Consultation Response


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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 Property Law Committee, Property and Land Law Reform Sub-committee, and Banking, Company and Insolvency Law Sub-committee welcome the opportunity to consider and respond to the Scottish Law Commission’s Discussion Paper 168 – Heritable Securities: Pre-default. We have the following comments to put forward for consideration.

Consultation questions

Q1: What information or data do consultees have on (a) the economic impact of the current legislation on heritable securities in relation to pre-default issues, or (b) the potential economic impact of any option for reform proposed in this Discussion Paper?

We have no specific data on these matters, but we agree that the current legislation is somewhat outdated and that there are various practical difficulties in relation to enforcement of heritable securities which can lead to uncertainties. If this leads to litigation, there is an inevitable cost impact involved.

We understand that section 11 of the Land Tenure Reform (Scotland) Act 1974 hinders the ability to structure the delivery of later-living residential development in a way that preserves long term investment value in the development by way of a standard security.

In considering the potential economic impact of the reform proposals, it would be useful to consider cross-border issues. As with any legal change, there may be costs involved in terms of new documentation.
Q2: The Conveyancing and Feudal Reform (Scotland) Act 1970 should be repealed and replaced with a new statute regulating heritable securities.

We agree with this suggested course of action. Having all relevant provisions within a single piece of legislation will help to ensure the law is clear.

Q3: The standard security should continue to be the only form of heritable security which can be granted.

Agreed.

Q4: It should remain incompetent to transfer land in security.

Agreed.

Q5: Should any transactions other than transfers in security be prohibited to ensure that a standard security is used instead?

No. In the event that other transactions were to be prohibited, this would likely require detailed statutory provision.

Q6: The term “standard security” should be retained.

As a general principle, we agree that there would be merit in retaining the term "standard security". However, if the changes to be made to the law are significant, it might be advisable to avoid the term "standard security" in order to avoid a lack of clarity around those standard securities created under the 1970 Act and those created under new legislation.

Q7: Should there be a non-accessory form of standard security?

No. We are not aware of any demand for a non-accessory form of standard security.
Q8(a): The grantor of a standard security (and any successor) should not require to be the same person as the debtor in the secured obligation.

Agreed

(b): The grantee of a standard security (and any successor) should not require to be the same person as the creditor in the secured obligation.

Agreed. Such a provision is necessary for syndicated loans in the context of commercial lending.

Q9: Do consultees have any comments on the use of security trustee or nominee arrangements in relation to standard securities?

Security trustee and nominee arrangements are necessary for syndicated lending structures. Were these arrangements not able to used this would hinder commercial arrangements.

Q10 (a): Do consultees agree that the parties to a standard security should continue to be referred to as the “debtor” and “creditor”?

We have no strong view on this but note that there is merit in clarity and consistency within the law. The terms “debtor” and “creditor” are well understood in legal terms. Terms could be simplified to "borrower" and "lender". "Borrower" and lender" are usually employed within a suite of commercial finance documents and so using those expressions has the added advantage of keeping terminology consistent. However, the terms "borrower" and "lender" may not be suitable for ad factum praestandum standard securities and using alternative terminology for these could result in a lack of consistency.

(b): Do consultees agree that “grantor” and “grantee”, and “proprietor” should continue to be used where appropriate?

We refer to our comments at 10(a) above. "Owner" may be a more readily understood term than "proprietor".

Q11: Section 47 of the Conveyancing (Scotland) Act 1874 and section 15 of the Conveyancing (Scotland) Act 1924 should be repealed and not replaced.

Agreed.
Q12(a): It should be competent for a standard security to secure monetary obligations which are owed or which may become owed in the future.

Agreed.

(b): A standard security should also secure ancillary obligations, in particular obligations to pay interest, damages and expenses (subject to rules governing what expenses are allowable).

Agreed.

Q13: Which of the following approaches do consultees prefer?

(a) Standard securities should not be able to secure non-monetary obligations (but they may secure a damages claim in respect of such an obligation).

(b) Standard securities should be able to secure non-monetary obligations, but in such case it would be the damages claim for breach of the obligation which would actually be secured.

Our preference is for option (b) for the obligation to be secured as well as any damages due. If option (a) is pursued and no damages claim had yet arisen, this could leave a creditor vulnerable to the debtor seeking a discharge as there is nothing owing to the creditor.

The likely timing of any breach of the non-monetary obligation, of any damages claim and of any enforcement should be considered. We also note that upon enforcement, the buyer of the security property would want the standard security to be discharged.

