

Moveable Transactions (Scotland) Bill

Policy Memorandum

Introduction

1. As required under Rule 9.3.3 of the Parliament's Standing Orders, this Policy Memorandum is published to accompany the Moveable Transactions (Scotland) Bill introduced in the Scottish Parliament on 25 May 2022.
2. The following other accompanying documents are published separately:
 - Explanatory Notes (SP Bill 15-EN);
 - a Financial Memorandum (SP Bill 15-FM);
 - a Delegated Powers Memorandum (SP Bill 15-DPM);
 - statements on legislative competence by the Presiding Officer and the Scottish Government (SP 15-LC).
3. This Policy Memorandum has been prepared by the Scottish Government to set out the Government's policy behind the Bill. It does not form part of the Bill and has not been endorsed by the Parliament.

Policy objectives of the Bill

4. The policy objective of the Bill is to modernise the law of Scotland in relation to transactions concerning moveable property (referred to as the law of moveable transactions). This encompasses the law relating to:
 - the assignation of a claim to the right to the performance of an obligation (typically the right to be paid money);
 - security over corporeal moveable property (such as vehicles, equipment, whisky or livestock); and
 - security over a certain kind of incorporeal moveable property, specifically intellectual property (IP) which includes copyright, trademarks, design rights and patents.

This document relates to the Moveable Transactions (Scotland) Bill (SP Bill 15) as introduced in the Scottish Parliament on 25 May 2022

5. Moveable transactions law is vital to the economy of any country with a developed legal system. It enables both businesses and individuals to use their assets to raise finance by selling debts owed to them or by granting security over moveable property. In these ways, businesses can secure crucial cash flow. If businesses cannot fully exploit their assets (other than heritable property – i.e. land and buildings) to raise finance, they might otherwise have to resort to seeking finance under riskier and more expensive types of lending. These “workarounds”, for example using leaseback arrangements, trusts or licensing, are inevitably more expensive to effect. English law is sometimes used instead which involves Scottish businesses registering in England.

6. For example, a business may wish to acquire funding by transferring to a financial institution its claims to payment of its customer invoices. This would be done by means of an assignment. Alternatively, it may want to retain assets such as vehicles, equipment and intellectual property, but to use these as collateral to obtain loan finance. Individuals might wish to use vehicles to secure finance.

7. At present, however, Scottish law in this area is badly outdated, unduly restrictive and unfit to meet the needs of modern Scottish commerce. It is mainly non-statutory and unclear in some important respects (parts of it have scarcely changed from Roman law and the principal relevant statute on assignment of debt dates from 1862).

8. The Bill, if implemented, will make various types of commercial transactions more efficient, less expensive and less complicated than they currently are. This will lead to greater access to finance for businesses (in particular) and individuals in Scotland. If enacted, the Bill will also clarify the existing law, thus encouraging people and businesses in Scotland to use Scots law with confidence.

9. The policy objectives of the Bill will contribute to the realisation of the Scottish Government’s purpose by contributing to the following Economic Vision:

We have a strong, dynamic and productive economy which creates wealth and employment across Scotland. Our economy is competitive and we have good international trade, investment and export networks. We are considered an attractive place to do business.

Background

Scottish Law Commission Report on Moveable Transactions

10. The Bill will implement the Scottish Law Commission (SLC) Report on Moveable Transactions (Scot Law Com No. 249)¹ published in December 2017. The SLC made 203 recommendations. The Scottish Government has broadly accepted the vision proposed by the SLC to reform and modernise the law on moveable transactions.

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

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Problems with the current law

11. The main problems with the current law on moveable transactions relate both to assignment of debt and the lack of availability of a “fixed” security over moveable property similar to a mortgage over heritable property.

Assignment of debt

12. The reform of the law on the assignment of debt will likely be most beneficial to businesses. The SLC described the rationale for reforming the law on assignment of debt thus in 2017: “Invoice factoring...is becoming an increasingly used means of obtaining finance as an alternative to bank loans: global factoring volume reached an all-time high in 2015, with annual turnover reaching €2,373 billion”².

13. The SLC went on: “Utilising these finance facilities can be particularly valuable for SMEs. The Scottish Government’s Small Business Survey published in 2017 found that the main reason small firms sought external finance was to secure working capital and cash flow. 41% of SMEs stated their reason for seeking working capital was to cover a short-term gap until funds were received from customers, whilst 15% said they sought working capital to cover unexpected late payments. SMEs rely heavily on steady cash flow, but are often burdened by the late payments of debts owed to them. A House of Commons briefing paper published in 2017 shows that the average late payment SMEs face is around £32,000, a figure which puts many businesses at risk of insolvency. The paper also showed that 12% of the SMEs which experience late payments say it impacts on their ability to pay their own staff on time, while 20% have difficulty paying business bills like energy, rates and rent. Some 29% rely on costly overdrafts to make up for cash flow shortfalls due to being paid late”³.

14. The Federation of Small Businesses in Scotland have indicated that 3,500 small businesses in Scotland fail each year not because the business is unsustainable, but because the firm cannot get its customers to pay due invoices.⁴ The Late Payment of Commercial Debts (Interest) Act 1998 was introduced to give small and medium sized enterprises (SMEs) the right to claim interest on late payments. It is, however, understood that 80% of small businesses do not do so, for fear of jeopardising business relationships with customers who often have greater bargaining power.⁵

15. Businesses who wish to raise finance on the basis of invoices which are due to be paid to them can assign the debts owed to them (in the form of their invoices due) to an invoice factoring company. The invoice factoring company will typically pay the assignor 80-90% of the money due under the invoices. This obviously aids cash-flow

² https://www.scotlawcom.gov.uk/files/7415/1359/9231/Business_and_Regulatory_Impact_Assessment_-_Report_on_Moveable_Transactions_Report_No_249.pdf page 3-4

³ https://www.scotlawcom.gov.uk/files/7415/1359/9231/Business_and_Regulatory_Impact_Assessment_-_Report_on_Moveable_Transactions_Report_No_249.pdf page 4

⁴ https://www.scotlawcom.gov.uk/files/7415/1359/9231/Business_and_Regulatory_Impact_Assessment_-_Report_on_Moveable_Transactions_Report_No_249.pdf page 4

⁵ https://www.scotlawcom.gov.uk/files/7415/1359/9231/Business_and_Regulatory_Impact_Assessment_-_Report_on_Moveable_Transactions_Report_No_249.pdf page 4

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by providing the business with income much more quickly than if it had to wait to be paid by its customers. Meanwhile the invoice factoring company will pursue the assigned debt. When the invoice factoring company has been paid, it will pay the balance of the sums due under the invoices to the assignor, less the invoice factoring company's fee, which will include an element of interest on the money advanced to the assignee based on the claims assigned.

16. At present, if a business wishes to assign its unpaid invoices to a financial institution in order to raise finance, there has to be written intimation (notification) of the assignation to every invoiced customer (i.e. the debtors). This is cumbersome, expensive and often impractical since there may be numerous debtors. In addition, it cannot be done in respect of future claims (such as invoices due by existing customers in the future) where the debtor cannot yet be identified.

17. The effect is that some Scottish businesses elect to enter into contracts governed by English law in order to avoid the need for intimation. Additionally, due to doubts about the ability to assign claims under future invoices, invoice financiers can charge more for their services in Scotland than they might in England and Wales.

