preferred to the holder of a filed security interest in inventory and its proceeds. It would, of course, be necessary for the acquirer to obtain from the dealer in the inventory an assignation of his right or interest and to perfect title in the appropriate way. The assignee would be under no duty to search the register of security interests where he acted in the ordinary course of his business. The holder of a filed security interest in inventory might protect himself to some

[1] Cf. sections 9-308 and 9-309 of Article 9.

extent by prohibiting the assignation by the dealer of his book debts but the prohibition should not prevail against an assignee for value unless he had actual knowledge of it.

Competition with rights under documents of title to corporeal moveables

63. The owner of goods which are shipped or which are stored in an independent warehouse may sell the goods or borrow money on the security of the goods. In any such case he will deliver to the purchaser or lender a document of title to the goods such as a bill of lading or (as the case may be) a delivery order addressed to the storekeeper. If the owner of the goods also creates or has already created a filed security interest in the goods, there will be a competition between the creditor in that interest and the consignee or indorsee under the document of title. In considering which of these two parties should prevail, we draw a distinction between the case where the document of title is a bill of lading and where it is a delivery order, storekeeper's warrant or any similar document. The bill of lading is recognised as a symbol of the goods to which it refers and its transfer has the same legal effect as transfer of the goods themselves.[1] Accordingly, nothing more is required to complete delivery of the goods to the consignee or indorsee under the bill. Where, however, the document of title is a delivery order addressed to the storekeeper or an indorsed storekeeper's warrant, there is no completed delivery of the goods until the transfer has

[1]Bell, Principles, 417.

been intimated to the storekeeper.[1] Delivery may not be essential for completion of the transferee's right where there is a transfer of goods on sale but it is, of course, essential for completion of the right where the transfer is in security. We think that it would seriously impede commercial transactions if the effectiveness of a bill of lading as a symbol of the goods it represents were in any way diminished. Accordingly, we recommend that a bona fide consignee or indorsee under a bill of lading should enjoy priority over the holder of a filed security interest even although perfection of that interest took place before the issue of the bill of lading.[2] Where, however, there is a competition between the holder of a filed security interest and the transferee under a delivery order or other document and constructive delivery by intimation to the storekeeper is a necessary element in completion of the transferee's right, the transferee should prevail if (and only if) his title was completed before the date of filing of the new security interest.

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[1] See e.g. Black v. Incorporation of Bakers (1867) 6 M. 136; Inglis v. Robertson and Baxter (1898) 25 R. (H.L.) 70.

[2] Section 7-503 of Article 7 of the Uniform Commercial Code gives preference to a filed security interest that has been perfected before the issue of the bill of lading in a case where the holder of the filed security interest did not give authority (actual or apparent) for the shipment or sale of the goods. The Working Party consider that it would be undesirable to introduce this qualification, their view being that a good faith acquirer of a bill of lading is in many respects similar to a buyer in the ordinary course of business and should be treated similarly.

D. ENFORCEMENT OF FILED SECURITY INTEREST

The main problems

64. Where there is a filed security interest the security subjects will usually remain in the possession of the debtor. This gives rise to problems as to the remedies available to the creditor in the event of default by the debtor in performance of his obligations under the loan agreement. The main problems are:-

(1) Obtaining possession of corporeal security subjects on default

It is essential to the value and effectiveness of the security that, in the event of default by the debtor in performing his obligations under the loan agreement, the creditor should be able relatively quickly to secure possession of the security subjects in order to realise or utilise them in or towards satisfaction of the amount due to him. In some cases the debtor may be willing to yield possession voluntarily, but the creditor must have power to obtain possession speedily if the debtor refuses to cede it. On the other hand it would be improper in our view for the creditor to take possession at his own hand without some form of official or judicial authority.

(2) The duties and obligations of creditors in realising the security subjects

Once again, it is essential that the creditor should be able with little delay to sell the security subjects, but there must be rules which ensure that intimation of the proposed sale is made to the debtor and other interested parties and that the sale yields the best price that can reasonably be obtained. There may be

circumstances in which the best price can be obtained by the debtor continuing to trade and effecting sales in the ordinary course of business subject to some form of supervision on behalf of the creditor to ensure that the proceeds are made available to him.

(3) Determination of priorities

In the field of commercial business in which the new security system will operate there may be complex legal questions as to the rights and priorities of several parties in the security subjects or the proceeds thereof. For example, the rights of the creditor in a filed security interest may be in competition with pledge of or lien over the security subjects, a purchase-money security interest or a floating charge over all assets which has crystallised or may do so at or about the same time as the creditor in the filed security interest seeks to enforce his security. If the security subjects consist of inventory, there may be problems of identification of proceeds, rights of set off by bankers and relative priorities of other securities created over proceeds. These problems in our view would be best resolved by a professionally qualified receiver. We suggest that in the event of the debtor's default the creditor in a filed security interest should be entitled to appoint a receiver whenever that course appears to the creditor to be desirable. There will be some simple cases where the appointment of a receiver will not be necessary and the creditor will effect enforcement himself, but he should be entitled to appoint a receiver to handle more complex situations. We refer further to this matter in paragraph 65 below.

(4) Rights and duties of creditors over incorporeal security subjects

Where the security subjects consist of incorporeal rights, e.g. rights under executory contracts, the creditor should be entitled on default by the debtor to exercise all such powers in relation to the rights and any related assets embraced in the security as the debtor might himself have done, including power to enter into possession and control of the assets and rights, and to sell, assign or otherwise deal with them.

(5) Publication of enforcement proceedings

If the register of security interests is to be of maximum value to prospective lenders, creditors or other parties having legitimate interests in assessing the debtor's financial position, then notification of the commencement of enforcement proceedings by the creditor in a filed security interest should appear on the register within the shortest practicable period after such proceedings are initiated. In paragraph 68 below we make proposals which are designed to secure that result.