We do recognise that it is not clear how one would enforce a security of this type apart from quantifying a claim for damages and receiving monetary compensation. An alternative may be a system of notice registration which would have the same effect in alerting other parties to the existence of the option without the need for a security.

Q14: There should be a separate reform project in relation to making options and similar agreements enforceable against third parties by means of registration. That review should consider other models, such as a special form of standard security which could secure non-monetary obligations and which would have special ranking and enforcement rules.

Agreed. There would be merit in a solution similar to the English "restriction" in the Land Registry to protect option agreements. While this work could sit within the scope of this project, we recognise the reasons for
dealing with this matter separately. We would welcome early consultation on such matters and suggest that these projects be covered by a single Bill to ensure clarity.

**Q15: A standard security may only be granted over immoveable property.**

We consider that it could be appropriate to expand the scope of standard securities to include directly related liabilities. For example, a solution which meant that separate assignations of rents were no longer required, and instead incorporated into a standard security document, would be welcomed in the commercial property field.

**Q16: (a) The new legislation should use consistent terminology to refer to the property affected by a standard security.**

Agreed. It is important that the law is clear and there is merit in consistency in terminology.

**(b) What term should be used?**

We note that section 9(2) of the Land Registration etc. (Scotland) Act 2012 expressly excludes heritable securities from the meaning of "encumbrance". We therefore consider that use of the term "encumbered property" may cause confusion. A standard security secures the debt rather than the property and therefore we do not consider that the expression "secured property" is appropriate. "Security property" or "security subjects" may be suitable terms.

**Q17: A standard security may not be granted over a real burden.**

Agreed.

**Q18: A standard security may not be granted over a proper liferent.**

Agreed.

**Q19 (a): A standard security may be granted over a lease, where that lease has been recorded in the Register of Sasines or registered in the Land Register as appropriate.**

Agreed.
(b): A standard security may not be granted over any other lease.

We agree with this at the present time. We note the Scottish Government’s current work on crofting which is considering the possibility of standard securities being granted over leases of croft land.

Q20 (a): Should it continue to be possible to create a standard security over a standard security or would it be preferable to allow a standard security to be assigned in security?

Standard Securities over standard securities are commonly used in commercial property transactions. The surrounding issues of assigning rights and enforcement issues are not ideal.

On balance, we consider that it would be preferable to allow a standard security to be assigned in security, meaning that both the underlying debt and standard security would be assigned together and this would avoid the more ‘difficult’ structure of the standard security over standard security. We understand that, from a banking perspective, the fact that it is not possible to grant an assignation in security inhibits the use of certain structures in debt capital markets, loan on loan, and structured finance transactions. There would potentially be difficulties with *ad factum praestandum* securities depending on the nature of the obligation being secured. For the sake of transparency, we think that any assignation in security should state clearly that it is granted in security. Presumably any such assignation in security would need to be registered in order for the borrower to know that its original lender has granted an assignation in security to a new lender.

(b): In either case what should be the rules on enforcement?

We consider that the rules on enforcement will need to be looked at carefully in relation to this situation where they are not currently suitable.

Q21: Are there other types of immoveable property over which it should be possible to grant a standard security?

We are not aware of other types of immoveable property over which it should be possible to grant a standard security.

Q22 (a): The secured obligation should be a matter for the parties to a standard security and no longer be the subject of default provisions.

Agreed.
(b): Form A should be abolished.

Agreed. We understand that Form A is seldom used even in domestic security transactions.

Q23 There should no longer be a statutory form of standard security. Form B, like form A should be abolished. Instead, the constitutive document of a standard security should require to:

(a) be signed by the debtor;
(b) identify the property which is to be the encumbered property;
(c) identify the secured obligation; and
(d) use the words “standard security”.

We agree with the proposal that there should no longer be a statutory form of standard security.

We would be keen to see the creation of a Scottish Debenture. We consider it should be competent to grant a standard security in gremio of another document to open the way for a Scottish Debenture and would be keen for the Scottish Law Commission to consider the possibility of a Scottish Debenture as part of this project.

We suggest that a standard security should require to be signed by or on behalf of the debtor and, if the debtor is not the owner of the security property, by or on behalf of the owner. This would allow for (i) digital standard securities which may need to be signed by the solicitor acting for the debtor/owner and for (ii) third party securities.

There requires to be clarity around how the words "standard security" are to be used. Perhaps the requirement could be that the document states on its face that it is (or incorporates) a “standard security”.

Q24: Should a non-obligatory model form of a standard security document be provided?