18. If passed, the Bill will introduce a new Register of Assignations which will provide an alternative to intimation as a means of assigning debt.

Security over moveable property

19. In Scotland, there is no such thing as a mortgage over moveable, as opposed to heritable, property as there is in England. The only way to use incorporeal moveable property as security for a debt in Scotland at present (other than by means of a floating charge – see paragraphs 21 and 22 below) is to transfer it into the name of the creditor. For example, intellectual property must be transferred to the lender and complicated licence-back arrangements put in place. Shares in a company similarly have to be transferred to the lender and the lender registered as shareholder. Again, contractual arrangements have to be used to deal with the consequences of transfer, such as entitlement to dividends and voting rights.

20. Effectively the only “fixed” security (other than a floating charge) over corporeal moveables is a pledge. In a consumer context this is known as “pawn”. It requires delivery of the encumbered property to the creditor. This is impractical commercially, as businesses require possession of their assets, such as vehicles and plant and machinery, in order to trade.

21. Floating charges can cover both corporeal and incorporeal moveable property and land, but can only be granted by corporate debtors such as companies, limited liability partnerships and building societies. Sole traders and partnerships cannot grant them. Assets acquired by a corporate entity automatically fall under the charge, but assets disposed of are automatically freed from the charge. As such, a company remains free to deal with its assets. So long as the company stays in business, the charge “floats” over its assets and the effect of the charge is limited. But if the company

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becomes insolvent and is liquidated or goes into administration or receivership, the charge attaches to the company's assets and takes effect as if it were a fixed security.

22. Floating charges give a relatively low ranking in the event of insolvency and lending rates are typically higher than they might be for a fixed security.

23. It is understood that at least one major financial institution will not lend on plant and machinery in Scotland because of the state of the law on moveable transactions. Others will lend, but at higher rates of interest due to the complex workarounds.

24. "Secured" lending is a huge commercial benefit. Individuals or businesses can grant a lender security against an asset (collateral) in exchange for a loan or credit arrangement. If the debt is unpaid, the lender has the right to enforce the security by realising (i.e. selling) the encumbered property, with any surplus returning to the debtor. Secured lending is therefore essentially a means by which creditors can mitigate risk, which in turn lowers the cost of borrowing.

25. The generally accepted advantages of being able to obtain secured, rather than unsecured, lending are:

- "fixed" securities give comfort to lenders because they mean that the loan is secured by the encumbered property, which the lender can possess and sell if the borrower defaults on the loan (similar to a mortgage provider where the homeowner defaults on mortgage payments);
- the cost of borrowing in terms of interest rates is usually lower;
- borrowing limits are normally higher for secured loans;
- secured borrowing usually means lower monthly repayments over a longer term.

26. The instrument under the Bill by which finance will be raised on assets owned or which are being purchased will be called a statutory pledge. It will be the moveable property equivalent of a standard security over land and will be registered in a new Register of Statutory Pledges.

27. Being a "fixed" security, it is designed to be more attractive to lenders than the floating charge as it permits more certainty as to the strength of the security, for example in the event of the borrower's insolvency.

28. By way of example, the Scotch Whisky industry is the third biggest industry in Scotland, behind only energy and financial services. It contributes £5 billion to UK GDP, supports 40,000 UK jobs and accounts for almost a quarter of UK food and drink exports. At any given time, some 20 million casks lie maturing in warehouses across Scotland. Under the current law, the only way whisky producers can grant security over this valuable, yet "idle", commodity is by way of a floating charge. If the Bill is implemented, the new statutory pledge could be used, completed with a straightforward

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online registration. Improving the lending environment for the whisky industry in this way will facilitate business growth in this vital pillar of the Scottish economy.

29. In addition, it is commercially impracticable at present to raise finance over vehicles already owned by the borrower. The only true security available (possessory pledge) requires the borrower to be dispossessed of the property, whilst a sale and leaseback arrangement requires ownership to be transferred, as well as initial physical delivery to the lender. This is impossible where vehicles are used in day-to-day business operations.

30. With the statutory pledge, a business could grant security over its fleet of vehicles in order to raise finance. This would be completed by a simple registration process and would allow the business to retain both ownership and possession of the property.

31. The statutory pledge could also be used in the context of the financing of the acquisition of, for example, plant and machinery – providing an alternative alongside other staged payment arrangements such as hire-purchase.

32. The SLC pointed out⁶ that “difficulties also arise in relation to IP, another form of incorporeal moveable property of significant importance to Scottish businesses and the Scottish economy. Scotland is home to many IP-rich sectors such as food and drink, oil and gas and renewable technologies, IT, life sciences and the creative industries. The UK Intellectual Property Office “Fast Facts 2017” publication⁷ indicates that the global trade in IP licences was worth over £220 billion and rising. The Scottish Enterprise Intellectual Assets Service⁸ estimates that IP assets form around 80% of a Scottish business’s value, and it is predicted that the value of IP to business will continue to increase in the future.⁹ Indeed, UK investment in incorporeal assets protected by intellectual property rights has risen from £23.8 billion in 1990 to £63.5 billion in 2011; a 167% increase¹⁰”.

33. The SLC commented that: “it is therefore crucial that businesses in Scotland are able to fully exploit their IP assets. Granting security over these is one way they can do this, but again, deficiencies in the law require recourse to expensive functional security arrangements which limit the benefits of using IP as security”¹¹.

⁶ https://www.scotlawcom.gov.uk/files/7415/1359/9231/Business_and_Regulatory_Impact_Assessment_-_Report_on_Moveable_Transactions_Report_No_249.pdf page 14

⁷ https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/581279/Fast-Facts-2017.pdf

⁸ <http://www.scottish-enterprise.com/services/develop-new-products-and-services/manage-your-ia/overview>

⁹ <https://www.inhouselawyer.co.uk/legal-briefing/intellectual-property-and-scotlands-constitutional-future/>

¹⁰ https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/467634/Fast_facts_2015.pdf

¹¹ https://www.scotlawcom.gov.uk/files/7415/1359/9231/Business_and_Regulatory_Impact_Assessment_-_Report_on_Moveable_Transactions_Report_No_249.pdf page 14

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34. Under the proposals in the Bill therefore, corporeal assets (such as equipment, livestock and vehicles) or incorporeal assets (limited to IP) will be capable of being offered as fixed security for a loan, rather like a house being used for mortgage finance.

Overview of proposals

35. The Bill introduces a new statutory scheme for moveable transactions law in relation to:

- the assignation of claims over moveable property; and
- security over corporeal and certain incorporeal moveable property.

Assignation of claims

36. In relation to the law of the assignation of claims, the main proposals are:

- Registration will be introduced as an alternative to intimation as a way of completing the assignation of a claim, though the option of intimation will be retained.
- The new option of registration will facilitate the assignation of future claims.
- Registration will be in a new electronic Register of Assignations, administered by the Registers of Scotland.
- The Register of Assignations will be searchable, primarily by reference to the assignor's details.
- The rules on intimation of assignations will also be brought up-to-date, in particular to facilitate electronic intimation.
- It will be made clear that assignations can be subject to a condition which must be satisfied before the assignation takes effect.
- It will also be made clear that the intimation of an assignation can instruct the debtor to continue to perform to the assignor (which in the case of a debt, for example, would mean continuing to pay the assignor).
- Debtors who perform to the wrong person in good faith in particular situations, such as because they are unaware of an assignation, will be protected.
- As under the current law, the parties to a claim will be able to provide for it to be unassignable.
- In order to comply with the Financial Collateral Arrangements (No. 2) Regulations 2003 (SI 2003/3226), assignations of financial collateral are excluded from the Bill.

