Law Society of Scotland

Written evidence

Moveable Transactions (Scotland) Bill

September 2022

Introduction

The Law Society of Scotland is the professional body for over 12,000 Scottish solicitors. With our overarching objective of leading legal excellence, we strive to excel and to be a world-class professional body, understanding and serving the needs of our members and the public. We set and uphold standards to ensure the provision of excellent legal services and ensure the public can have confidence in Scotland's solicitor profession.

We have a statutory duty to work in the public interest, a duty which we are strongly committed to achieving through our work to promote a strong, varied and effective solicitor profession working in the interests of the public and protecting and promoting the rule of law. We seek to influence the creation of a fairer and more just society through our active engagement with the Scottish and United Kingdom Governments, Parliaments, wider stakeholders and our membership.

Our Banking, Company and Insolvency, Intellectual Property Law, Obligations Law and Consumer Law sub-committees welcome the opportunity to respond to the call for evidence on the Moveable Transactions (Scotland) Bill from the Delegated Powers and Law Reform Committee.[1]

We have the following comments to put forward for consideration.

Consultation questions

1. Do you agree that the law covered by the Moveable Transactions Bill (raising finance on moveable property like cars, machinery or intellectual property) should be reformed?

Yes, we agree that the law covered by the Moveable Transactions (Scotland) Bill should be reformed and we are pleased to support the modernisation of Scots law in relation to security over and assignation of moveable property. We consider reform in this area to be an priority to be implemented as soon as possible.

2. Have difficulties raising finance on moveable property in Scotland affected you or your business? If so, what impact has this had for you?

Yes, we have seen that parties have incurred difficulties in raising finance on moveable property in Scotland. This creates difficulties for parties accessing finance in Scotland and this impacts negatively on the business sector. The Bill removes a competitive disadvantage for Scottish businesses in comparison to their English

[1] Moveable Transactions Bill - Consultation - Scottish Parliament - Citizen Space

counterparts. There are a number of categories of assets over which lenders are unwilling to provide access to finance to Scottish companies or in respect of Scottish assets:

A. We note that difficulties have arisen where lenders would not let corporate groups incorporate Scottish companies because of difficulties taking securities over their shares but the same concerns did not apply to English and Channel Islands companies.

B. Similarly, we note that companies may incorporate under English law using English Bank Accounts and writing contracts under English law because it is easier to raise finance using English assets than Scottish assets.

C. We also note the importance of intellectual property within, for example, the games industry: these types of businesses do not have (or need) tangible assets and members report that under the current system it is cumbersome to grant security over it. The same is true of start-up companies at the mid stage of development. These types of funding issues mean Scotland is currently less attractive as a place to set up these IP-rich businesses as they would be able to raise funds against their intellectual property more easily elsewhere.

Transactions do, of course, still occur in respect of Scottish assets and to Scottish businesses. However, the existing legal rules provide an extra level of cost and administration which makes it more expensive to operate within Scotland than it is within England. The Bill is an important step to redressing this balance.

We further note that for larger businesses, this may be less of an issue as security is less crucial from a credit risk perspective but in the SME space, this is a more acute problem. Another sector where the ability to take a fixed security over moveable property would be beneficial is Scottish-made spirits held in bond warehouses. The need to have possession in order to grant a real right in security over corporeal moveable property causes difficulty in raising finance over these assets.

In addition to the possessory requirements of the current law causing difficulties, we also consider that there is a difficulty with the unclear rule arising from case law which provides that you need actual rather than constructive delivery to constitute a pledge. This is a particular problem for small producers where the spirit is held by a third-party custodian, as it means that such goods cannot be pledged without being physically delivered to the creditor. This rule would be effectively repealed by the Bill.

3. Do you have any concerns about the proposed dual system for assignation of claims (for example, to repayment of a debt). This means it will be possible to assign claims either by intimation to the debtor (as at present) or by registration in the new Register of Assignations? This will provide flexibility, but will mean that the new Register will not be comprehensive.

We have no concerns about the dual approach and consider it superior to any alternative. We consider that flexibility is key, and that this overrides the divergence of the register. The alteration to the requirement of

intimation to allow assignation to be given legal effect through registration provides a more practical mode of assignation which we consider is better suited to modern commerce.