A non-obligatory model form would be useful. This would help to ensure all necessary requirements are covered.

Q25: What comments do consultees have in relation to identification of the encumbered property?

It is important that the property can be identified. The description of the property will need to meet the Keeper’s requirements for descriptions set out in the Land Registration etc. (Scotland) Act 2012.
Q26: What comments do consultees have in relation to identification of the secured obligation?

The secured obligation must be capable of being identified. We consider that there would be merit in a flexible approach - parties should be free to set out the secured obligation in the standard security, in a separate document referred to in the standard security, or in a combination of both.

Q27: Should it continue to be possible for unregistered holders to grant standard securities?

We believe that it might be useful to have this option, however, the Scottish Government may wish to consider the consequences of this in relation to the stated aim to increase transparency of land ownership.

Q28: A standard security should continue to be made real by registration.

Agreed.

Q29: The power under section 893 of the Companies Act 2006 should be used so that standard securities granted by companies do not require to be registered twice.

Agreed. We consider that the dual registration system is an unnecessary administrative burden. It can have serious consequences if the time limits are missed. We note that in practice, this would require information-sharing between Registers of Scotland and Companies House and proper funding and resourcing would be required for this to take place.

We also consider that this power should be utilised in the context of moveable transactions. We note that the Scottish Government intends to consult on this area, following on from the Scottish Law Commission's previous work and consider that a consistent approach should be taken to bring about efficiencies in both scenarios.

Q30: What comments do consultees have on whether it should be permissible to create a servitude in a standard security deed?

We consider it useful to be able to create a servitude in a standard security deed which arises if enforcement of the security is required. This has the advantage of ensuring that, if there is no default, the servitude would be deleted from the Land Register when the standard security is discharged.
Q31: Rules on enforcement (including the recovery of expenses by the creditor) and redemption in relation to a standard security should not be dealt with in standard conditions but in the substantive provisions of the new legislation.

Agreed.

Q32: Statute should provide for a freely variable default set of standard conditions in relation to preservation of the value of the encumbered property and expenses (other than in relation to enforcement). If consultees agree:

(a) should these conditions be set out in primary or secondary legislation?
(b) what default conditions should be included?

We consider that it would be useful to have a default set of standard conditions.

We suggest that the conditions be set out in secondary legislation so that there is sufficient flexibility for the conditions to be amended to keep pace with practice.

Consideration should be given as to how default conditions can cater for residential, commercial and ad factum praestandum standard securities. We consider that redemption and enforcement should be excluded. There may be merit in a default condition in relation to disclosure of notices of planning applications or other statutory notices served on the owner to the creditor, and a condition that requires the debtor to insure the property for reinstatement value (rather than market value).

Q33: The standard conditions should be abolished, but statute should set out:

(a) a broad rule requiring the debtor to preserve the value of the encumbered property;
(b) a default rule that the debtor should be liable for the creditor’s reasonable expenses (with enforcement expenses being dealt with separately in terms of the rules on enforcement); and
(c) a default rule allowing the creditor either to (i) require the debtor to insure the property for reinstatement value or to (ii) insure the property directly.

Should there be any additional rules?

Our preference would be for a set of default standard conditions (as per question 32) which would apply unless the security specifies otherwise.
Q34: Where property which is encumbered by a standard security has a lease granted over it without the creditor’s consent, the secured creditor should be entitled to remove the tenant if the security is enforced.

Agreed.

Q35: Should the secured creditor be entitled to remove a tenant under a lease granted after a standard security prior to enforcement if express provision is made in the security documentation prohibiting the grant of a lease? Should that provision require to be on the face of the Land Register?

For commercial property, we agree that the creditor should be able to remove the tenant. In that scenario, the restriction on letting does not need to be on the face of the register as the tenant will be aware when it sees the standard security on the landlord's title that the heritable creditor’s consent may be required.

Separate and full consideration needs to be given to any power to remove tenants of residential property as the interests of the lender should be balanced with the security of tenure provided to tenants of residential property and how any right to remove would be exercised in conjunction with that security of tenure. There is a question as to the state of knowledge of a residential tenant of the existence of any security and/or its terms given that residential tenants would not ordinarily check the security documentation (or indeed the title to the property) when taking the lease.

Q36: What comments do consultees have on the rights of the secured creditor where the debtor carries out a juridical act in relation to an existing lease without the secured creditor’s consent?

