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Modernising Scottish Moveable Transactions Law

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Summary

- Scots law on transfer of intangibles and fixed security over tangible and intangible moveables is cumbersome & out of date.
- Scottish Law Commission report recently published proposing pragmatic incremental reforms but not radical Personal Property Security Act.
- New modern statutory pledge proposed over corporeal moveables, intellectual property & financial instruments by registration in new register in parallel to modernised existing regimes.
- Modernised transfer of claims by registration in new register proposed in parallel to modernised existing regime.

Scottish Law Commission Report

Currently, transferring Scottish intangible ('incorporeal') moveable property is quite cumbersome. Similarly, creating fixed security over incorporeal moveable property is quite cumbersome under Scots law, as is creating fixed security over corporeal moveable property. However, in December 2017, the Scottish Law Commission (the 'SLC') published its Report on Moveable Transactions, with a view to reforming some of Scots law's cumbersome rules in these fields – along with a draft Bill that could be used by the Scottish Parliament to implement the SLC's proposed reforms.¹ The reforms proposed relate to the assignment ('assignation') of claims and the creation of a new form of 'statutory pledge' over corporeal moveable property, intellectual property and financial instruments. It is thought that the Scottish Government may well take the proposals forward.

Current Scottish position

Currently, it is thought only to be possible under Scots law to assign an existing claim that is specifically identified at that time – and the assignation will only take effect on

notice ('intimation') then being given to the counterparty to the claim in question. Fixed security over intellectual property and financial instruments is currently taken by way of outright transfer to the security holder – who must go on the register for registered shares or registered intellectual property. Other financial instruments or IP licences will normally require to be assigned to the security holder, with intimation of the assignation being given to relevant counterparties. In turn, fixed security over corporeal moveable property, such as vehicles, equipment or inventory, requires the security holder to take possession of the property in question under a possessory pledge. Equity does not exist in Scots law and so the equitable assignments, mortgages or fixed charges that may arise under English law over present and future claims, intellectual property, financial instruments or chattels transferred, charged or pledged without notice or possession being given or registration taking place in asset registers do not arise in Scots law in corresponding situations. In effect, from the English perspective, only 'legal' transfers and fixed security interests are available under Scots law and there is no distinction between 'creation' and 'perfection' of a property interest – it either exists as a full *ius in rem* in the sense of Roman law or it does not.

As a consequence, it is more complicated in Scotland than in England or various other jurisdictions to trade in claims or assign them in security or to use corporeal moveables, intellectual property or financial instruments to provide security. A statutory floating charge regime exists in Scotland for incorporated companies, similar to that in England, and reservation of title, hire purchase and leasing of corporeal moveables can also be used in Scotland in many situations in which they can be used in England in place of fixed security. However these techniques only mitigate to a certain extent the consequences of the current absence in Scotland of a modern moveable transactions regime.

Approach to reform

Many jurisdictions have reformed or are in the course of reforming their moveable transactions laws, driven

Notes

¹ <https://www.scotlawcom.gov.uk/law-reform/law-reform-projects/completed-projects/security-over-corporeal-and-incorporeal-moveable-property/>.

in part by the examples of Article 9 of the US Uniform Commercial Code ('UCC9') and the Personal Property Security Acts ('PPSAs') initially introduced in Canada and more recently in New Zealand, Australia and elsewhere. As indicated in the SLC's report, there have been a number of failed attempts to reform moveable transactions law in both Scotland and England over the last 40 years or so and there are two projects currently under way in England² – over and above the more limited Goods Mortgages Bill promised for England by the current UK Government, following its proposal by the Law Commission (of England and Wales).

With this background, the SLC's proposed reforms are intended to be pragmatic and incremental rather than radical. The reforms to assignation will accordingly apply to 'claims' and not to all assignable incorporeal moveable property. A 'claim', in turn, is broadly defined as a right to performance of a monetary or non-monetary obligation (other than a negotiable instrument) and is extended to include monetary claims relating to land (largely to address current practical problems with assignations of rents). Similarly, the new statutory pledge will be applicable to corporeal moveables other than ships and aircraft and, for incorporeal property, will only initially be applicable to intellectual property (including applications and licences) and financial instruments within the meaning of the Financial Collateral Arrangements (No.2) Regulations 2003 (the 'Financial Collateral Regulations') – while being extendable by statutory instrument to other categories of incorporeal property.