Security over corporeal and incorporeal moveable property

37. In relation to the law of security over corporeal and incorporeal moveable property, the main proposals are:

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- A new fixed security called a “statutory pledge” will be introduced.
- This will be available in respect of corporeal moveable property, such as vehicles, equipment, whisky and livestock. The property will not require to be delivered to the creditor. This will be the equivalent of a standard security (i.e. a mortgage) over heritable property.
- The statutory pledge will also be available in respect of certain types of incorporeal moveable property, namely intellectual property. The property will again not require to be transferred to the creditor.
- While primarily aimed at businesses, the statutory pledge will be capable of being used by individual consumers to raise finance against assets they already own (of a value above a certain monetary level where the asset is a corporeal one). It will also be capable of being used when purchasing an asset (above that same financial threshold), much like hire-purchase. However, the effect of the monetary threshold is that in practice it will not be possible to use the statutory pledge in relation to essential household items. There will also be an ability for particular items to be expressly excluded from being pledged by individual consumers.
- The rules on possessory pledge will also be clarified. In particular, it will be made clear that this type of pledge can be created by constructive delivery – i.e. by intimation to a third party holder, such as a warehouse.
- There will be a generally uniform enforcement regime for possessory and statutory pledges, with a range of remedies in the event of default including sale, lease and licensing. Enforcement against a private individual will require a court order or express written agreement (which cannot be given in advance).
- A new Register of Statutory Pledges will be established in which statutory pledges will be registered. Like the Register of Assignations, this will be electronic and maintained by the Registers of Scotland.
- Registration in the Register of Statutory Pledges will be required for a statutory pledge to be created.
- It will be possible to update the Register of Statutory Pledges to take account of amendments to, and assignations, restrictions and discharges of, statutory pledges. This latter category will be processed as corrections. The correction process will also be able to be used if the pledge has been extinguished by any other means or if there has simply been an error in what was initially registered.
- The Register of Statutory Pledges will be searchable electronically, primarily by reference to the details of the party that provided the security. But it will also be possible to search by reference to the unique numbers of certain assets, notably motor vehicles.
- Floating charges will be retained (although this is not expressly provided for in the Bill).

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Policy objectives: Specific provisions

38. Part 1 of the Bill relates to the assignation of claims and the establishment of a Register of Assignations. Part 2 relates to the grant of security over moveable property and the establishment of a Register of Statutory Pledges. Part 3 covers interpretation and general matters relating to the Bill.

Part 1: Assignation

39. The policy objective is to modernise the law on the assignation of obligations (usually of debt) generally, including the law on intimation.

General

40. The assignation of a claim will require that an assignation document is executed or authenticated by the assignor, but there will not be any requirement as to the form it must take.

41. The claim will require to be identified in the assignation document because otherwise the document would be meaningless. In commercial practice, however, it is normal to assign multiple claims. For example, a company may assign several or all customer invoices to an invoice discounter. To require every invoice to be individually described in the assignation document would be cumbersome. It would also be impossible in the case of future invoices where the supply of goods or services has yet to be carried out for customers who may yet be unknown. To address these issues and thus facilitate commerce, the Bill will not require the assignation document to contain a specific description of a claim. Identification by reference to a particular class will be permitted: for example, all invoices issued in a particular month.

42. A claim will not be transferred until it becomes identifiable as a claim to which the assignation document relates and which falls within the relevant class. It will therefore be necessary as a matter of good practice, when purporting to assign more than one claim, to list rights of payment in schedules which are sent to the assignee (who may be a factoring company) which enables the rights to be transferred. This obviously will require the careful keeping of agreements and schedules of invoices, particularly if the assignor were to become insolvent.

43. It will continue to be possible to assign a claim subject to a condition which must be satisfied before the claim is transferred.

Dual system of assignation

Bill proposal

44. For an assignation to be completed, intimation to the debtor is required at present. A company may wish to assign to a factor payments which are due to it from

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customers. While the same assignation document can be used to assign multiple claims, the individual assignments cannot be completed unless there is intimation of the assignation to each customer. There are thus three stages to the transfer: (a) the contract to assign; (b) the execution and delivery of the assignation document; and (c) the intimation to the debtor. Without intimation there is no transfer. For the assignation of multiple claims, the current law is thus costly and cumbersome.

45. The SLC concluded¹² that requiring an external act would make fraud more difficult in relation to assignation and would make it clear when the assignation took place. It would also promote economic efficiency since third parties will be able to check the position. The external act proposed would be registration of the assignation document in a new register.

46. The Bill will make it possible to intimate by means of registration of the assignation document in a new Register of Assignations (“RoA”) as well as by intimation to the debtor (in which regard it will become possible to intimate electronically). This will accommodate both large scale transactions such as the transfer of a company’s invoices but also smaller, more private arrangements.

Other options

47. The SLC Report acknowledged (at paragraph 5.9¹³) that the policy matter of completion of title to claims and the combined system of intimation and registration was a difficult one. A “claim” is a right to the performance of an obligation, typically the payment of a debt. Concerns were expressed to the SLC about the retention of intimation to the debtor as a means of assigning debt, rather than registration in the RoA only, largely along the same lines referred to at para 5.19 of the Report (namely that a “combined system” of intimation/registration means that a third party cannot rely solely on the register).

48. The Scottish Government therefore considered the possibility of only permitting assignation of claims by means of registration in the RoA – in other words, removing the possibility of assignation by intimation. This was broached with the SLC since the current system is expensive and cumbersome due to the need to intimate to all debtors and the inability to deal with future claims and future debtors. Assignation by intimation will also not reveal the existence of an assignation to a third party searching the RoA.

49. The points raised with the SLC by the Scottish Government were as follows:

- The combined system of intimation/registration means a third party will not be able to rely on the RoA alone. There could therefore still be fraudulent assignments by intimation to more than one party.

¹² https://www.scotlawcom.gov.uk/files/1715/1361/1309/Report_on_Moveable_Transactions_-_Volume_1_Report_249.pdf Chapter 5

¹³ https://www.scotlawcom.gov.uk/files/1715/1361/1309/Report_on_Moveable_Transactions_-_Volume_1_Report_249.pdf

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- It is proposed that registration in the RoA will be online, cheap and easy. One-off transactions could be completed by intimation to the debtor which, it is assumed, would also be cheap and easy. However, if there is a functional equivalent which is not significantly more expensive or onerous, it may not be necessary to offer the alternative.
- The three rationales for intimation are publicity, debtor protection and priority. The RoA will provide all of these.
- Assignations in favour of financiers will in future invariably be registered because this will be simpler and easier than intimation to multiple debtors.
- Intimation will still not be an option for future claims as the identity of the debtor will be unknown.
- With the RoA, an assignee is only at risk from a fraudulent or negligent assignor who does not disclose that the claim has already been assigned by intimation. This possibility would be removed if intimation was not possible.