Receivers

65. We have already emphasised that the procedure for enforcing the rights of the creditor in a filed security interest should be expeditious. It is also in the interests of both parties that it should be as inexpensive as practicable. Nevertheless there will be many cases in which the procedure for enforcement can most effectively be carried out by a professionally qualified receiver and the creditor should have the right to appoint a receiver for that purpose if he so decides. We suggest

that it should be competent to appoint as a receiver only a solicitor or duly qualified accountant. To distinguish him from a receiver under the Companies (Floating Charges and Receivers) (Scotland) Act 1972 we suggest that he be given a distinctive description, e.g. Receiver in Moveables. (For convenience we refer to him simply as "receiver".)

66. Some of the circumstances in which we consider that the appointment of a receiver might be desirable are:- (1) Where the debtor was unwilling to yield possession of the security subjects. We suggest later (in paragraph 68) that, in the interests of speed, the creditor should be able to commence enforcement proceedings upon execution of an enforcement certificate by virtue of antecedent authority of the keeper of the register of security interests flowing from the original filing in relation to the security interest. We consider that instructing action to be taken for obtaining possession should be done on the basis of that antecedent authority only by a receiver, who would do so with professional responsibility. This proposal would be without prejudice to the power of the creditor to instruct diligence under any warrant or other authorisation contained in the security agreement or other document to which he has right under his security.

(2) Where the security subjects included inventory. In such a case there could frequently be competing or multiple claims to the security subjects or proceeds, and an independent receiver would be well qualified to assess priorities and to make arrangements with other creditors for realisation of the security subjects and distribution of proceeds.

(3) Where the security subjects consisted of rights under commercial contracts. In these circumstances a receiver might negotiate more effectively with the other parties to the contracts, and the creditor who had appointed the receiver might be prepared to provide interim finance in order to complete the contracts and obtain the full benefit of the security.

67. Circumstances in which it might not be necessary to appoint a receiver are:-

(1) Where the security subjects consisted of a specific item or items, the debtor was willing to yield possession or the creditor was entitled to instruct diligence under a consent to execution, and there were no significant problems as to competing interests in the security subjects.

(2) Where the security was over book debts (when intimation to the debtors of the creditor's right to receive payment of the debts would interpel them from making further payments to the granter of the security and require them to make payment to the secured creditor).

Procedure for enforcement

68. Upon the filing of a financing statement the keeper of the register of security interests would issue to the creditor a document in prescribed form certifying that a financing statement relating to the security subjects (which would be described as in the statement) had been filed. The document would contain the reference number of the filed statement and incorporate a blank form (the enforcement certificate) authenticated by the keeper and bearing the reference number which could,

when necessary, be completed by the creditor or an authorised officer of the creditor certifying that the debtor had defaulted in his obligations and that the crditor was entitled to enforce his security. There would also be a separate form (the instrument of appointment), similarly authenticated by the keeper for appointment of a receiver which could be completed by the creditor or authorised officer and would have a space for signature by the receiver accepting that office. Upon default occurring the creditor would require to execute and lodge the enforcement certificate, and where a receiver was appointed the receiver would require to lodge the instrument of appointment, with the keeper of the register of security interests within seven days of the date of execution of the certificate or (as the case might be) instrument. The certificate would, however, be effective as from the date of its execution and the appointment of the receiver as from the date when it was delivered to him. The keeper would record in the register of security interests particulars of any certificate or instrument lodged with him, stamp the document to the effect that the particulars had been so recorded, and thereafter return it to the creditor or receiver.

Default

69. Default might occur either conventionally by reason of failure of the debtor to implement his obligations under the loan agreement or by force of statute, which would prescribe certain events which would constitute default. The enforcement certificate would be an ex parte statement made on the creditor's responsibility,

but where a receiver was appointed the receiver would be under obligation to satisfy himself that default had occurred. It would be open to the debtor or any other interested party to challenge the validity of the enforcement certificate or the appointment of the receiver by way of application to the appropriate court. The court would have power either to stay the proceedings or in appropriate cases to authorise the sale of the security subjects and the deposit or payment into court of the proceeds until the court had disposed of the application.

Obtaining possession

70. The appointment of the receiver would give him authority to obtain possession of corporeal security subjects from the debtor or the custodian of them and to employ Sheriff Officers for that purpose. Where no receiver was appointed, however, the enforcement certificate would not confer any such authority on the creditor; he would require to obtain it by way of a decree of court.

Sale of security subjects

71. The enforcement certificate or where a receiver was appointed the instrument of appointment would authorise the creditor or the receiver, as the case might be, to effect a sale of the security subjects in accordance with rules to be prescribed in or under the legislation. These rules might provide for intimation of the proposed sale being given, at least seven days prior to the date of sale, to the debtor and all other parties appearing from the register or from the Register of Companies (e.g. in respect of floating charges) to

have an interest in the security subjects whether prior, pari passu or postponed in relation to the interest of the selling creditor or the receiver appointed by him. There would be an exception to that rule where the subjects of the security were perishables, in which case intimation would be given if practicable but that would not be a prerequisite of the sale. The rules would provide generally that the duty of the creditor or the receiver would be to sell at the best price that could reasonably be obtained, and might permit various methods of sale, including sale by auction at the premises of the auctioneer.

Prohibition of disposal by debtor

72. After the debtor had received notice of an enforcement certificate or appointment of a receiver, the security subjects would be under the control of the creditor or the receiver and it would be unlawful for the debtor to dispose of the security subjects or any part thereof.