We consider that any act should be capable of being reduced. The act, albeit prohibited in the security documentation, may be of benefit to the creditor and/or property (or at least neutral in economic effect) and therefore there would be merit in flexibility for the creditor as to reduction of any such act.

Q37: Should the Private Housing (Tenancies) (Scotland) Act 2016 be amended to make it clear that a heritable creditor cannot evict a tenant whose lease was granted prior to the creation of the security?

In principle, we agree with this proposal. However, we note a potential difficulty based on the state of knowledge of the parties. There are two possible aspects to this: on one hand, if the lease is not registered and the borrower has misled the creditor by stating that there is no lease, should the heritable creditor be precluded from evicting in such circumstances? On the other hand, the tenant will have no knowledge of the security process so why should they be penalised? We would tend to favour the tenant in such
circumstances as the lender should have carried out due diligence (or be relying on a certificate of title) in advance and if there is a lease whose existence has not been disclosed to the lender then the lender is likely to have recourse against the borrower.

Q38: What comments do consultees have on the situation where a heritable creditor is enforcing its security and there is a residential tenant whose lease was granted after the security?

Any power for a lender to remove tenants of residential property should be balanced with the security of tenure provided to tenants of residential property. There is a question as to the state of knowledge of a residential tenant of the existence of any security and/or its terms given that residential tenants would not ordinarily check the security documentation (or indeed the title to the property) when taking a lease.

Q39: The holder of a private residential tenancy should prior to enforcement be unaffected by a prohibition on leasing in a standard security encumbering the property unless that person knows of the prohibition at the date of entry under the lease.

In principle, we agree with this. However, similar to our answer to question 37 above, consideration requires to be given as to how holders are put on notice and how the state of knowledge is proven.

Q40: Do consultees have any comments on the interaction of standard securities with agricultural leases?

Most agricultural leases are not registerable as they are for less than 20 years – many tenancies under the Agricultural Holdings (Scotland) Act 1991 continue on a year by year basis.

Q41: Where property is encumbered by a standard security and the debtor carries out a juridical act in relation to a right affecting that property without the creditor’s consent, the creditor should be entitled to reduce the debtor’s act if the security is enforced.

We consider that any act should be capable of being reduced. The act, albeit prohibited in the security documentation, may be of benefit to the creditor and/or property (or at least neutral in economic effect) and therefore there would be merit in flexibility for the creditor as to reduction of any such act.
Q42: Should the creditor prior to enforcement be entitled to reduce any juridical act by the debtor which is prohibited in the security documentation?

We consider that any act should be capable of being reduced. The act, albeit prohibited in the security documentation, may be of benefit to the creditor and/or property (or at least neutral in economic effect) and therefore there would be merit in flexibility for the creditor as to reduction of any such act.

Q43: It should continue to be possible to vary a standard security as under the 1970 Act, except that there should be no mandatory form of deed.

Agreed.

Q44: It should continue to be impermissible to vary a standard security to increase the encumbered property.

Agreed. We note the potential for difficulties regarding ranking with other creditors.

Q45: It should continue to be possible to restrict a standard security:

(a) as under the 1970 Act, except that there should be no mandatory form of deed; or
(b) by means of a consent in gremio in a disposition transferring the property.

Agreed.

Q46: Should (a) the assignation of the secured debt alone be sufficient to transfer the standard security, or should (b) registration of a document assigning the standard security continue to be required?

We consider that the assignation of the security should not be sufficient on its own to transfer the standard security and registration of a document assigning the standard security should continue to be required.
Q47: If registration should still be required, should the effect of registration be to transfer the debt (without intimation to the debtor)?

No. We consider that intimation should still be required.

Q48: (a) There should be no mandatory form of deed for the assignation of a standard security.

Agreed.

(b) The same deed may assign multiple standard securities.

Agreed

(c) Upon registration the assignation should give the assignee the benefit of any corroborative and substitutional obligations, the right to recover expenses from the debtor and the right to rely on any notices sent or enforcement procedure started by the assignor.

Agreed.

Q49: The effect of an assignation of a standard security should not be to limit the standard security to the amount due at the time of the assignation and future advances made by the assignee may be secured depending on the terms of the security contract.

Agreed. We note that limiting the standard security to the amount due at the time of the assignation would be unhelpful in loan portfolio transactions.

Q50: (a) Should there be any restrictions on what an all sums standard security may secure?