50. The SLC indicated that they appreciated that the register would not be comprehensive but had concluded that the benefits of a facilitative approach outweighed the benefits of further reducing the risk fraudulent transactions by making registration compulsory. They argued that no-one could be disadvantaged by the facilitative approach, but the benefits of registration were available if desired. They feared that there was a risk of active opposition if people were forced to carry out their assignment transactions in a different way. They cited the example of project finance transactions where only a small number of parties are involved (in comparison with factoring and invoice discounting where there may be hundreds of debtors) and where there will be a desire to continue to use intimation rather than having to register.

51. The SLC also drew attention to the debtor protection measures in the Bill and specifically the right to withhold performance until evidence of, or a statement as to, the granting of an assignment document is provided. They thought that this protected the debtor where there are multiple fraudulent purported assignments and was a considerable improvement on the current law.

52. A number of stakeholders pointed out that some creditors will prefer to continue to assign by means of intimation since they will not want to publicise the assignment of a debt in a public register and would prefer the confidentiality offered by intimation. Obviously the decision may depend on how many debtors would have to be informed and whether the assignment relates to any future claims. Both of these factors may persuade parties to register rather than continue to use intimation.

53. The Asset Based Finance Association (now part of UK Finance), representing the factoring and invoice discounting industries, favoured the flexibility offered by the joint system of intimation or registration and their view was persuasive in relation to the SLC proposals¹⁴. While factors and invoice discounters will prefer to register, many

¹⁴ https://www.scotlawcom.gov.uk/files/1715/1361/1309/Report_on_Moveable_Transactions_-_Volume_1_Report_249.pdf para 5.11

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transactions will continue to be completed by intimation, particularly small, one-off transactions. Under the Bill, the Scottish Ministers will, however, have a power to specify categories of claim where registration will be required for the transfer of a claim.

54. The Scottish Government also asked whether there was any particular group whom the SLC thought might wish to intimate assignation rather than register and for whom the option should remain available. The SLC noted that while financial institutions would know about registration, those involved in one-off transactions may not. Such parties might carry on as they always have and then discover that what they have done is invalid because of non-registration in a register of which they have never heard. There may also be particular types of commercial transaction where intimation is favoured over registration. One law firm wrote to the SLC in 2017:

“We understand the upcoming SLC report will propose an electronic [register]. Our understanding is that registration on this Register would replace intimation by post, although such intimation would remain as an option. Many of our clients may choose not to intimate on a public register, due to (i) confidentiality reasons and (ii) a reluctance to have information in respect of debt publicly available. In these circumstances, intimation by email would be a valued option and would mirror the efficiencies of an electronic filing on the Register.”.

Conclusion

55. The Bill provides for the combined system of intimation and registration proposed by the SLC. It does seem possible that some parties will wish to continue to intimate assignation (possibly for reasons of confidentiality) rather than register in the new RoA. If, at some point in the future, it is thought that the intimation has dropped in usage to the point where the advantages of the flexibility offered is outweighed by the desirability of eliminating the risk of fraud by requiring registration, it may be desirable to require registration for all transfers. If that were to happen, the law could be revisited at that point.

56. The Scottish Ministers are also given a power under the Bill to specify particular categories of claim where registration is required for transfer. If this power was used, the RoA could then increasingly be assumed (in relation to those particular categories of claim) to be comprehensive from the date of that change and this would avoid any need for further investigation with the assignor as to whether an assignation document has been granted.

Assignation of future claim

57. Due to the requirement of intimation, it is impossible under current Scots law to assign claims which do not exist at the time the assignation document is granted. These claims may be, for example, invoices issued over a particular future period. But one cannot intimate an assignation to a debtor who is unknown. The current law in Scotland in relation to the assignation of claims arising after the assignation document is granted contrasts unfavourably with the position in England and Wales.

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58. The SLC consulted on whether the law should allow a future claim to be assigned (subject to the right in due course coming into being and being identifiable as the claim to which the assignation document relates). All the consultees who responded to this question agreed that this should be permitted. The WS Society said that this was “the single reform of the law which is probably the one most fundamentally required to make Scots law a usable system for invoice finance and securitisations”.¹⁵ The Asset Based Finance Association said that because of the current law “much of the Scottish business [carried out by our members] is artificially channelled through English law to avoid Scots law difficulties”.¹⁶

59. The Bill will make it possible to assign a claim which does not exist at the time the assignation document is granted (though it would not be effective until the claim was acquired by the assignor and all of the requirements for the transfer of the claim were met). For a future claim to be transferred, it would therefore, in addition to the usual requirements for an assignation, have to (1) have come into being; (2) be identifiable; and (3) be held by the assignor. As above, rights to payment will in practice have to be set out in schedules which are sent to the assignee by way of further intimation and this will transfer the right to payment. Registration, as an alternative to intimation for completion of an assignation, will permit the assignation of future claims because it will not be necessary to register the details of the debtor as well as the assignor and assignee.

60. In practice, invoice financing will almost always proceed by means of registration. This is because it is invariably dealing with claims arising subsequent to the assignation document being granted and therefore the details of account debtors are not known. As such, intimation is not possible. The RoA would therefore be a near-definitive source of information as to whether invoice financing has taken place.

Financial collateral - assignation

61. Security over financial collateral is the subject of dedicated, and complex, legislation. The Financial Collateral Directive (the “Directive”), dating from 2002 and substantially amended in 2009, applies in EU Member States. It was implemented in the UK by statutory instrument, the Financial Collateral Arrangements (No.2) Regulations 2003 (“the 2003 Regulations”).¹⁷

62. The Directive aims to achieve a harmonised set of rules on financial collateral in the European Union which enable security over this type of asset to be taken and enforced more easily. However, it has been the subject of significant negative comment, notably for its wide scope of application and lack of clarity.

¹⁵ https://www.scotlawcom.gov.uk/files/1715/1361/1309/Report_on_Moveable_Transactions_-_Volume_1_Report_249.pdf para 5.95

¹⁶ https://www.scotlawcom.gov.uk/files/1715/1361/1309/Report_on_Moveable_Transactions_-_Volume_1_Report_249.pdf para 5.95

¹⁷ <https://www.legislation.gov.uk/ukSI/2003/3226/contents>

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63. It had been the intention that the Bill should provide for the assignation of claims including those which are financial collateral arrangements pursuant to the 2003 Regulations.

64. However, in order to comply with the Directive and the 2003 Regulations, the Bill would have had to make provision for the application of the new rules on assignation. One of the ways in which it would have done so would be to disapply the usual rules for execution or authenticity in relation to the registration of a claim in the proposed new Register of Assignations, in accordance with the 2003 Regulations.

65. The Scottish Government has concluded that it cannot include the provisions which were included in the SLC Bill in relation to the assignation of claims under the 2003 Regulations, but has asked the UK Government to grant an Order under section 104 of the Scotland Act 1998. The Order would have the same effect as if the provisions had been included in the Bill and would therefore complete the full extent of the reforms recommended by the SLC.

Assignation of claims: insolvency

66. The Bill makes provision for the effect of the assignor's insolvency where the assignor granted an assignation document in respect of a claim not yet held by them. An assignation document granted before the assignor becomes insolvent will, as a general rule, be ineffective in relation to a claim if the assignor is insolvent at the time of becoming the holder of the claim.