Purchaser's title

73. A bona fide purchaser for value of the security subjects would acquire all the debtor's rights therein and take the subjects free of all security interests affecting them. He would have no obligation to verify that the procedure in relation to the enforcement notice or the appointment of the receiver or the conduct of the sale had been regular.

Application of proceeds of sale

74. The creditor or receiver would throughout the proceedings require to take cognisance of the rights and interests of other persons in the security subjects and would be under obligation to apply the proceeds of sale (1) in payment of the expenses incurred in respect of the enforcement and sale proceedings, and (2) in satisfaction of the claim of the creditor enforcing his security and the claims of the holders of prior, pari passu and postponed securities in accordance with their respective priorities, and to account to the debtor for any surplus.

Proceeds of security subjects previously sold

75. If the security subjects or part of them had already been sold before enforcement proceedings were commenced and the proceeds were included within the security, the creditor or the receiver would have no power to recover proceeds from the debtor or other holder of the proceeds unless these were voluntarily paid over by the holder. Any dispute as to the proceeds available to the creditor or receiver would require to be determined by the court.

Adjudication

76. Where the security subjects or any part of them could not be sold, or could not be sold at a reasonable price, the enforcing creditor could have the subjects adjudged to him at a value determined by the court. The proceedings for having the subjects so adjudged to the creditor would require intimation to all interested parties, who would be entitled to make representations to the court.

Discharge

77. On completion of his duties the receiver could file with the keeper of the register of security interests a notice of discharge by the creditor who appointed him. If the enforcing creditor had recovered the amount of his debt in full, he would be obliged, if so requested by the debtor, to transmit to the debtor a notice of discharge of the creditor's security interest.

The role of the courts

78. Although the procedure for enforcement of a filed security interest could in many cases be carried out without intervention by the courts there would be certain circumstances in which resort to the courts might be necessary or might be made voluntarily by the parties concerned. Resort to the court would be required, for example, where a creditor (no receiver having been appointed) sought to take possession of the security subjects, or where issues as to the right to proceeds arose, or where the creditor sought to have the security subjects adjudged to him. Moreover, it would be competent for the creditor or the receiver or any interested party to obtain a decision of the court on issues such as the validity of an enforcement certificate or the appointment of a receiver, the procedure on sale, the determination of priorities or other issues arising out of the process of enforcement. We suggest that any court action on matters arising from the enforcement proceedings should be determined by way of summary application to the sheriff court rather than by interdict or other process.

79. We should also make it clear that the special procedure for enforcement outlined above, although it would normally be adopted by a creditor for reasons of speed and economy, would not preclude the creditor from enforcing the debtor's obligation by the normal court process of obtaining decree and executing appropriate diligence thereon.

E. ASSIGNATION OF FILED SECURITY INTEREST

80. The holder of a filed security interest may wish to assign it to another person. Article 9 makes provision for this as follows -

> "If a secured party assigns a perfected security interest, no filing under this Article is required in order to continue the perfected status of the security interest against creditors of and transferees from the original debtor."[1]

This provision gives protection only against persons deriving right from the original debtor and not against the creditors of, or other persons deriving right from, the assignor. The assignee will also wish to be protected against these persons. If A, the holder of a filed security interest in the moveable property of X, assigns that interest to B, B will wish to be safeguarded against the creditors of both A and X. A provision akin to that of Article 9 would protect B against X's creditors, and the question that remains is how B should obtain protection against A's creditors.

81. The position is complicated by the fact that the assignation by A to B may be an outright sale of the security interest or may itself be a transfer in security.

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[1] Section 9-302(2).

Where the assignation by A to B is an assignation of X's book debts the distinction is not material, because we have recommended that our scheme should apply to sales as well as to transfers in security of book debts. Accordingly, in a case where A assigns X's book debts to B, whether in security or on sale, it will be necessary for B to file a new financing statement showing A as the debtor and the book debts of X as the security subjects. There would thus be a new independent entry in the register of security interests disclosing the assignation granted by A. We recommend that in any such case the original financing statement showing X as the debtor and A as the creditor should be cross-referenced with the statement showing A as the debtor and B as the creditor. A person interested in the fact that X had created a security interest in favour of A might also be interested to know that A had assigned that interest to B. Moreover, where the effective 5-year period for the security granted by X to A is about to expire, it would be desirable that the keeper of the register of security interests should notify both A and B.

82. In a case where the assignation by A to B relates to security subjects belonging to X other than book debts, the procedure described in the preceding paragraph would be followed where the assignation is a transfer in security. Where, however, the assignation effects a sale of the security interest, the appropriate procedure would be for B to file a statement amending the original financing statement by substituting himself for A as the creditor in the filed security interest. The register

of security interests would thus be kept up to date and, when the effective period for the security interest was about to expire, the keeper of the register would notify only B to that effect.

83. In any of the cases above described it would clearly be to the advantage of the assignee (B), whether the assignation in his favour implements a transfer in security or a sale, to file without delay the financing statement showing the new security interest or (as the case may be) the amending statement. The date of filing would regulate his priority in a competition with other persons deriving right from A. But an assignee might nevertheless neglect to file timeously and it is in the public interest that the register of security interests should be kept up to date. We have already recommended (in paragraph 55) that in order to be effective the filing of a financing statement must take place within 21 days after the execution by the debtor of the security agreement, subject to provision for an extension of time by the court. We recommend that filing should likewise be of no effect except with leave of the court where there is an assignation in security of an existing security interest (or an assignation on sale of book debts), and the assignee fails to file a financing statement within 21 days of the date of execution of the assignation. On the other hand, where the assignation effects a sale of an existing filed security interest in moveable property other than book debts, filing after the expiry of the 21 day period would not be incompetent.

