

## KEY POINTS

- Reform of archaic Scottish moveable transactions law is imminent.
- Receivables funders are likely to be early adopters.
- Fixed security over Scottish shares will no longer be problematic.
- New option to be available for equipment sale and hire-purchase back.

## Feature

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# Moveable Transactions (Scotland) Bill: some funding opportunities

The Moveable Transactions (Scotland) Bill was recently introduced to the Scottish Parliament. The reforms were proposed by the Scottish Law Commission in December 2017 and the author and Dr Andrew Steven, the Scottish Law Commissioner responsible for the Commission's report, outlined the proposed new regime in the February 2018 edition of this journal (2018) 2 JIBFL 71. It is not proposed to repeat that analysis, but instead to discuss in a little more detail some of the opportunities which arise from the Bill.

## INTRODUCTION

The reforms relate to assignment outright or for security purposes of broadly defined "claims" and to fixed security over corporeal (tangible) moveables, intellectual property, financial instruments and other incorporeal moveables that may be specified by statutory instrument. Scots law currently applying to these matters is undoubtedly unfit for the needs of modern commerce, but there was little appetite for radical reform along the lines of a personal property security act with functional recharacterisation of transactions having security effect, like hire purchase. Instead, an incremental approach will be adopted under which the existing regimes will be preserved and reformed and overlaid with a new Register of Assignations and a new Register of Statutory Pledges, electronic registration in which of an assignment or pledge document will provide an option to constitution of an assignment by notice and to constitution of a fixed security by possession or by perfected transfer.

Receivables finance, sale and hire-purchase back of equipment and security over shares in Scottish companies each provide good examples of situations in which the reforms are likely to be beneficial and they are discussed in turn below. There are many further situations in which the reforms will provide benefit to those seeking or providing funding.

## RECEIVABLES FINANCE

Book debts are a central category of "claim" to which the new assignment regime will apply

and it seems likely that early adopters of the new regime will include invoice discounters, debt factors, asset based lenders and supply chain financiers.

Currently, book debts are transferred, outright or to create fixed security, by the creditor assigning them, with notice being given to the book debt debtor. If notice is not given, the assignment has only contractual effect and the assignee has no preference in the insolvency of the assignor as regards debts purported to be assigned nor relative to creditors of the assignor attaching those debts or later assignees giving notice first. Notice is given by posting a certified copy of the assignment to the debtor under the Transmission of Moveable Property (Scotland) Act 1862 (1862 Act) or otherwise normally requires acknowledgement by the debtor. There is also doubt about the competence of assigning debts that do not exist at the time they are purported to be assigned and about giving notice in advance of a given debt coming into existence. In theory an assignment does not need to be written or signed, but signed assignments are very common so that book debts assigned are clearly identified and to facilitate notice under the 1862 Act.

The current regime works well in some circumstances, particularly when small numbers of existing specified debts among active parties to a given transaction are involved. It is then straightforward to have a simple assignment document with a schedule describing the debts assigned and the debtor

party to the assignment to acknowledge a notice contained in it. As the reforms permit the current regime to continue to be used, it seems likely that this will happen in transactions of this nature, which sometimes involve high value debts and commercial sensitivity.

However, for many transactions the current notice regime and doubts relating to future debts or identifying them create significant practical problems, as do concerns around assignment taking place subject to conditions, such as acceptance by an assignee or compliance of assigned debts with eligibility criteria for assignment. Accordingly, modern online platform-based supply chain financing systems under which batches of debts are uploaded for approval for funding can cause some technical concerns in Scotland even if the system can build in some form of acknowledgment of assignment by the debtors.

The reforms seek to clarify the competence of assigning debts that do not exist at the time of assignment and permit assignments to take effect from satisfaction of conditions. They also seek to ensure that rules on identifying debts purported to be assigned are not needlessly prescriptive and facilitate notice being given electronically. It is therefore possible that some online supply chain financing systems may be able to work quite smoothly under the new regime without requiring relevant documents to be registered in the new Register of Assignations, although it may prove as simple in many situations to register an initial umbrella agreement or assignment.