It is proposed that the existing regimes for assigning claims outright or in security with intimation to counterparties, for possessory pledges over corporeal moveables and for transferring intellectual property or financial instruments in security will remain in place in parallel with the new regimes – with some modernisation of the intimation regime for assignation of claims and of enforcement of possessory pledges. In addition, a notice filing system as used in UCC9 and most PPSAs is not proposed for the new regimes, nor is it proposed to recharacterise title-based financing arrangements, such as hire purchase, functionally as security interests or require their registration.

The SLC's proposed regimes are, however, capable of further incremental reform and if, for example, notice filing or recharacterisation were later considered worthwhile across the whole of the UK, the regimes proposed would be capable of further adjustment to take account of such changes.

Basic proposals

The SLC proposes that two new electronic registers be set up and operated by Scotland's main public registration entity, Registers of Scotland – a Register of Assignations and a Register of Statutory Pledges. Assignations of claims and statutory pledges over corporeal moveables, intellectual property and financial instruments would take effect when (i) an assignation or pledge document has been registered in the relevant new register, (ii) the assignor/pledgor has become owner of an asset assigned/pledged under the document, (iii) the assigned/pledged asset has become identifiable and (iv) for assignations, any condition precedent to the assignation referred to in the assignation document has been satisfied. It would then be possible to register a physical or electronic assignation or pledge document upfront and for assets to become assigned or pledged on an ongoing basis as they arise and are identified relative to the registered document.

Intimation of an assignation of a claim to the relevant counterparty would remain as an alternative to registration of the assignation document in the Register of Assignations as an element in transferring the claim. Intimation would also remain relevant as a means (applicable also to registered assignations) of protecting the assignee from settlement of the claim assigned by the counterparty to the assignor, if that were a practical risk in any given circumstances. It would also be confirmed that simple unacknowledged electronic intimation of an assignation would be competent.

As indicated above, transfers in security of intellectual property and of financial instruments would also remain as alternatives to statutory pledges, as would possessory pledges of corporeal moveables – and the rules for physical and civil possession of corporeal moveables subject to a possessory pledge would be clarified.

In addition, when the Financial Collateral Regulations apply to a given assignation of a claim or pledge of a financial instrument, it is to be provided that possession and control as defined under the Financial Collateral Regulations of the relevant claim or financial instrument could take the place under the new regimes of registering an assignation or pledge document in the relevant new Scottish register.

It should be further noted that the SLC's proposals contain some specific protections for individuals, in addition to those mentioned below in relation to the new pledge enforcement regime and those applying under general consumer protection legislation. It is, for example, proposed that individuals may only pledge their non-trading assets if specifically identified and owned

Notes

² <https://securedtransactionslawreformproject.org/> & http://www.citysolicitors.org.uk/index.php?option=com_content&view=category&id=129.

at the time of the pledge or specified to be acquired by funding secured by the pledge, that non-trading corporeal assets pledged must exceed a prescribed value and that wages and similar claims could not be assigned.

Enforcement regimes

No specific enforcement regime is anticipated for assignments under the new regime, although provisions are included with a view to ensuring that payment and other performance is made to the right person. The draft Bill does, however, set out a detailed enforcement regime for new statutory pledges over corporeal moveables, intellectual property and financial instruments and applies it also to traditional possessory pledges over corporeal moveables.

The enforcement regime proposed for statutory pledges is layered, to take account of different types of pledgor and asset pledged. Accordingly, a court order will normally be required to enforce against an individual, special rules are proposed to be set out for the likes of occupied caravans and repossession or immobilisation of corporeal moveables held with a third party will very often require to be carried out by a court officer, insolvency practitioner or other prescribed person.

In all cases, enforcement action will require to be preceded by service on the pledgor and others known to have interests in pledged assets of a prescribed pledge enforcement notice and to be carried out to 'reasonable standards of commercial practice'. Letting or licensing income from corporeal moveables or intellectual property and sale prices for all assets will require to be the 'best reasonably obtainable' if those particular enforcement powers are exercised.

Specific provision is also to be made for enforcement by appropriation of all types of pledged assets, but not normally when pledged by individuals. Notice of intended appropriation will require to be given to pledgors, secured and attaching creditors and certain office holders. Pledgors will be able to object to appropriation if a market value determination methodology for appropriation has not been agreed in advance and other notified parties will be able to object in any event. Secured creditors will, however, normally be entitled in any event to buy pledged assets sold by them publicly, at market value.

In addition, secured creditors will be empowered to take reasonable steps to protect, maintain, manage and preserve the value of pledged assets, including exercising voting rights, insuring, settling liabilities, taking legal proceedings and taking other steps agreed with the pledgor, in the pledge document or otherwise.

It is also worth noting that the regime under the Financial Collateral Regulations will take precedence over the general enforcement regime regarding statutory pledges over financial instruments falling within their scope.