84. The holder of a filed security interest may become insolvent with the consequence that his estate is sequestrated or, if the holder is a registered company, liquidation or receivership ensues. There should, we think, be provision for a trustee in sequestration or liquidator or a receiver appointed under a floating charge to file particulars of his appointment in a separate section of the register of security interests. That filing would perfect the title of the trustee, liquidator or receiver, and the date of filing would therefore be material if the trustee, liquidator or receiver should find himself in competition with an assignee from the insolvent holder of the security interest.

85. It is clear that the filing of a financing statement in respect of a security interest in book debts, whether the statement of the original acquirer of the security interest or that of any subsequent assignee, will not constitute effective notice to the various debtors in the book-debts of the changed identity of their creditor. Article 9 caters for this by providing -

> "The account debtor is authorised to pay the assignor until the account debtor receives notification that the amount due or to become due has been assigned and that payment is to be made to the assignee. A notification which does not reasonably identify the rights assigned is ineffective. If requested by the account debtor, the assignee must seasonably furnish reasonable proof that the assignment has been made and unless he does so the account debtor may pay the assignor."[1]

We recommend the incorporation of a like provision in our proposed scheme. Notification to the debtors in the

[1] Section 9-318(3).

book debts would have no legal effect beyond requiring them to make payment of the debts to the assignee. The assignee would require to file an appropriate statement in the register of security interests in order to protect himself against competing claims to the book debts such as those of other purchasers of the debts or the assignor's trustee in sequestration. Conversely, failure by an assignee to notify the book debtors would not in any way affect his right to call for an accounting for the debts from the assignor, if he should continue to collect them, or from any other person having a right inferior to that of the assignee.

86. None of the foregoing proposals would affect in any way transactions (other than the sale of book debts) which are not related to the creation or assignation of security interests. If A assigns (absolutely) to B his rights under an executory contract and B thereafter assigns the rights to C, B and C would each complete title according to existing law and practice, that is, by intimation of the assignation to the other party to the contract.

F. TERMINATION OF FILED SECURITY INTEREST

Discharge of secured obligation

87. Following both the Crowther Report and Article 9 we have recommended[1] that a filed financing statement should be effective only for a period of five years, although the effect of the statement might be renewed for successive periods of five years. The reason for this limited duration of effect is, of course, that

[1] See para. 56 above.

moveable property has not the certainty and permanency of heritable property. Incorporeal moveable property such as debts will in general be extinguished by payment or, if not paid, will become worthless, and corporeal moveable property may be lost or destroyed or have a limited life-span. If financing statements remained effective for any unlimited or lengthy period they would often become associated with security subjects that no longer existed or had become valueless.

88. In many cases, however, a secured obligation would be extinguished by payment or in some other way while the financing statement was current and the security subjects remained in being. There must be provision to ensure that in these circumstances the security subjects are no longer affected by the security interest. Accordingly, we recommend that when there is no outstanding secured obligation exigible by the creditor in a security interest and no obligation upon him to make further advances or otherwise give value to the debtor, the creditor must on written demand by the debtor furnish him with a notice of discharge in a prescribed form duly signed by the creditor. The notice would state that the creditor no longer claimed a security interest under the relative financing statement (which would be identified by its file number). Where a creditor refused to furnish or delayed in furnishing a notice of discharge, the debtor (and in this context we would include in that expression any guarantor or cautioner) should be entitled to apply to the court for a judicial discharge of the security interest. The court, if it thought fit, might grant a discharge on such terms as it might decide.

89. After a notice of discharge had been delivered to the debtor he could present it to the keeper of the register of security interests for filing in the register. The keeper would then file the notice in the register and note it in the index. The debtor would be entitled to submit to the keeper an additional copy of the notice of discharge which the keeper would stamp to show the date of receipt and return to the debtor.

90. A debtor would usually wish to file a notice of discharge in order to inform interested persons that moveable property belonging to him was no longer burdened with a security interest. There should, however, be no requirement upon a debtor to file a notice of discharge, and failure to file a notice should not in any way affect its validity in a question between the creditor granting the notice of discharge and the debtor. The debtor would, however, be exposed to the risk of fraudulent dealings by the creditor until the notice of discharge had been filed or (as the case might be) the financing statement relating to the security interest that was the subject of the notice lapsed on the expiry of the relevant five-year period.

91. The primary function of the notice of discharge would be to disburden, and give notice of the disburdenment of, moveable property from a security interest. Quite apart from this notice of discharge, the debtor might wish to obtain a personal discharge of the obligatiaon in respect of which the security interest was created. We do not think it necessary to prescribe any form of discharge in this respect. The form of a

personal discharge - as opposed to the form of the notice of discharge filed in the register of security interests - would be essentially a matter for the secured creditor and the debtor. They might find it convenient simply to endorse a discharge on the original security agreement.

Release of security subjects or part thereof from a security interest

92. It would always be open to the creditor in a security interest and the debtor to agree that the whole or some part of the security subjects should be disburdened of the security interest. Accordingly, we recommend that there should be a prescribed form of notice whereby (without prejudice to any outstanding personal obligation of the debtor) a secured creditor may release from the security interest the whole or a part of the security subjects as described in the relative financing statement. It would be necessary for the notice of release to contain an adequate description of the property to be released but identification of particular assets, while appropriate in the case of release of equipment, might be less appropriate for release of inventory. In the case of inventory it should suffice for the notice of release to contain a description of the category of assets to be released, as for example, all the cars or all the new cars in a specified showroom. The recommendations that we have made in the context of a notice of discharge relating to the signature of a notice by the creditor and the duty upon the keeper of the register of security interests should also apply in relation to a notice of release.