67. The SLC concluded, however, that the assignation of certain subsequently-held claims should not be rendered ineffective as a result of the claim coming to be held by the assignor after the commencement of an insolvency process. The types of claims which they considered should continue to be transferred to the assignee during the assignor's insolvency are claims to income deriving from property. For example, if someone assigned future royalties from a patent or future rents under a lease, the assignation should continue to be effective. But this rule will not apply to any income attributable to anything agreed to, or done by, the assignor after the assignor becomes insolvent. So invoices in relation to jobs carried out after sequestration would not be assigned. Similarly, income from property which is not in existence at the time the assignor became insolvent (for example, intellectual property rights from new works) will not be transferred.

68. If a person who has assigned a claim is discharged following either sequestration or the granting of a protected trust deed, the assignation will be ineffective as regards the claim to which it relates if, as at the time of discharge, the assignor has not become the holder of the claim. This means that the category of assignations which continue to be effective despite an insolvency (as set out under paragraph 67) are limited to the period of the insolvency. The assignor is thus assisted in making a fresh start once the insolvency ends.

Assignment in part

69. Usually a whole claim will be assigned, but it is possible in other jurisdictions for only part of a claim to be assigned. This can be more of a burden to the debtor, particularly if it is not a monetary claim, since they will have to perform to two or more parties. For that reason, the Bill provides that a right to performance of a non-monetary obligation may be assigned in part only if the debtor consents or the right is divisible and the assignment does not make the obligation significantly more burdensome.

70. At the suggestion of consultees of the SLC, the rule will, however, be subject to any express provisions agreed between the parties to the claim. So it will be possible to exclude assignment in part entirely and also to depart from the default rule that the assignor will be liable to the debtor for any expense incurred by the debtor because the claim was assigned in part.

71. Anti-assignment clauses preventing assignment of claims will generally continue to be valid.

Claim in respect of wages or salary

72. The Bill will not permit assignments of salary or wages or similar payments since, as a matter of public policy, people should not be able to assign away their core income. Under existing law, social security payments and pension rights cannot be assigned.

Requirements for intimation

73. The SLC noted in relation to the law relating to assignment by intimation that “the uncertainty in the current law is unsatisfactory and detrimental to the needs of business. We consider that there should be clear modern statutory rules”.¹⁸ The Bill will provide for the ways in which assignment can be intimated. The most common method will be by written notice to the debtor and this may be by electronic notice where an email address has been provided. Another method will be by the debtor acknowledging to the assignee that a claim is assigned either by performance by the debtor to the assignee or a promise to perform of something which the assigned claim obliges the debtor to perform. Notice in judicial proceedings to which the debtor is a party that the assignment is founded upon will also serve as formal intimation.

Protection of debtors

74. The Bill provides a number of rules to prevent a debtor being prejudiced by an assignment of which they are unaware. The existing law on defences (which ensures the debtor’s rights are not prejudiced by the assignment) is also put on a statutory

¹⁸ https://www.scotlawcom.gov.uk/files/1715/1361/1309/Report_on_Moveable_Transactions_-_Volume_1_Report_249.pdf para 5.34

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footing, since debtors have no control over assignment unless there is an anti-assignment agreement. The following paragraphs describe the main protections.

Protection of debtor who performs in good faith

75. Under the existing law, a claim will only transfer if it is intimated to the debtor, but the effect of the Bill will be to extend the scope of intimation and to enable registration as a method of effecting a transfer of a claim. If the assignment document has been registered, the debtor may therefore not know that the claim has been assigned and may in good faith continue to pay an assignor who is no longer the creditor. The Bill therefore provides that a debtor who does not know that a claim has been assigned will still be discharged from the debt to the extent of any payment that is made in good faith to the last known holder of the claim.

76. This general rule will protect a debtor who performs in good faith to the assignor where a claim has been assigned in whole or in part. It is not considered reasonable to expect the debtor to search the RoA as this would involve time and cost. The fact that an assignment document has been registered or that it has been deemed to have been intimated by post or email (but has in fact not been received safely) would not of itself mean that a debtor is in bad faith. In any dispute as to whether the performance was in good faith, the burden of proof will lie on the party who argues that performance was not in good faith.

77. The Bill will also provide protection for debtors who are in good faith where the assignor is not in good faith (or has acted in error) and granted multiple assignment documents in respect of the same claim. The debtor should be protected, particularly since an assignment of a claim could be completed by registration instead of intimation. For example, an assignor might assign a claim and the assignment document may be registered by the assignee (which would not involve intimation to the debtor). The assignor might then purport to assign the claim to another assignee who intimates to the debtor. The debtor might then perform to the purported assignee, being unaware of the prior assignment by registration. The debtor would be discharged to the extent that the debtor has performed in good faith to the first assignee about whom the debtor receives notice by means of intimation.

78. This further rule of debtor protection would be similar to the general rule in that:

- discharge would only be to the extent of the performance,
- the debtor would not be regarded as not being in good faith merely because the assignment document has been registered or notice of the assignment has been deemed to have been received, and
- it would be for a party asserting that the debtor is not in good faith to prove this.

79. In addition, the Bill provides protection where a claim is not transferred only because the Scottish Ministers have, by regulations, provided that the type of claim in question cannot be transferred by intimation of the assignment and must instead be

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registered. If the debtor is unaware of that rule, they can be protected where they act in good faith in reliance upon the intimation they receive.

Asserting defence or right of compensation

80. The Bill puts the common law rule *assignatus utitur jure auctoris* into statutory form. The effect is that the defences which the debtor can plead against an assignor can also be pled against the assignee, so that the debtor is not prejudiced by the assignation. The new rule applies by default, so that it is open to the debtor and the assignor to agree that the debtor may not assert a particular right (for example, as part of a deal to make the assignation a more attractive prospect to a potential assignee).

81. The debtor would also be able to assert against the assignee any right of compensation (including a right of contractual set-off where the basis of that right is the contract which gave rise to the claim) available to the debtor against the assignor, up to the time when the debtor would no longer have been in good faith had the debtor performed to the assignor. This replaces the existing law that compensation can only be pled in relation to debts which arose prior to the date of intimation of the assignation and is necessary because under the Bill a claim can transfer by registration.

82. The fact only that an assignation document has been registered, or that a notice of an assignation has been deemed to have been received, will not of itself mean that a debtor (or any co-debtor) is to be regarded as having performed other than in good faith.

Right to withhold performance until evidence of, or statement as to, assignation is provided

83. Under the current law, the debtor is protected by the requirement for intimation to effect assignation. Other than in the case of the intimation not actually reaching the debtor (for example, by going missing in transit), the debtor will know that there has been an assignation because of the intimation. It will often be the case that the debtor has little or no knowledge of an assignee, either before or after an assignation is intimated (given that there is no requirement to include a copy of the assignation document when intimating the assignation).

84. Under the Bill, however, it will be possible for assignation to be effected by registration. The Bill therefore provides protections for debtors who have only limited knowledge of a possible assignation and might pay a purported assignee of a claim rather than the true holder of the claim.

85. A debtor to whom an assignation has been intimated by an assignee will be entitled to request from the assignee reasonable evidence of the granting of the assignation document. "Reasonable evidence" would include the written confirmation from an assignor that an assignation document has been granted by that assignor. This need not include a copy of the assignation document.