We consider that there should be a legal presumption that a security over a principal private residence (i.e. a home) covers only financial accommodation (past, present or future) extended for the acquisition and/or improvement of the secured subjects and their parts and pertinents. Any such presumption could be rebutted by evidence of the informed express consent of all habitual residents in the property (including coproprietors) having legal capacity as well as the curator(s) of incapax/ces habitual resident(s). That evidential requirement could be met by them signing clear documentation containing explicit “health” warnings and being subject to the expiry of a cooling-off period.
(b) In particular, should there be restrictions on
   (i) pre-assignation debts owed to the assignee; and
   (ii) debts originally owed to other parties being secured?

We consider that there should be restrictions on such debts. In the event that pre-assignation debts and/or debts owed to others were secured, we would expect this to lead to a change to a corporate debtor’s balance sheet between secured and unsecured creditors. In addition, it is likely that higher interest rates will be payable for an unsecured loan and for this to become secured without the agreement of the borrower, would appear to be unfair.

Q51: It should continue to be possible to discharge a standard security in whole:
   (a) as under the 1970 Act, except that there should be no mandatory form of deed; or
   (b) by means of a consent in gremio in a disposition transferring the property.

Agreed.

Q52: (a) Do consultees consider that the law should require creditors to discharge standard securities where there is no outstanding debt?

We consider that the law should require creditors to discharge standard securities where there is no outstanding debt in respect of residential cases. For commercial lending, we do not consider that this would be suitable.

In respect of commercial lending, standard securities can be used to secure contingent liability, for example overage payments. Assessing whether there is any outstanding "debt" in the context of a contingent liability is not straightforward. In addition, in circumstances where a borrower has a revolving credit facility, the balance could periodically fall to zero, but the lender would not necessarily want the borrower to have a right to a discharge of the standard security. If such a rule were to be introduced, we suggest that parties be able to contract out of it to cater for more complex lending scenarios.

(b) If so, should such a rule be restricted to residential cases and should there be exceptions? What should be the sanction for non-compliance?

As referred to above, any such rule should be restricted to residential mortgages (and specifically exclude any residential property used to secure guarantor obligations in commercial transactions).
Q53: Section 41 of the 1970 Act should be restated and clarified by means of a new statutory provision.

Agreed.

Q54: (a) Do consultees agree that the rules on redemption should be replaced with a general rule entitling the debtor to a discharge on the secured obligation being performed in terms of the contractual arrangements between the parties and a court procedure for discharge where the creditor has disappeared or refuses to grant a discharge?

Agreed

(b) What comments do consultees have on the owner of the encumbered property (where that person is not the debtor) having the right to have the security discharged by paying the value of the property?

Generally, we can see merit in a course of action that would give the owner of an encumbered property who is not the debtor to have the security discharged on payment of the value of the property to the creditor. A creditor is unlikely to be disadvantaged by such a provision.

However, if the owner is a guarantor of the debtor, we do not agree that that owner should be able to have the security discharged by paying value of the property. This would be inconsistent with the principles of cross collateralisation which customarily apply in loans over property portfolios. Lenders may not want the property to be sold for commercial reasons.

Q55: Section 11 of the Land Tenure Reform (Scotland) Act 1974 should be repealed.

As referred to in our answer to question 1, we understand that this section hinders the ability to structure the delivery of later-living residential development in such a way that preserves long term investment value in the development via standard security. We would therefore welcome its repeal.

Q56: The doctrine of confusio should not extinguish a standard security.

Agreed.
Q57: Should there be a sunset rule for standard securities? If so, what should be the period be? If not, why not?

We do not agree with this proposal. If a creditor cannot grant a discharge by reason of death, absence or for any other cause, the debtor can consign the amount due in terms of Section 18(2) of the 1970 Act or any comparable provision. In addition, there may be transactions which could involve the need for a standard security to remain in place for many years.

Q58: The existing statutory provisions on the older forms of heritable security should be repealed. Where necessary, appropriate provision should be made in the new legislation.

Agreed. We note appropriate transitional provisions may be required.

Q59: The rules in relation to transactions involving, and the enforcement of, a (a) bond and disposition in security, or (b) bond of cash credit and disposition in security, should be the same as for the standard security with appropriate modifications. Any sunset rule for standard securities should also apply to these securities.

Agreed. In the event that a sunset rule is introduced for standard securities, this should also apply to these older forms of security.

Q60: Section 40 and Schedule 9 of the 1970 Act (which provide for a form of discharge for the ex facie absolute disposition) should be repealed and not replaced.

Agreed.

Q61. Should the new legislation make provision to bring ex facie absolute disposition arrangements to an end? If so, how?

We do not consider that the legislation should provide for this due to the potential complexities involved.
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