Lapse of a financing statement

93. It is necessary to consider the consequences of the lapse of a financing statement, that is, the expiry of the five-year period for which the statement endures without the filing of a notice of discharge or a renewal statement.[1] Failure to file a renewal statement might result from oversight. In order to minimise the risk of oversight we suggest that it should be the practice of the keeper of the register, but not obligatory upon him, to notify the creditor in a filed security interest of the date of expiry of the five-year period at least 30 days before that date. Nevertheless, we consider that it would be unduly harsh to deny any redress to a creditor whose financing statement has inadvertently lapsed. We would propose that the creditor should be entitled to file a renewal statement on application to the keeper of the register of security interests within the period of six months from the date of the lapse. Application to the court would be unnecessary, but no application for renewal would be entertained after the expiry of the period of six months save with the leave of the court.

94. After the submission to the keeper of the register of security interests of a competent application for filing of a renewal statement, the lapsed financing statement would be deemed to have been continuously effective from the date of the original filing subject, however,

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[1] We have recommended in paragraph 56 that it should be permissible to file a renewal statement within the 30 days immediately preceding the expiration of the relevant five-year period.

to the important qualification that any interests acquired in or securities created over the security subjects, or any preferences in the subjects obtained by the use of diligence, during the period between the lapse of the financing statement and the filing of the renewal statement should not be adversely affected by the filing of the renewal statement. "Securities" in this context would include any floating charge which, although it had not attached to the property of the debtor company concerned, contained provisions prohibiting or restricting the creation of any fixed security having priority over, or ranking pari passu with, the floating charge.[1] The creditor filing the renewal statement would, however, regain his priority in a question with creditors whose security interests were postponed to the renewed interest before the lapse of the financing statement relating to that interest. This would be subject to the qualification that if in the period between the lapse of a financing statement and the intimation of its subsequent renewal to any such postponed creditor, an advance or further advance was voluntarily made by that creditor, he should be preferred in respect of that advance to the creditor who had allowed his security

[1] See Companies (Floating Charges and Receivers) (Scotland) Act 1972, section 5(1).

interest to lapse.[1] Renewal of a lapsed financing statement should become incompetent after the estate of the debtor is sequestrated or, in the case of a debtor which is an incorporated company, winding up proceedings are commenced. We so recommend.

95. Where a secured creditor had allowed his security interest to lapse, the restoration of his position (subject to the qualifications already noted) by renewal in the

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[1] Complicated situations could result where three or more secured creditors are involved. A possible case is that a security interest filed by A has lapsed, that a security interest has been filed by B subsequent to the filing of A's interest but before its lapse, and that C has filed a security interest after the lapse of A's interest (that is, C had no notice of A's interest). If A applies for the filing of a renewal statement within the permitted period of six months after the lapse of his interest, the result that should follow from the application of the principle recommended by us is as follows -

> Where the available fund did not exceed the amount of B's secured debt A would have priority for his previously secured debt over B and C to the extent of a sum equal to B's secured debt less any advances voluntarily made by B during the interval between the lapse of A's security interest and its renewal. (C is postponed to B to the extent of B's secured debt, so it is immaterial to him whether a sum not exceeding that debt is paid to B or A.) In the event of the available fund exceeding the amount of B's secured debt, matters would be so adjusted that neither B nor C would be prejudiced by the renewal of A's secured interest. This could result in a reduction of the amount paid to A.

manner indicated would, as already noted, not be fully effective in a question with any other creditor having a filed security interest which was originally postponed to the renewed security interest until intimation of the renewal had been made to the postponed creditor. The creditor whose interest had been renewed might, if he so wished, also give notice of the renewal in accordance with paragraph 61(5) of this Report to any creditor who had filed a security interest in the period between the lapse of the interest which had been renewed and the date of its renewal.

Destruction of documents after discharge of security interest, release of security subjects from a security interest or lapse of a financing statement

96. It would be impracticable and unprofitable to require the keeper of the register of security interests to retain indefinitely a filed financing statement and any related documents after the discharge of the security interest or the release of the security subjects to which the financing statement relates or after the lapse of the statement. But it would be necessary that the keeper should retain the spent financing statement and any related documents for the period during which there is any reasonable likelihood of renewal of the statement or the occurrence of anything that might require reference to the contents of the statement or the related documents. Article 9 permits a spent financing statement and its related documents to be destroyed immediately where there is a microfilm or other photographic record and in other cases after the expiry of one year from the lapse of the statement or (as the case may be) the filing of a statement terminating the security interest

to which the financing statement relates.[1] The period of one year may be sufficiently long, but we consider it preferable that the period should be determined in the light of experience as to the length of time during which any real likelihood of the need for the financing statement and any related documents is likely to arise. The length of the period should be fixed by statutory order so that it can readily be reduced or lengthened.

[1]See sections 9-403(3) and 9-404(2).

SUMMARY OF RECOMMENDATIONS

1. There should be a new system of security over moveable property based upon the establishment of a register of security interests with notice filing. There would be no requirement of possession of the security subjects by the creditor. Certain categories of transactions would be excluded from the scheme and would continue to be regulated by existisng law. Apart from pledge in the case of corporeal moveable property, the new security would be the only competent form of security by agreement within its area of application. Provision should be made for the form and content of a loan agreement, the establishment of a register of security interests, the extent and effect of the new security, the regulation of competing interests in the security subjects, and the enforcement, transfer and discharge of the new security. (Paragraph 25).

2. The scheme for the new security should be broadly similar to that recommended in the Report of the Committee on Consumer Credit (the Crowther Report). The new scheme should, however, be restricted to the area where existing law is unsatisfactory. Primarily that is the field of commercial transactions where security is required over specific corporeal moveables, stock in trade, book debts, rights under contracts and other valuable assets of the debtor. Specified categories of transactions should be excluded from the scheme. (Paragraphs 27 and 28).