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86. A debtor who has reasonable grounds to believe that an assignment document has been granted (other than by it being intimated to them) will be entitled to ask the assignor whether there has been an assignment.

87. Finally, given that a claim does not transfer under an assignment document until all the requirements of section 3(2) of the Bill are met, a debtor who knows that an assignment document has been granted (whether because they availed themselves of the rights discussed above or not) is entitled to ask the assignor or assignee whether the assignment is conditional and, if so, whether the condition has been satisfied.

88. Until the debtor receives the evidence or confirmation, the debtor is entitled to withhold performance from the assignor and assignee.

Register of Assignations

Structure

89. The new RoA will be a public register under the control of the Keeper of the Registers of Scotland and under the auspices of the Registers of Scotland. The RoA is principally likely to be used by banks and other institutions which provide finance in return for the assignment of claims – for example, the assignment of invoices and income streams such as rents and intellectual property royalties.

90. The RoA is required to facilitate the practice of registering claims as an alternative to intimation, and so there will be a register of assignments of claims held in the assignments record. In line with the position in the Land Register of Scotland, there will also be an archive record, in which archived material will be kept by the Keeper, for example in relation to corrections to the register. This is important as it will allow a record to be kept of why any changes were made and what the nature of those changes were, which may be important if, for example, an attempted correction proves not to be right and later needs to be reversed.

91. The Scottish Government intends for the register to be as user-friendly as possible. An entry for each assignment document will therefore contain key information, such as the names and addresses of the parties and the date and time of registration, which will facilitate searches. Where the assignor is an individual, the assignor's date of birth will be included in an application but, under rules to be made under the Bill, will not be disclosed on the face of the register for data protection purposes. Where the assignor or assignee is a legal person with a unique identifying number, such as a UK limited company or limited liability partnership, the Scottish Ministers will be able to specify that these unique numbers are included in the entry in the assignments record because, whilst the names of an entity are subject to change, the unique identifying number ought to remain the same.

92. While an entry in the assignments record must include a copy of the assignment document, the Scottish Ministers will be able to specify that information in the record,

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including information in the assignment document, will not be disclosed in a search of the RoA in order to protect confidential information of the parties.

Applications for registration

93. Applications for registration of assignment documents will be made by the assignee or their legal representative in line with the normal rule of property law that the recipient of the property completes title. Registration will usually be completed online. It will, in general, be automated and require minimum human intervention by Registers of Scotland staff (unlike the Land Register of Scotland). Commercial demands require that the registration process is as fast and efficient as possible. This also removes the potential for human error in the information being transferred from an application form to the register.

94. Verification statements confirming the date and time of registration and the registration number for the entry will be sent to both the assignee and the assignor by email, and for this purpose the applicant should provide up-to-date email addresses for both. It is assumed that the assignee as applicant will be able to provide their own email address, but if they fail to provide the email address of the assignor then the assignor will not receive a verification statement and may request a copy of the statement from the assignee.

Effective registration

95. To ensure the accuracy and reliability of the RoA, the registration of an assignment document will be ineffective if:

- the entry made up for it does not include a copy of the assignment document,
- that document is invalid (possibly because it is a forgery), or
- there is an inaccuracy in relation to the data registered which, as at the time of registration, is seriously misleading.

96. However, if an inaccuracy is seriously misleading in relation to only part of an assigned claim, that does not affect the validity of the rest of the entry. Likewise, if it is seriously misleading in relation to one assignor but not another, the registration is only ineffective in relation to the assignor in respect of whom the entry is seriously misleading. The intention is only to negate the effect of registration to the extent that is necessary in order to avoid users being seriously misled.

Seriously misleading inaccuracies

97. There is not a closed list of cases where an inaccuracy will be treated as being seriously misleading. There are a number of cases where an inaccuracy will conclusively be deemed to be seriously misleading but, outwith these cases, it will still be possible for the seriously misleading threshold to be reached based on an objective reasonable person test (which will be informed by the cases specified in the section). This non-exhaustive approach has been taken in order to avoid inadvertently setting the

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parameters for what is seriously misleading too narrowly in a way that would not allow all the circumstances of a particular case to be considered.

98. The policy is that if an entry contains an inaccuracy that prevents it being disclosed by a properly formatted search, that inaccuracy should generally be regarded as being seriously misleading. The rules are formulated accordingly. However, where the assignor is a company or other body with a unique identifying number, it will not matter if the assignor's name contains an inaccuracy as long as the number is correctly recorded, as the policy is that searches should be carried out by reference to that number (since it will not change in the way that names might).

99. Further, an entry will be seriously misleading if the assignee's name is wrong in a way that would seriously mislead the reasonable person (meaning that a simple typo is unlikely to meet this threshold). However, unlike with assignors, this rule is not formulated by reference to searching since the policy is that, for reasons of commercial sensitivity, it should not be possible to search by assignees. In addition, although it is not a means by which the Bill provides for the assignments record to be capable of being searched, incorrectly recording the type of claim assigned will also result in the entry being seriously misleading if RoA Rules consider this a sufficiently important aspect that they require it to be listed.

100. An inaccuracy in an entry in the assignments record may be seriously misleading irrespective of whether any person has been misled: what matters in relation to searching is what results a search would return if it were done. Beyond that, what matters is whether the reasonable person would be misled. In determining whether an inaccuracy is seriously misleading no account would be taken of the assignment document included in the entry as the search is not made against that document and the register entry is considered more important as it will provide more readily accessible information.

Corrections

101. The Keeper will be able to correct a manifest inaccuracy in the assignments record where what is needed to correct the inaccuracy is also manifest. The Keeper is to make a note of the inaccuracy on the entry for the assignment in the assignments record if what is needed to correct the inaccuracy is not manifest.

102. A correction might mean, for example, correction by the removal of data included in an entry from the assignments record (and the transfer of that entry to the archive record), the replacement of data, or of a copy document, included in an entry or the restoration of data, or of a copy document, to an entry (whether or not by removing it from the archive record and transferring it to the assignments record). Any correction will be notified to anyone specified under rules made by the Scottish Ministers, as well as any other persons whom the Keeper believes to be materially affected by the correction.

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103. A correction may occur because an inaccuracy is drawn to the Keeper's attention or because a court directs the Keeper to correct it. A registration which was inaccurate to the extent that the registration was ineffective will be considered effective once correction has taken place.

104. A correction is only likely to be necessary in relation to the Register of Assignations if an error has been made by the applicant in the original application form or if a fraudulent application has been submitted maliciously. Supervening events will not have a bearing on the accuracy of the register because the record is only intended to show that an assignation document was granted and registered at a particular time, and that will not change. As such, a corrections application process has not been provided for (in the way it has in relation to the Register of Statutory Pledges) but there is a power to introduce such a process if it transpires that more corrections are sought than is expected.

Searches and extracts

105. The SLC noted: "One of the principal policy reasons for having a Register of Assignations is so that it can be searched against particular persons to check whether they have granted an assignation. It is therefore self-evident that the RoA requires an effective searching mechanism. Searches would of course be made electronically under the automated system and would not require the involvement of the Keeper's staff."¹⁹

106. Any person will be able to search the assignations record, but only:

- by reference to any of the following data:
 - the names of assignors,
 - the names and month and year of birth of assignors who are individuals (for data protection purposes, the full date of birth will not appear on the RoA),
 - the unique numbers of assignors required by RoA Rules to be identified in the assignations record by such a number,
- by reference to registration numbers allocated to entries in that record, or
- by reference to some other factor, or characteristic, specified for these purposes by RoA Rules.