Where even electronic notice may be impracticable or otherwise undesirable, as may often be the case for conventional invoice discounting or debt factoring (and particularly where there are high volumes of relatively short-dated debts), registration of an umbrella discounting or factoring

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agreement or a related umbrella assignment in the new Register of Assignations is likely to be quite an attractive option. Currently, trusts by an assignor in favour of an assignee are often taken in these circumstances as trusts of this nature provide an element of protection from the creditors and insolvency of the assignor without notice being given to debtors. However, such trusts are subject to similar uncertainties on conditionality, future debts and identification of trust property to those currently applying to assignments and also require to be constituted in writing (and using Advanced or Qualified Electronic Signatures if that writing is electronic). This in turn often leads to back-up floating charges being taken by assignees from assignors over book debts purported to be assigned or held in trust as floating charges do not suffer from the same uncertainties. Registration up front in the new Register of Assignations of an umbrella discounting or factoring agreement or a related umbrella assignment would eliminate the need for these trusts or back-up floating charges and provide greater protection to assignees than such trusts and floating charges.

As sole traders and partnerships cannot grant floating charges under Scots law, it is understood that some funders are reluctant to provide invoice discounting or debt factoring facilities to sole traders or partnerships in Scotland as back-up floating charges will not be available. It is to be hoped that the reforms will make these forms of funding more readily available to these significant categories of SMEs.

Clearly many receivables funders will consider whether or not their systems and documents could be adjusted to take advantage of the reforms, while not being required to do so as the reforms do not require the new registers or other new methods of assigning book debts to be used in place of current methods. There may also be scope for systems and documents used in Scotland to be simplified and automated more and for increased uniformity of systems and documents used in Scotland with those used in England and other jurisdictions.

Receivables funders may also consider uploading their existing receivables

funding agreements or supplements to those agreements to the new Register of Assignations when the reforms come into effect in order to take immediate advantage of the reforms, depending on the terms of those existing agreements.

Online searching of the new Register of Assignations should provide some increased protection to assignees against pre-existing assignments to third parties, although as existing methods of assignment will continue this protection will not be complete. It is anticipated that the reforms will make provision (through statutory instrument) for registration in the new Register of Assignations to be made the only method of effecting assignments in specified situations. While this would improve the protection provided by searching the new register, it may raise confidentiality issues for some types of transaction even if details of receivables assigned need not be on the register and would add an unnecessary extra step for other types of transaction. Consultation on this is therefore likely.

Similar issues to those arising on the financing of book debts also currently arise in relation to securitisation of Scottish receivables and it is anticipated that the new regime will be used when securitising assets like personal loans, but not mortgages as the reforms do not extend to land rights other than rents – where the new regime will facilitate assignments of rents from lease portfolios, which again currently suffer from similar problems.

### EQUIPMENT SALE AND HP BACK

As financing of equipment and similar assets through leasing and other title-based financing techniques is well established and works reasonably well in Scotland, it is likely that a lot of asset finance will initially continue as it does at present. The reforms do not prevent this. The new “statutory pledge” is likely to be used in the financing of equipment, inventory or similar physical assets when multiple ranked security interests are planned, for the likes of whisky, manufactured goods or livestock where possessory pledges or title-based financing raise practical problems or when registering

a security document up front in the new Register of Statutory Pledges is otherwise a more convenient way to protect a funder's position.

One particular situation in which a statutory pledge may be an attractive replacement for title-based financing is where an equipment owner wishes to raise finance on that equipment and may be considering a sale and hire-purchase back transaction with a funder. This is because s 62(4) of the Sale of Goods Act 1979 disappplies the Sale of Goods Act to sales intended to operate by way of security and some of the Scottish caselaw suggests that s 62(4) may apply on this basis to sale and hire-purchase back. The Scots common law applying to a transfer of ownership on sale of goods requires the buyer to take delivery of goods sold in order that ownership may pass and there is therefore a risk on sale and hire-purchase back transactions in Scotland that the funder never acquires title to goods hired back and is not therefore protected against the creditors or insolvency of the seller/hirer. Sometimes buyers seek to take delivery in these circumstances, although immediate redelivery to the hirer may be seen to cast doubt on the initial delivery. Similarly, to the position noted above regarding purported assignments of book debts, buyers also sometimes take back-up floating charges over equipment subject to sale and hire-purchase back transactions. Taking and registering a statutory pledge in security of a loan may be seen by some asset financiers as a less risky and complex option than sale and hire-purchase back once the new regime is in place. While the s 62(4) risk to equipment sale and lease-back transactions is thought to be less than that for sale and hire-purchase back transactions, as ownership is not intended to return to the original seller, it is possible that some sale and lease-back transactions may also be structured in Scotland as loans secured by statutory pledges once that option becomes available.