3. Where the security subjects consist of corporeal moveables being "equipment", there should be excluded from the scheme transactions where the amount of the secured loan does not exceed such amount as may be prescribed, it being suggested that the prescribed amount might be fixed initially at £5,000. The exclusion should not apply where the security subjects consist of corporeal moveables being "inventory".[1] (Paragraph 29).

4. The requirement of a minimum amount of secured loan should not apply where the security subjects are incorporeal moveables. (Paragraph 30).

5. Possible exclusions from the scheme might be (1) transactions involving the creation of security interests in consumer goods, (2) transactions where the security subjects are equipment and the secured loan does not exceed a prescribed amount, (3) securities over subjects for which adequate facilities for the creation of securities already exist, for example, ships, aircraft, patents and trade marks, (4) securities over stocks and shares and security interests in "commercial paper", and (5) securities over assets that are not normally used in commercial transactions, for example, securities over life assurance policies and interests in trust estates. (Paragraph 31).

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[1] For an explanation of the expressions "equipment" and "inventory" see paragraph 17 of the Report.

6. The new scheme should apply to the sale of book debts as well as to the creation of security interests therein. (Paragraph 32).

7. It should be competent for a secured party to take a security interest in both existing property of the debtor and property which he might acquire in the future. A security interest in after-acquired property should not be regarded as security for a pre-existing debt where the secured creditor has given value for the security provided in whole or in part by the after-acquired property and that property is acquired by the debtor in the ordinary course of business. (Paragraph 34).

8. Where money is lent for the purchase of property which constitutes security for the sum lent, the security interest of the lender should take precedence over an earlier security interest in after-acquired property of the same description provided that certain conditions are fulfilled. (Paragraphs 35 and 61(4)).

9. The new security should be the only competent method of creating a security by agreement in its field of application (subject to a saving for pledge) and conversely its use should not be allowed in transactions involving the creation of security outside that field, which should continue to be created by the methods permitted or required by the existing law. If a hire-purchase or like agreement is used in a transaction to which the new scheme

applies, it should have effect as an immediate sale of goods to the debtor, his personal obligation to make payment remaining in force. (Paragraph 36).

10. Where there is a security agreement which relates partly to things within the scheme and partly to things excluded from it, there should be a valid security only quoad the former. (Paragraph 37).

11. The only competent method of creating a new security should be by an agreement in writing between the parties concerned. (Paragraph 39).

12. There should be no mandatory form of security agreement (as there is a great variety of commercial transactions) but a form might be prescribed for the general guidance of practitioners. The agreement must, however, contain certain essential particulars, namely (a) identification of the creditor and debtor, (b) a description of the secured debt, (c) a description of the security subjects, (d) a clear indication that the purpose of the document is the creation of a security over these subjects, and (e) the date (or dates) of execution of the agreement. (Paragraphs 40 and 41).

13. A security interest should become effective against the debtor (it should "attach") not by mere agreement but only when in addition the creditor has given value to the debtor and the debtor has acquired "rights" in the security subjects. (Paragraph 44).

14. "Perfection" or completion of a new security interest should be effected by attachment conjoined with the filing of a "financing statement" giving particulars of the security in a public register of security interests. (Paragraphs 44 and 45).

15. The filing system of the register of security interests must be operated by reference not to the security subjects but to the name of the debtor by whom the security interest is granted. Accordingly, there will be readily obtainable from an inspection of the register only the existence of security interests created by the owner of the security subjects with whom an interested party is negotiating - with the result that he could be at risk from security interests created by prior owners of the security subjects. It will be necessary to identify with certainty in the financing statement the debtor by whom the security interest has been created. Safeguards against fraud must be provided. (Paragraph 47).

16. The register of security interests should be a new independent register consisting only of filed financing statements and related documents. The Working Party's provisional view is that the most acceptable system for Scotland would be one based on a central register in Edinburgh but with facilities for the filing of financing statements, and for obtaining information about filed security interests, in Glasgow and other principal centres of business in Scotland. (Paragraphs 48 and 49).

17. There should be rules for the guidance of the transacting parties, the keeper of the register of security interests and the courts in relation to transactions where more than one system of law may be involved. (Paragraph 50).

18. The document to be filed in the register of security interests should be not the actual security agreement but a "financing statement" which would be signed by the creditor and the debtor and contain the names and addresses of the parties to the security agreement, the date (or dates) of the agreement, a description of the security subjects and such other information as might be prescribed. (Paragraph 51).

19. Where there is an error in a financing statement which has the effect of understating the amount of the secured debt or the extent of the security subjects, it should be permissible for the creditor to file an amending statement. Until he does so his security should be restricted to the amount or extent shown in the financing statement. Any interests in, or securities or preferences over, the security subjects constituted before the filing of the amending statement should be unaffected by it. (Paragraph 52).

20. Corporeal moveables forming the security subjects might be described generically or, where that is necessary, specifically in the financing statement. (Paragraph 53).

21. It should not be permissible for a creditor to file a financing statement before there is a written security agreement between the debtor and the creditor. On the other hand, it should not be necessary for "attachment" (with its requirements that value has been given by the creditor and the debtor has acquired rights in the security subjects) to precede filing. (Paragraph 54).

22. The filing of a financing statement in the register of security interests must take place within 21 days after the execution by the debtor of the security agreement, subject to provision for extension of time by the court in an appropriate case. (Paragraph 55).

23. The filed financing statement should be effective only for a period of five years but should be renewable for successive periods of five years. It should be permissible to file a renewal statement within the period of thirty days immediately preceding the expiration of the relevant five-year period or within the period of six months after the date of expiry of the period. (Paragraph 56). (See also recommendations 54 and 55 below.)