107. While some registration systems restrict the categories of persons who can search the register in order to protect the privacy of parties whose details are registered, the logic of registration is publicity, not privacy. For that reason, anyone will be able to search the RoA provided they pay the requisite fee. However, information which the Scottish Ministers consider should remain confidential will be able to be exempted from disclosure under RoA Rules. In addition, the Scottish Ministers could make Rules limiting the number of searches by reference to the same name and different months

¹⁹ https://www.scotlawcom.gov.uk/files/1715/1361/1309/Report_on_Moveable_Transactions_-_Volume_1_Report_249.pdf para 10.1

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and years of birth that can be made in a particular time period. This will allow the appropriate balance between accessibility and protection to be provided.

108. The Keeper will be required to provide a search facility allowing searching as set out in paragraph 106.

109. As in the Land Register, it will be possible for an application to be made to the Keeper for a formal extract of an entry.

Information duties

110. It will be possible for certain information about an assignment to be demanded by those with particular reason to require information about the assignment.

111. The SLC noted that: “The information which would appear in entries in the RoA would not always be comprehensive. This is true even although a copy of the assignment document appears in the entry. For example, an assignment may be of future invoices specified in schedules to be sent from the assignor to the assignee. Thus the register by itself would not reveal whether a particular invoice has been assigned. Another possibility is that the assignment document contains a suspensive condition. The register would not reveal whether the condition has been purified.”²⁰ A “suspensive condition” is one which has to be satisfied (i.e purified) before the assignment is completed and the claim transfers and, as such, is of direct relevance to anyone who needs to know whether the claim has transferred (since registration is only one of the elements required under section 3 in order for that to occur).

112. The SLC therefore recommended that that there should be limited statutory information duties owed to a limited number of third parties. The information which can be requested is limited: a third party will only be able to ask whether a particular claim is assigned by the assignment or whether a condition to which the assignment is subject has been satisfied. It will not be possible simply to ask for a list of all the claims that have been assigned. The starting point will be that the third party identifies the claims in respect of which the information is sought. For example, an information request could be made as to whether invoices issued in May 2022 have been listed in a schedule in a case where the assignment is of future invoices to be specified in schedules.

113. Only a limited category of persons will be entitled to make a request – namely those who are affected or potentially affected by the assignment in specified ways. Normally, third parties will only be able to make a request if they have the permission of the person identified in the entry as the assignor.

²⁰ https://www.scotlawcom.gov.uk/files/1715/1361/1309/Report_on_Moveable_Transactions_-_Volume_1_Report_249.pdf para 11.2

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114. The person identified as the assignee in the entry in the RoA will then have 21 days to comply with the request. The assignee will be entitled to recover costs reasonably incurred in providing the information to the requester.

Entitlement to compensation

115. It is considered that a person should be entitled to be compensated by the Keeper of the Registers for loss suffered in consequence of an inaccuracy in the record to the extent that it is attributable to the Keeper in the making up, maintenance or operation of the RoA (including in an attempted correction of the register). This liability to compensation also arises where loss is suffered due to applications being processed in the wrong order, being accepted or rejected in error, or being unable to be submitted due to an error with the Keeper's systems. It is considered appropriate that there should be liability in the event that such a situation were to arise because it might allow another assignee of the same claim to register a competing assignation first, meaning (if registration is the final element under section 3 of the Bill) that the claim transfers to them instead. There is also a right to be compensated where certain materials produced by the Keeper are incorrect.

116. In addition, it is considered that there should be a right to be compensated where the fault is caused by someone other than the Keeper and who fails to take reasonable care. As such, where a person suffers loss in consequence of an inaccuracy in an entry in the RoA which is not attributable to the Keeper, the person is entitled to be compensated for that loss by the person who made the application which gave rise to the inaccurate entry, or who caused an incorrect "correction" to be made, if that person failed to take reasonable care in doing so. In addition, where a person suffers loss in consequence of a failure to respond to a request for information under the information duty provisions, or the provision of information in which there is an inaccuracy, the person is entitled to be compensated for that loss by the person who failed to supply the information if that failure was without reasonable cause or if, in supplying it, that person failed to take reasonable care.

117. In both cases, the rules are limited to cases where the loss could not reasonably have been avoided and do not cover cases where the loss was not reasonably foreseeable. Non-patrimonial loss is also not covered.

RoA Rules

118. The detailed rules of procedure for the RoA will be set out in secondary legislation which will be brought forward by Scottish Ministers following consultation with the Keeper.

The Transmission of Moveable Property (Scotland) Act 1862

119. The Bill renders this legislation, which provided for assignation by intimation only, obsolete. As such, it is disapplied in so far as it relates to assignations provided for under the scope of the Bill. The Act is left unchanged in respect of those assignations to which the Bill does not relate – i.e. the assignation of a claim as part of a financial

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collateral agreement, within the meaning of regulation 3(1) of the Financial Collateral Arrangements (No.2) Regulations 2003.

Benefits

120. This reform is expected to significantly assist the invoice financing sector in Scotland and the indicative figures given above indicate that significant sums may become available to business in Scotland if invoice factoring were to take place in Scotland to the same extent as it does south of the border. The registration option will also allow the effective assignment of claims which have yet to come into existence, where intimation is thus not possible.

121. The current requirement for intimation in order to assign a claim is clumsy, time-consuming and expensive as it requires intimation to all debtors. It is currently detrimental to the invoice discounting sector (the invoice is discounted because the assignee will not get paid until much later) which wants to be able to assign claims which do not yet exist. This can be bypassed by workarounds including using English law, but this increases transaction costs of Scottish parties.

Other options

122. The only other options, other than the reforms proposed in the Bill, would be (1) to continue to rely on the 1862 legislation on assignation by intimation alone (which is clearly out-of-date and incapable of properly serving modern commerce) or (2) to move to a system of assignation by registration alone. While the second option was considered fully, as set out at paragraphs 47 to 54 above, it was ultimately rejected for the reasons set out at paragraphs 55 and 56.

Part 2: security over moveable property

Pledge

Overall approach

123. Part 2 of the Bill deals with reform of the law of security over moveable property in Scotland. A pledge is a right in security over moveable property. It will be possible to create a pledge over corporeal moveable property, as under existing law, but it will now also be possible to create a pledge over incorporeal moveable property which takes the form of intellectual property.

124. Corporeal moveable property is property that has physical form, other than land or buildings (known as heritable property). It includes plant and machinery, whisky and motor vehicles. Incorporeal moveable property is property that does not have physical form, such as intellectual property or financial instruments (although the latter is not covered by the statutory pledge provisions in the Bill).

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125. The obligation secured by a pledge is referred to in the Bill as a “secured obligation”. The property over which the pledge is created is known as the “encumbered property”. The person who grants the pledge is known as the “provider”.

