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ARTICLE

Post-Insolvency Working Capital and the Moveable Transactions (Scotland) Act 2023

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Summary

- The new Scottish moveable transactions regime will create more effective commercial secured funding from late 2024 that will reduce the current excess (relative to England) of floating charge assets
- Post-insolvency assets are intended to be protected from potentially over-strong assignation and pledge under the new Scottish regimes so as to protect trading insolvencies
- But what is a post-insolvency asset
- And what should be an 'insolvency' that triggers protection of those assets without prejudicing the more effective secured funding intended by the reforms

Introduction

The Moveable Transactions (Scotland) Act was passed by the Scottish Parliament in May 2023 and is expected to come into force in the second half of 2024. It radically reforms the Scottish law of assignation (assignment) of receivables and other 'claims' (as very broadly defined) and introduces a new 'statutory pledge' over corporeal (tangible) moveables (broadly, chattels) and intellectual property. A new Register of Assignations and Register of Statutory Pledges are to be introduced, to be maintained by Registers of Scotland and with electronic registration of an assignation or pledge document in the relevant register assigning the claim or creating the statutory pledge. Registration will be an alternative to the existing methods of assigning claims by giving notice of ('intimating') the assignation and of taking fixed security by taking possession of the 'chattel' or transferring the intellectual property – which will continue, with some modernisation.

The reforms derive from a report and draft Bill issued by the Scottish Law Commission in 2017 and volume 15 issue 4 of this journal (2018, pp. 222-225) contains a summary of the Commission's proposals and some general commentary on their insolvency and enforcement aspects by Hamish Patrick. While differing in some details, the 2023 Act as passed largely implements the reforms as described in that 2018 article. The most significant changes are that consumers were removed from the statutory pledge provisions while the Act was going through the Scottish Parliament (to be replaced with provisions allowing sole traders, charitable trustees and voluntary associations to grant statutory pledges) and that court orders will be required to enforce statutory pledges by sole traders (but not normally those granted by others).

The view was also taken that the Scottish Parliament did not have the necessary powers to apply the new regimes to shares or other financial collateral, but it is anticipated that the UK Government will make a statutory instrument under s.104 of the Scotland Act 1998 in order to facilitate assignation under the new regime of bank accounts and other claims that may fall within the ambit of the Financial Collateral (No. 2) Regulations 2003 and to provide for statutory pledges over shares and other financial instruments. It is anticipated that the s.104 Order will come into effect along with the 2023 Act and will follow a similar approach to assignations and statutory pledges of these assets as taken in the Scottish Law Commission's draft Bill – as noted in the previous article in this journal mentioned above.

It is not proposed to go through the reforms again in detail. It is instead intended to focus on the post-insolvency effects of the new regimes.

Insolvency cut-off

Currently, it is very cumbersome in Scots law to assign receivables or other claims or to take fixed security over equipment or other tangible moveables or over intellectual property. This is because notice requires to be given, possession taken or transfers registered in title registers in relation to an assignation or fixed security – and also because there are doubts about assigning and granting fixed security over assets not owned by the granter when the assignation or fixed security is granted. This means that, currently, there can be more

Scottish assets in an insolvency that are subject only to a floating charge than (for example) English assets, as it is currently more straightforward to take fixed security in England. Accordingly, a Scottish administrator may currently have more floating charge assets than an English counterpart with which to carry on trading or which are available for fees, expenses or preferential creditors, like HMRC. While, in practice, leasing, invoice discounting and other title-based financing techniques (which are generally effective in Scotland) may often reduce what would otherwise be extra Scottish floating charge assets, the general point remains.

One feature of the reforms is that assets may be assigned or pledged very easily, by using a relatively brief and generic document uploaded to one of the new registers. Another is that the reforms make it easy to assign future receivables and other claims that do not exist at the time the assignation document is uploaded and similarly easy to pledge future equipment, other future tangible moveables and future intellectual property. Scottish floating charge assets available to an administrator on appointment may therefore be fewer following the reforms than they are currently – and may indeed be fewer than those currently available in England. Beyond this, the new regimes would, without specific preventative provisions, permit receivables and other claims generated following administration and tangible moveables or intellectual property acquired or created following administration to be assigned or pledged by a pre-administration assignation or pledge, removing working capital otherwise available to an administrator to trade.