### SHARES IN SCOTTISH COMPANIES<sup>1</sup>

Shares in Scottish companies are a key “financial instrument” that will be subject to the new statutory pledge regime. Some

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lenders currently have policies against taking fixed security over shares in Scottish companies and it is not uncommon for companies incorporated in England to be used as special purpose companies for projects and similar transactions in Scotland rather than Scottish companies when fixed security over their shares is seen as an important security or enforcement mechanism.

At present, fixed security is taken over Scottish shares by transferring them to the security holder or its nominee and registering the security holder or nominee as the holder of those shares in the register of members of the Scottish company (or, as applicable, through Crest). The security nature of this ownership transfer is then recorded in what is often termed a "share pledge" document, but which is in reality a contract indicating how the security holder and its nominee should deal with those shares. Share pledges often provide for a voting proxy and divided mandate to be granted back to the "pledgor", terminable on default under relevant finance documents. The security interest derives entirely from the registration of the security holder or its nominee as a member of the company and delaying this until a pre-default trigger event (as some lenders are prepared to do) raises significant risks.

The current approach creates multiple problems, including the incompetence of taking multiple fixed securities over Scottish shares, because the first registered transferee will own them. Those currently granting or taking share pledges are often also concerned about the company in question ceasing to be a subsidiary of the grantor or becoming a subsidiary of the security holder, although if the share pledge is properly drafted para 7 of Sch 6 to the Companies Act 2006 should normally stop this happening. There is greater concern about the drafting of Sch 1A to the Companies Act and some take the view that a holder of fixed security over shares in a Scottish company should be registered up front as a person with significant control over that company – and greater concern still that the National Security and Investment Act 2021 clearance

regime applies to the taking of fixed security over the shares in a Scottish company operating in a relevant sensitive sector rather than only following enforcement of such a security. In addition, some concerns remain regarding the possible application to holders of fixed security over Scottish shares of the expanding powers of pension regulators in relation to entities related to groups with defined benefits pension schemes, despite the comfort given a number of years ago on the subject by the regulator to the Financial Markets Law Committee.

Furthermore, the concerns outlined above regarding assignment of future debts also apply to share pledges and where fixed security is taken over a portfolio of shares that is likely to change from time to time, transfers to and from the security holder or its nominee are currently required to be registered in order to constitute a fixed security over relevant shares. Sometimes such share portfolios can be dealt with using a custodian system under which the custodian is the registered member of the Scottish company throughout and security is really taken over English law rights against the custodian and sometimes the share pledge will constitute a financial collateral arrangement relative to book entry securities collateral concerning which registration in the Scottish company's register of members is disapplied under the Financial Collateral Arrangements (No.2) Regulations 2003. These mechanisms are not, however, entirely satisfactory and neither is the growing practice of taking floating charges over specific Scottish shares rather than share pledges.

Taking fixed security over Scottish shares by registration in the new Register of Statutory Pledges of what would be a real "share pledge" document would eliminate nearly all of these problems arising from registering a security holder or its nominee in a Scottish company's register of members. It is therefore likely that many lenders having a policy against taking fixed security over Scottish shares would revisit that policy following the reforms coming into place and that other lenders may consider uploading their existing share pledges to the

new register and coming off the company's register of members, depending on the terms of their share pledges. Where additional shares are to be pledged after an initial share pledge is taken, they can then become subject to fixed security with little additional administration under the new regime.

Fixed security over intellectual property suffers from similar difficulties in Scotland to fixed security over shares, with full transfers being required along with licences back. The new regime is therefore likely to be useful in technology financing.

**NEXT STEPS**

There is no set date for the reforms to come into effect, but not impossible that this could happen by the end of 2023. Registers of Scotland already have the new registers under development and are liaising with stakeholders to ensure they operate effectively. That development will continue while the Bill passes through the Scottish Parliament and is followed by the statutory instruments implementing relevant details. Various interested parties have also been liaising on development of the Bill and increasing engagement is anticipated while the Bill goes through the Scottish Parliament. Meantime, funders need to look further at the opportunities presented by the reforms so that they and their customers are in a good position to take advantage of them. ■

- 1 It is intended to implement the reforms in relation to shares and other financial instruments by means of statutory instrument rather than directly in the Bill.

**Further Reading:**

- Moveable transactions law reform coming in Scotland? (2018) 2 JIBFL 71.
- Demystifying Scots law: Scottish aspects of debt finance transactions (2016) 1 JIBFL 38.
- LexisPSL: Moveable Transactions (Scotland) Bill – an introduction to the issues and proposals.