4. Do you have any concerns about the interaction between the new security over moveable property – which will be created by registration in the Register of Statutory Pledges – and traditional pledge, which involves delivering moveable property to the creditor? Are there any circumstances in which businesses or individuals might wish to continue to use existing methods of raising finance over moveable property?

No, we do not have concerns regarding the interaction between the new security over moveable property and the traditional pledge. As highlighted above, we do not consider there to be an alternative, and flexibility should be the key driver to reforms. We consider that asset finance may continue to operate using existing policies and structures, but that corporate transactions will heavily use the Register of Statutory Pledges (RSP).

We are very much supportive of the Bill being passed and would hope that this occurs in early course. We do have some minor comments of detail, though, on the Bill that are provided as an appendix to this response.

5. The Bill contains detailed provisions on how the registers will be set up and searched. Do you have any suggestions for improving the approach set out in the Bill?

Yes, we consider that the search functionalities and provisions of the registers should be amended to also include the registered number of a business entity (company, limited partnership, or limited liability partnership (LLP)), as names can change but these numbers remain constant. This search functionality should be added to the search function in respect of an individual (name, month, and year of birth).

We consider that searching by security granter is the most important part. The registers have some inherent limitations – they are registers of transactions rather than registers of assets (like the Land Register) or registers of persons (like Companies House). The registers will not – and cannot – be definitive statements that the assets underpinning them (a) exist, (b) are owned by the party purporting to grant the right, or (c) that the right/asset still exists. This is not a problem, but it does mean that searching by assets has some fundamental limitations.

We also consider that parties will not insert any additional information when registering the asset, as parties will provide the information required by statute and parties will wish to avoid the risk of inaccurate information. It is also worth noting that pledges and assignations in security are accessory to the underlying debt obligation – a pledge over all assets can still only incur debt actually incurred.

In light of these limitations, we are of the view that it would be helpful to have a tick-box for the category of the assets covered by the pledge, particularly for large lenders, rather than requiring the listing of each asset secured. The registers also can capture future assets and those part of an identifiable class, meaning that the list of assets on the register will not and cannot ever be exhaustive and conclusive.

We would also suggest a text box for comments for the end date of the pledge would be useful. Some transactions involve groups of corporate lenders acting as a syndicate, and so it would be helpful to include a tick box to be ticked if the lender is holding the pledge (or, if applicable, assignation) as a trustee for others.

6. The proposals in the Bill would apply to consumers as well as businesses. Do you think there are enough protections in place for consumers?

As noted above, we support the dual system for assignation; however, we have some additional points to make in relation to the system's proposed application to consumers. We consider it important that the provisions which enable consumers to identify the identity of the party to whom the debt has been assigned should be clear and cost free to consumers. This is particularly important during a cost-of-living crisis, where more people might be seeking support from creditors, such as payment holidays. We acknowledge that section 10 of the Bill offers a notable degree of protection in this area, as it will mean that if a debtor is not aware of a transfer that has taken place (including following registration of an assignation) and they perform in good faith to the assignor, they will still be discharged from the claim to the extent of the performance. With reference to our comments regarding section 10 in the appendix below, our proposed change could be limited to non-consumer cases to provide consumers with an extra level of protection.

We have concerns about statutory pledges in the business to consumer space, if consumers were to be actively encouraged down this route as an alternative to other consumer credit instruments which are more protective towards consumers (in the absence of such protections being extended to statutory pledges).

We do note, however, that the provisions in the Consumer Credit Act 1974 regulate security rights granted by consumers (for example, sections 105-113), and will apply to the new statutory pledge and that the requirements in the Financial Conduct Authority's sourcebook will also apply. We note also that a court order will always be required for the enforcement of a statutory pledge granted by a consumer. Yet, we acknowledge that requiring court action to enforce a statutory pledge may be considered onerous, especially where the consumer may expressly agree to the enforcement/sale of the statutory pledge. In addition, consumers may incur liabilities for legal expenses in such circumstances.

We accept that the statutory pledge will be particularly useful where a party already owns the collateral (as acquisition finance like hire purchase will not assist). However, we do have concerns that consumers may end up being encouraged to borrow against essential household goods, which will result in consumer detriment if the pledged items are sold.

Therefore, in order to support giving consumers the ability to grant a statutory pledge, personal and household items that are reasonably required by a consumer should be excluded from being the subject(s) of a statutory pledge. If the best way to achieve this is by having a limit on the value of the goods that can be used for a statutory pledge, we would be comfortable with a limit of £3000 or £5000, rather than the £1000 limit that is currently specified in section 48(3) of the Bill.