There are varying views in England about how well pre-administration fixed security works following administration or other insolvency procedures in relation to post insolvency assets and it is not proposed to discuss them here, save to note that insolvency practitioners very commonly treat such fixed securities as floating charges in practice. Sections 4 and 50 of the 2023 Act contain specific provisions restricting the effectiveness of assignations and statutory pledges in relation to post insolvency assets – with a view to protecting trading insolvencies. The boundaries of ss.4 and 50 will be of great interest both to insolvency practitioners and to those providing funding supported by assignations and pledges of relevant types of assets.

Assignation cut-off

Section 4(2) provides that an 'assignation is ineffective in relation to [a claim which, at the time the assignation document is granted, is not held by the assignor] if the assignor becomes the holder of the claim after becoming insolvent'. Section 4(3) then validates an assignation of such a future claim if it is 'in respect of income from property insofar as that claim (a) is not attributable to anything agreed to by, or done by, the assignor after the assignor became insolvent and (b) relates to the use of property in existence at the time the assignor became insolvent'.

The Scottish Law Commission's report (Report on Moveable Transactions – Volume 1 (Report 249) (scotlawcom.gov.uk))[1] refers at para. 5-107 to post insolvency royalties deriving from pre-insolvency intellectual property and to post insolvency rent payable under pre-insolvency leases of land as examples of income streams that would fall within what has become s.4(3). A loan advanced prior to insolvency is another example of property relative to which post insolvency income (i.e., interest) would be assigned under s.4(3), unless such interest claims should, in fact, be considered to exist prior to insolvency and therefore to be held at that time by the assignor directly for the purposes of s.4(2), rather than requiring to be protected by s.4(3).

Statutory Pledge cut-off

Section 50(2) of the 2023 Act provides that a 'statutory pledge is not created over any property which ... is acquired by the provider after becoming insolvent'. This seems relatively straightforward and 'acquired' is presumably to be construed as including 'created' so as to exclude the likes of goods manufactured in the course of an administration from a pre-administration statutory pledge purporting to cover them.

Section 50 contains no equivalent to s.4(3) to protect post insolvency assets coming into existence following insolvency but deriving from pre-insolvency property. This may not cause significant problems in relation to tangible property. Questions may, however, arise in relation to pledged intellectual property where rights, such as options, may be triggered by post-insolvency events or actions of various people other than the pledgor. Such rights may, of course, be 'claims' that have been assigned under that regime and protected under s.4(3) as mentioned above or they may indeed be contingent elements of pledged property existing prior to insolvency, as is suggested above may be the case for future interest payments on loans.

It is to be hoped that these issues will be addressed more clearly in the s.104 Order adding shares to the statutory pledge regime as it will need to be clear that the likes of post-insolvency dividends and shares issued under post insolvency bonus issues go to the holder of a pre-insolvency statutory pledge over the relevant shares rather than to an administrator appointed to the pledgor as it will otherwise be difficult for the pledgee to value the shares pledged when providing funding.

Notes

1 https://www.scotlawcom.gov.uk/files/1715/1361/1309/Report_on_Moveable_Transactions_-_Volume_1_Report_249.pdf.

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Insolvency trigger

The time at which an assignor or pledgor 'becomes insolvent' is obviously important as the point following which relevant new assets will cease to be assigned or pledged by a pre-insolvency assignation or pledge.

Sections 4(6)(b) and 50(3)(b) list the following corporate insolvency triggers:

- entering administration (with reference to para. 1(2) of Sch.B1 to the Insolvency Act 1986 ('IA')
- being wound up (under Parts 4 or 5 of the IA or s.367 of the Financial Services and Markets Act 2000)
- appointment of an administrative receiver (as defined in s.251 of the IA)
- approval of a creditors voluntary arrangement ('CVA') taking effect (under s.4A of the IA)
- sanctioning of a scheme of arrangement ('Scheme') (under s.901F of the Companies Act 2006, the 'CA')
- becoming subject to any analogous foreign order, appointment or arrangement

Sections 4(6)(a) and 50(3)(a) list broadly corresponding personal insolvency triggers of being adjudged bankrupt/sequestrated, entering into a trust deed, composition or arrangement with creditors, having a voluntary arrangement or debt payment programme approved or becoming subject to any analogous foreign order or arrangement.