24. An interested person, on payment of a prescribed fee, should be able to obtain from the keeper of the register of security interests a certificate as to information contained in a filed financing statement or other filed document or a copy of any such document. An enquirer should be protected through a state insurance scheme against loss

resulting from error on the part of the keeper. A claim for loss should be submitted within the period of one year from the date of loss or (where it was not immediately ascertainable) from the date when the claimant discovered, or could with reasonable diligence have discovered, the loss. (Paragraph 57).

25. The secured creditor should be obliged to supply the debtor or any other interested party, on his paying a prescribed fee, with information regarding the amount of the indebtedness, the security subjects, or the parties having rights or obligations under the security agreement. (Paragraph 58).

26. A filed security interest should prevail over an arrestment or poinding unless the arrestment has been executed or the schedule of poinding delivered to the debtor before the date of perfection of the filed security interest. But where an arrester or poinder has given notice of his arrestment or poinding to the holder of a previously perfected filed security interest, the preference of that holder in a question with the arrester or poinder should be limited to advances already made by the holder or future advances which he is obliged to make with interest on such advances. (Paragraph 60(1)).

27. A filed security interest that has been perfected before the sequestration or commencement of winding-up of the debtor and is not reducible as an illegal preference should prevail over the claim of the trustee in sequestration or liquidator. (Paragraph 60(2)).

28. A filed security interest that has been perfected before the crystallisation of a floating charge should prevail over the charge, subject, however, to any conventional ranking arrangements. (Paragraphs 60(3)).

29. Where a filed security interest is in competition with another filed security interest or with a pledge, the first-mentioned security interest should prevail if it was filed before the filing of the other security interest or (as the case may be) before the pledgee's right was completed. (Paragraph 61(1)).

30. A lien should prevail over a filed security interest unless the holder of the lien has actual knowledge that the deposit of the goods is in breach of the security agreement. (Paragraph 61(2)).

31. Unless and until the law is changed to the effect that only goods actually belonging to a tenant are subject to the landlord's hypothec, the exercise of the right of hypothec should not be affected by the creation of a filed security interest in any goods within the leased property. (Paragraph 61(3)).

32 Where there is a competition between a filed security interest in after-acquired property of a specified kind and a later filed security interest in respect of advances made to the debtor for the purchase of property or additional property of the same kind, the holder of the later interest (the purchase-money security interest) should have priority over the holder of the earlier filed security interest provided that the purchase-money security interest is perfected when the debtor receives possession of the purchased property and due notification is given to the holder of the earlier filed security interest. (Paragraph 61(4)).

33. Where the creditor in a filed security interest is notified of the creation of a subsequent security interest in the same security subjects, the preference of the creditor receiving the notice will be restricted in a question with the giver of the notice to advances that the creditor has already made or is obliged to make and interest on such advances. (Paragraph 61(5)).

34. A person who acquires a title to goods from a seller who has sold them in the ordinary course of his business takes the goods free of any security interest in the goods created by the seller or a prior party unless the acquirer is aware that the sale to him violates the ownership rights or security interest of a third party. (Paragraph 62(1)).

35. Where security subjects are sold, the security interest continues in the subjects except where there is provision to the contrary, and the proceeds of sale as far as identifiable also fall within the security. "Proceeds" should include whatever results from or is received upon the sale of the subjects e.g. book debts, cash proceeds, replacement goods purchased with cash proceeds. There should be rules regulating a competition between the holder of a filed security interest and other persons claiming an interest in the proceeds of sale of the security subjects. Provision should be made for the pro rata distribution of commingled proceeds among the competing claimants therefor. Persons acquiring for value proceeds such as cheques or book debts should be preferred to the holder of a filed security interest whose claim to the proceeds results from a disposal of the security subjects represented by the proceeds. (Paragraph 62(2)).

36. A bona fide assignee or indorsee under a bill of lading should enjoy priority over the holder of a filed security interest even although perfection of that interest took place before the issue of the bill of lading. Where there is a competition between the holder of a filed security interest in goods stored in an independent warehouse and a transferee whose right to the goods requires constructive delivery for its completion, the transferee should prevail only if his right is completed before the date of filing of the competing security interest. (Paragraph 63).

37. Where the debtor is in default and the creditor is entitled to enforce his security, the creditor should have the right to appoint a receiver to carry through the enforcement procedure. A receiver should be a solicitor or qualified accountant and be named a "receiver in moveables" (to distinguish him from a receiver under the Companies (Floating Charges and Receivers) (Scotland) Act 1972). (Paragraphs 64(3) and 65).

38. The appointment of a receiver is considered to be desirable where the debtor is unwilling to yield possession of the security subjects, where the security subjects include or consist of inventory (as in such a case there could frequently be competing claims to the inventory or its proceeds), or where the security subjects consist of rights under commercial contracts. It might not be necessary to appoint a receiver where the security subjects consist of a specific item or items, the debtor is willing to yield possession or the creditor is entitled to instruct diligence under a consent to execution, and there are no serious problems in regard to competing interests in the security subjects; or where the security subjects consist of book debts. (Paragraphs 66 and 67).

39. There should be a procedure for enforcement of a filed security interest based upon the completion and registration in the register of security interests of a certificate by the creditor (which would have been previously authenticated by the keeper of the register) certifying that the debtor

had defaulted in his obligations and that the creditor was entitled to enforce the security. There would also be a pre-authenticated form for the appointment by the creditor of a receiver and for acceptance of office by the receiver. In a case where a receiver is appointed the instrument of appointment would also be lodged for registration. The document or documents would require to be lodged for registration within seven days of the date of execution. (Paragraph 68).