7. Do you have any other comments on the Bill or this area of policy?

We support the need to extend the statutory pledge to shares and other financial instruments using section 44(3) and statutory instruments.

Appendix – detailed comments on the Bill

1. Claims and Pledges

In sections 1, 43, 46 and 56 an equivalent provision to section 2(4) is required, to clarify that cross reference to another document for the assigned claim/pledged property is competent.

It is worth noting that the ability to assign/pledge categories of items, and future items, means that neither register can ever itself be a complete source of information in respect of claims assigned or items pledged. This is not a problem, but it is worthwhile remembering in register design that this is an inevitable consequence of the policy and legal design (which we agree with).

2. Registered Numbers for Juridical Persons

Following from point 1 above, these registers will ultimately be a way to search against a granter to see if they have purported to assign a right or grant a pledge. As the registers will not contain all assets, it is important that searching against persons is possible. For juridical persons, this should include registered numbers as names can change but registered numbers cannot.

3. Searching by Property/Claim

In light of our comments above, it is doubtful that searching should be possible against property or claims other than by reference to unique numbers as suggested by the Scottish Law Commission for vehicles for the purposes of section 102(2)(b). Such a search result can never be conclusive, as they can never show that (a) a result of such identification means the right still sits where vested/the pledge is still valid, or (b) that a blank result means that there is **not** a valid pledge of assignation. As such, any ability to search against property will need to be heavily caveated to avoid risk of confusion for the public.

4. Financial Collateral Exclusions

Section 1(5) excludes assignation of claims that comprise financial collateral arrangements. We consider that this should be changed so that the provisions of Part 1 are without prejudice to these rules, as the precise boundaries of the financial collateral arrangements are not entirely clear.

5. Capacities of Assignees/Pledgees

For both registers, it is possible for creditors to hold claims/pledges as trustees and/or agents for themselves and other creditors. Both registration systems should be able to accommodate this (for example by a tick-box mechanism if the creditor is holding the right as agent or trustee), as it is an important part of corporate debt transactions.

6. Insolvency Equivalents

Section 4(6)(a) should refer to a “protected trust deed” being registered, rather than any other less formal mechanism. Similarly, debt payment programmes and voluntary arrangements should only be relevant if they affect all of the assignor’s liabilities. For section 4(6)(b), consideration should also be given to the inclusion of arrangements under Part 26A of the Companies Act 2006 (restructuring plans). Equivalent comments apply in relation to section 47.

7. Assignations: Link to Underlying Claim

Claims which are assigned will be subject to their own terms (in the same way that the amount that Person A owes to Bank B is subject to terms between Person A and Bank B). Sections 6 and 8 should both be made subject to such terms, to avoid mandatory rules in this Bill overriding commercially agreed terms.

8. Onus of Good Faith Debtor

Section 10 protects a good faith debtor. It also states that being notified of the assignation does not necessarily mean a debtor is not a good faith debtor. We think that this has merit, but that in such circumstances the onus should be on the debtor to demonstrate that they are in good faith, to give certainty to lenders.

9. Acquiescence

A pledge can be released if the secured creditor acquiesces to the sale of the property. We consider that clarity as to acquiescence is required – it is possible in large financial institutions that (a) one part provides acquiescence without appreciating the legal ramifications, or (b) that such acquiescence be provided on the assumption that it does not constitute the legal release itself (merely an agreement to effect such release, which may be associated with conditions (for example, partial repayment of debt)).

10. Appropriation: Unencumbered Acquisition

With reference to section 74, more attention needs to be given to the consequences where a secured creditor appropriates property. The provision states that the secured creditor acquires the property unencumbered by any right in security or diligence. As prior ranking creditors may not receive payment by virtue of for example section 75(3), it ought to be provided that the secured creditor appropriating the property should either make payment to such creditors up to the value of their prior ranking debts or the value of the appropriated property, whichever is less.

11. Interaction with Diligence

Section 76(1)(c) provides for effects if the pledge has been extinguished by virtue of diligence being executed against the property. It is not clear, though, that diligence actually extinguishes the pledge – it should be clarified that this only applies to prior-ranking diligence.

For further information, please contact:

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