A number of amendments were proposed to the insolvency triggers while the 2023 Act was going through the Scottish Parliament, some of which were accepted. The final result did, however, remain controversial and the relevant Scottish Government minister undertook to consult on the possible exercise prior to the 2023 Act coming into force of powers that came through from the original Bill to amend the insolvency triggers by statutory instrument.

Insolvency trigger consultation

A limited consultation on the insolvency triggers closed in November 2023 and it is hoped (by the authors at least) that:

(a) an option canvassed to broaden the trigger to a state of insolvency (whether on a balance sheet or revenue basis) from the existence of an insolvency procedure is not taken up;

(b) the triggers are narrowed to entering administration, being wound up and possibly administrative receivership (and for personal insolvency being adjudged bankrupt/sequestrated and possibly registration with the Scottish Accountant in Bankruptcy of a protected trust deed for creditors under the Bankruptcy (Scotland) Act 2016); and

(c) analogous foreign orders, appointments or arrangements are restricted to those accorded recognition by a UK court under the Cross-Border Insolvency Regulations 2006 or s.426 of the IA and in accordance with the order of that court under the relevant recognition legislation.

The main reason for suggestions (a) and (c) is certainty – both of the insolvency practitioner dealing with an insolvency procedure and of the assignee and pledgee. If there is no clear way in which the occurrence of an insolvency state trigger can be checked, neither an insolvency practitioner nor an assignee or pledgee can take actions that may be beneficial to or protective of relevant stakeholders and numerous disputes would be inevitable.

A simple example would be the position of an invoice discounter whose customer may have financial problems. If simple insolvency is the trigger, the discounter is likely to stop funding invoices at the first sign of financial problems – as it will not be able readily to check the factual solvency of its customer and may otherwise advance funds intended to be repaid from invoices that turn out not to have been assigned to it because the insolvency trigger has in fact happened. Given the role played by invoice discounting in business rescue this would be an unfortunate result.

Funders are well aware of risks posed to them by winding up and administration of their customers and those dealing with customers likely to become subject to foreign insolvency proceedings should likewise be aware that steps may be taken to have them recognised in the UK. Their internal processes can then manage these risks, with relevant public searches being carried out as appropriate. Administrative receivership is obviously now very rare and specialised as a result of s.72A of the IA, but its potential for use as a business rescue mechanism through ongoing trading and the possibility of checking for the appointment of an administrative receiver suggest such an appointment should trigger ss.4(2) and 50(2).

The consultation asked if restructuring plans under Part 26A of the CA should be added to the insolvency trigger list, to join Schemes and CVAs, to which they are similar in some ways. It is suggested that none of these procedures should be triggers in this context. This is because all three procedures are premised on creditor voting procedures and are very flexible in what they can do. Each is therefore capable of putting in place working capital arrangements similar to ss.4(2) and 50(2) by virtue of a creditor vote. They are also capable of putting different working capital arrangements in place that are more suited to the situation at the time. Requiring ss.4(2) and 50(2) working capital arrangements take effect on CVAs, Schemes and restructuring plans taking effect prejudges those procedures, creditor

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views and the optimum short and longer term working capital outcome for the company subject to the procedure. It would also create an inherent disadvantage to those funding using relevant assignations and pledges in the creditor negotiations that very commonly take place as part of processes around restructuring plans, Schemes and CVAs.

It should be added that each of these procedures can relate to part only of the liabilities and assets of a given company, as has commonly been the case for CVAs of only leases of retailers or Schemes or restructuring plans relating only to certain financial liabilities, and it seems counter-intuitive and penal always then to restrict those funding using assignations and pledges that are not within a given CVA, Scheme or restructuring plan.

Conclusions

Clearly a number of points require to be resolved in relation to what counts as post-insolvency receivables, goods and other post-insolvency assets that are not assigned or pledged under the new Scottish regimes by a pre-insolvency assignation or pledge. And clearly some of these points may require to be worked out through the courts, as with any new legislation. It is unfortunate, however, that the minister's powers to amend the regimes under ss.4 and 50 extend only to the definition of the insolvency triggers and not also to the definition of relevant post-insolvency assets as it will be necessary to wait for court decisions in some situations and to remedy any that do not make commercial sense by primary legislation.

Hopefully, however, a workable set of insolvency triggers will emerge by statutory instrument so that working capital is created to facilitate business rescue through trading while protecting the expanded funding through effective commercial assignations and pledges that the 2023 Act is intended to promote.

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International Corporate Rescue

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