Priorities

The new regime proposed for assignation of claims contains no express general priority rules. This is largely because the basic Roman priorities regime applicable in Scotland will apply as it does otherwise in Scottish property law. Once the criteria for assignation have been satisfied for a given claim it will be owned by the assignee and no longer owned by the assignor and other *iures in rem* or *iures in personam* will take effect (or not) accordingly relative to the assignor or assignee and in their respective insolvencies. It is, however, specifically provided that assignments under the new regime will be ineffective in relation to claims that are not held by the assignor prior to commencement of various specified insolvency proceedings, although they will assign income arising passively following insolvency from pre-insolvency property.

While also following the basic Scottish rule that *iures in rem* prevail over *iures in personam* and rank by date among themselves, the proposed new pledge regime will rank registered pledges among themselves by date of registration in the new Register of Statutory Pledges so far as relating to assets not owned by the pledgor when the pledges originally take effect, will prefer securities arising by operation of law and will prefer diligence (execution) by creditors to the extent that secured amounts are not committed prior to execution of diligence. Similarly to the position on assignments, it is provided that statutory pledges will only be effective in relation to relevant assets acquired prior to commencement of specified insolvency proceedings. In addition, priorities agreements among secured creditors are recognised as taking contractual effect among those creditors, but not effect *in rem*.

Conclusions

Clearly further discussion of a number of aspects of the proposed reforms will be beneficial before they are implemented and there will obviously be a certain amount of devil in the detail of the primary and secondary legislation ultimately brought into force.

There has, for example, already been some suggestion that the power in the draft Bill mentioned above to extend the categories of incorporeal property for which a statutory pledge is available beyond intellectual property and financial instruments should be exercised to include petroleum licences. Scottish assignments in security are not currently permitted by the Oil & Gas Authority's 'Open Permission' for security interests over petroleum licences as it has concerns about the technical effect of a Scottish assignation in security as a transfer of the licence. Only floating charges are therefore currently available in Scotland. Statutory pledges would provide a useful form of security over petroleum licences and should hopefully not give rise

to the same concerns for the Oil & Gas Authority as assignments in security.

The draft Bill also includes an option by statutory instrument to make registration of assignments in the new Register of Assignations mandatory for types of claims to be specified in order to make them effective – and to exclude this optional function of intimation. This would make it easier for prospective assignees to check for prior competing assignments of those types of claims but obviously restricts practical options for making assignments effective.

Clearly the new registers create scope for double registrations, particularly with registration by UK companies of charges with Companies House under the Companies Act 2006. While registration in the new Scottish registers will simply be an extra way of creating a charge (and thus a bonus to those complaining of double registration), it may be worth giving some thought to the possibility of exercising the powers under s.893 of the Companies Act to feed registration in the new Scottish registers direct into the Companies House charge register – or indeed vice versa. The registration of assignment or pledge documents themselves in both registers may indeed facilitate this at a practical level.

The practical effects of the pledge enforcement regimes may also need to be considered further relative

to alternatives available. If, for example, pledge enforcement notices and appropriation mechanisms are too cumbersome in practice there may be less incentive for those currently using title-based security to switch to using pledges instead.

Some further discussion of priorities systems may also be expected, for example as to whether preference should be given over pre-existing pledges to statutory pledges that would be ‘purchase money security interests’ in the UCC9/PPSAs jargon when such pre-existing pledges would otherwise be preferred over new assets acquired. There may, similarly, be some benefit in considering further the practical adequacy for working capital purposes in trading insolvencies of the restrictions of assignments and pledges proposed in relation to post-insolvency assets, bearing in mind the current effects of asset and invoice finance in those situations.

However, such further discussions as may be required should not detract from the general point that the current Scots law of moveable transactions is not fit for current purposes and that the SLC has proposed some pragmatic reforms to remedy this and modernise this part of Scots law in a way which should provide practical benefits for Scottish businesses and others dealing with Scottish assets. It is therefore to be hoped that the Scottish Government will take the proposed reforms forward.

International Corporate Rescue

International Corporate Rescue addresses the most relevant issues in the topical area of insolvency and corporate rescue law and practice. The journal encompasses within its scope banking and financial services, company and insolvency law from an international perspective. It is broad enough to cover industry perspectives, yet specialized enough to provide in-depth analysis to practitioners facing these issues on a day-to-day basis. The coverage and analysis published in the journal is truly international and reaches the key jurisdictions where there is corporate rescue activity within core regions of North and South America, UK, Europe Austral Asia and Asia.

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