40. Default might occur through failure of the debtor to fulfil his obligations under the security agreement or under statute. The enforcement certificate (which would consist of an ex parte statement by the creditor) or appointment of a receiver could be challenged by application to the court by the debtor or any other interested party. The court could stay the enforcement proceedings or allow them to continue subject to a safeguard for the proceeds of sale. (Paragraph 69).

41. A receiver should have authority by virtue of his appointment to obtain possession of corporeal moveables forming the security subjects. Where no receiver is appointed, the creditor would require to obtain authority for possession from the court. (Paragraph 70).

42. The enforcement certificate or the appointment of a receiver should empower the creditor or receiver to effect a sale of the security subjects in

accordance with rules to be prescribed. Intimation of a sale should be given to interested parties except where that would be impracticable as in the case of a sale of perishables. The duty of the creditor or receiver would be to sell at the best price that could reasonably be obtained. (Paragraph 71).

43. After the debtor has received notice of an enforcement certificate or appointment of a receiver, it should be unlawful for him to dispose of the security subjects. (Paragraph 72).

44. A bona fide purchaser for value of the security subjects should acquire all the debtor's rights therein and take the subjects free of all security interests affecting them. The purchaser should have no obligation to verify the regularity of the enforcement procedure. (Paragraph 73).

45. The proceeds of sale should be applied (a) in payment of the expenses of the enforcement and sale proceedings, and (2) in satisfaction of the claim of the creditor enforcing his security interest and the claims of any other secured creditors according to their respective priorities. The debtor would receive any surplus. (Paragraph 74).

46. Disputes as to the proceeds of security subjects that have been sold prior to the enforcement proceedings should be referred for determination to the court. (Paragraph 75).

47. Where the security subjects could not be sold, or could not be sold at a reasonable price, the creditor could have them adjudged to him at a value determined by the court. (Paragraph 76).

48. The receiver, on completion of his duties, should be entitled to file in the register of security interests a notice of discharge by the creditor who appointed him. If the creditor had recovered his debt in full he would be obliged, on request by the debtor, to deliver to him a notice of discharge of the creditor's security interest. (Paragaph 77).

49. Disputes and other questions arising from enforcement proceedings should be submitted for determination to the sheriff court. (Paragraph 78).

50. There should be provision for the assignation of security interests and for the registration in the register of security interests of any assignation by means of either a new financing statement (where the assignation of the security interest is itself a transfer in security or implements a sale of book debts) or an amending statement (where the assignation is an absolute transfer of a security interest in property other than book debts). The filing of a financing statement relating to an assignation in security must, in order to be effective, take place within 21 days after the date of execution of the assignation unless the court authorises late filing. A trustee in sequestration, liquidator or receiver

upon the estate of the holder of a filed security interest should file particulars of his appointment in a separate section of the register of security interests. (Paragraphs 80 to 84).

51. Where the security subjects consist of book debts, registration of a financing statement in the register of security interests should not constitute notice to the debtors in the book debts, who might safely pay the original creditor in the security interest (the cedent) unless and until the assignation is intimated to them. Such intimation would have no legal effect beyond requiring the debtors to make payment to the assignee. (Paragraph 85).

52. Where there is no outstanding secured obligation exigible by the creditor in a filed security interest and no obligation upon him to make further advances, the creditor must on written demand by the debtor furnish him with a notice of discharge of the security interest. Refusal or delay by the creditor should entitle the debtor to apply for a judicial discharge of the security interest. A debtor should be entitled, but should not be required, to file a notice of discharge in the register of security interests. (Paragraphs 88 to 90).

53. The creditor in a security interest and the debtor could agree to the release of the whole or part of the security subjects from the security interest. There should be a prescribed form of notice of release, which could be registered in the register of security interests. (Paragraph 92).

54. A financing statement that has lapsed at the end of a five-year period should be renewable by application to the keeper of the register of security interests within the period of six months from the date of the lapse or after the expiry of that period with the leave of the court. (Paragraph 93).

55. The submission of a competent application for filing of a renewal statement in respect of a lapsed financing statement should result in that statement being deemed to have been continuously effective from the date of the original filing subject, however, to the qualification that any interests acquired in or securities created over the security subjects, or any preferences in the subjects obtained by the use of diligence, between the lapse of the financing statement and its renewal should not be adversely affected by the filing of the renewal statement. It would also be necessary for the renewing creditor to intimate the renewal of his security interest to those creditors whose security interests were originally postponed (and had again become postponed) to that interest. Renewal of a lapsed financing statement should be incompetent after the sequestration of the estate of the debtor or the commencement of winding-up proceedings. (Paragraph 94).

56. A secured creditor whose interest had been renewed might, if he wished, also give notice in accordance with paragraph 61(5) of the Report to any creditor who had filed a security interest in the period between the lapse of the renewed interest and its renewal. (Paragraph 95).

57. Where a financing statement is no longer operative (because of the discharge of the security interest or the release of the security susbjects to which the statement relates or because the statement has lapsed), the keeper should retain the spent statement and any related documents for such period as may be prescribed. (Paragraph 96).

APPENDIX

LIST OF MEMBERS OF WORKING PARTY ON SECURITY OVER MOVEABLE PROPERTY

Professor J M Halliday, CBE (Chairman)	Solicitor, Glasgow
Mr R H Barclay, OBE	Solicitor, Glasgow
Mr T Gardiner	Solicitor, Glasgow
Mr A M Hamilton, CBE	Solicitor, Glasgow
Professor R B Jack	Solicitor, Glasgow
Mr G R H Reid[1]	Solicitor, Glasgow
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Secretary: Mr A J Sim, Scottish Law Commission.

[1]Mr Reid died on 9 October 1980.