126. In the case of corporeal property, it will still be possible to create a pledge in the two ways provided for under the current law:

- by delivery of the property to the person in whose favour the pledge is granted (i.e. the creditor), provided that the property is the provider’s at the time of delivery, or
- in a case where the property is not the provider’s at the time of such delivery, when the property becomes the provider’s subsequent to such delivery.

127. Under the provisions of the Bill, however, it will also become possible to create a pledge over corporeal or incorporeal property (or property which is both corporeal and incorporeal) by registration in the proposed new Register of Statutory Pledges.

128. The Bill will thus enable secured lending to take place more easily and widely in Scotland. It will be possible for:

- security to be granted over corporeal moveable assets without having to deliver these to the creditor, and
- security to be granted over certain incorporeal moveable assets without having to transfer these to the creditor.

Possessory Pledge

129. Under the existing law in Scotland, a pledge is a possessory security. In other words, the relevant property must be physically delivered to the secured creditor in order to restrict the ability of the provider of the pledge to deal with the property. Thus while in principle the provider can still sell the property to a third party, the third party is warned of the existence of the pledge by the fact that the provider does not have direct possession of the property. It is, however, considered that the requirement for physical delivery is an unnecessary and restrictive interference with the intentions of the parties and particularly that it is out of keeping with commercial realities.

130. The Bill therefore sets out the forms of delivery which are permissible for possessory pledge. In policy terms, it should, first of all, clearly continue to be possible to pledge corporeal moveables by physically handing these over to the secured creditor or to a person authorised to accept delivery on that person’s behalf. Larger items such as vehicles might not be physically handed over as such, but rather control might be given to the secured creditor perhaps by means of keys. Second, the policy is that it should be competent for goods in a particular location to be pledged by giving the secured creditor, or a person authorised to act for that party, control of the location. The usual way to do this would be to hand over the keys to the relevant location, such as a store. Third, constructive delivery by instructing an independent third party holder of the property to hold it on behalf of the secured creditor, or that party’s authorised

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representative, should also be possible. The usual case would involve goods held in a warehouse. Fourth, means of handing over a bill of lading should be available, as it is under English law.

Statutory Pledge

131. A pledge which is created by registration will be known as a statutory pledge. The statutory pledge will require to be constituted in a document which makes the grant of the pledge by the provider in favour of the secured creditor. There are a number of reasons for this. First, with possessory rights in security, the secured creditor takes possession of the encumbered property. With non-possessory rights in security, the encumbered property remains in the possession of the provider and other evidence is therefore needed to prove the existence of the right. Second, the new security right will be created in a similar way to a standard security over heritable property, namely by the registration of a constitutive document in a register. As such, it would not be possible for a statutory pledge to be granted orally as that would not be capable of registration in the new Register of Statutory Pledges. Third, where the provider of a statutory pledge is a company or LLP, Part 25 of the Companies Act 2006 means that the statutory pledge as a right in security would also need to be registered in the Companies Register. Since 1 April 2013, this requires registration of the constitutive document.

132. The constitutive document will have to be subscribed by the provider using a physical signature (“executed”) or signed electronically (“authenticated”).

133. The constitutive document will have to identify the encumbered property. In general, that may be either property of the provider, or property to be acquired by the provider (including property not yet in existence). The level of identification will have to be sufficiently clear to allow third parties to determine which assets are covered. It will, however, be possible in most cases for items of encumbered property to be described in terms of an identifiable class such as “all computers owned by the company” or “the computers to be listed on schedules to be sent” from the provider to the secured creditor. The rules which will apply to individuals (other than sole traders) are slightly different though, in order to protect them from granting a pledge which applies more broadly than they might have intended when granting it – see paragraphs 154 to 159.

134. The constitutive document will also require to state the secured obligation – for example, the loan which is to be repaid.

135. It will not be possible to grant a statutory pledge over aircraft and ships, since these are subject to different statutory security regimes.

136. The SLC accepted that the optimum position would be for all incorporeal moveable property to be capable of being encumbered, but suggested that this ought to await future developments, in particular in corporate insolvency law.²¹ The SLC

²¹ See in general chapter 22, https://www.scotlawcom.gov.uk/files/9215/1361/1360/Report_on_Moveable_Transactions_-_Volume_2_Report_249.pdf

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therefore recommended that the statutory pledge should, at least initially, only be available in respect of incorporeal moveable property for certain asset classes – specifically intellectual property and financial instruments. However, the Scottish Government do not consider that the statutory pledge can be made available to financial instruments (at this point, but see paragraph 151 below). It specifically considered whether the new statutory pledge should be applicable to all types of incorporeal moveable property, but concluded that this should not be the case.

137. There is provision in the Bill for the creation of a statutory pledge over incorporeal moveable property of such kind as is prescribed. It will therefore be possible for the Scottish Ministers to add to the classes of incorporeal moveable property in the future without further primary legislation as and when it is considered appropriate and desirable, so that the Bill is future-proofed as much as possible. This is intended to make it possible for the provisions of the Bill to be applied to, for example, crypto-assets and smart contracts in the future.²²

Compulsory registration for creation

138. A statutory pledge will be created over the relevant property by registration. The SLC considered that there were strong arguments in favour of registration:

“[Registration] helps third parties, in particular future potential lenders, to know the position. The transparency brought about by registration also reduces the scope for disputes. It thus facilitates non-possessory security, while at the same time protecting third parties. In addition it reduces the scope for fraud. A debtor’s statement that certain assets are unencumbered can be checked by inspecting the register. In the event of insolvency, registration makes it easier to ascertain what rights the various creditors have. The general effect is to promote economic efficiency. Furthermore, because of the digital revolution, registration can be done quickly and cheaply”.²³

139. In addition, the property which is the subject of the statutory pledge must be the provider’s property, and it must be identifiable as property that is subject to the pledge. The pledge is only created when each of these requirements is met, regardless of which occurs first.

140. Any amendment to the statutory pledge which adds property to the encumbered property or which increases the scope of the secured obligation (in a case where the extent of the secured obligation is clear from the entry in the register) will also be effected by registration.

141. It will, however, remain possible for it to be anticipated at the time of the original registration that the statutory pledge will apply to future-acquired property (for example, “all computers to be acquired by the company”) and an amendment to the Register of

²² For a definition of crypto-assets and smart contracts, see “Legal statement on crypto-assets and smart contracts” published by the UK Jurisdiction Taskforce in November 2019.

²³ https://www.scotlawcom.gov.uk/files/9215/1361/1360/Report_on_Moveable_Transactions_-_Volume_2_Report_249.pdf para 23.12

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Statutory Pledges (RSP) would not be necessary to add such property to the property encumbered by the statutory pledge. As noted at paragraph 133, the rules are slightly different for individuals though (see paragraphs 154 to 159 for full details).

142. The statutory pledge will not be created without registration and an amendment adding to the encumbered property will not have effect without registration.

Voluntary registration of certain changes in the RSP

143. Assignations, restrictions and discharges of statutory pledges, and other changes affecting the detail, will take effect legally off-register, as proposed by the SLC. It will, however, be possible for assignations, restrictions and discharges and other changes to be registered on a voluntary basis (as an application for a correction) and it is hoped that an online and very straightforward system of registration – and low registration fees set by Ministers after consultation – will encourage the registration of these events.

144. This approach is supported by UK Finance (who represent approximately 75 bank and non-bank finance providers providing a range of lending products to businesses, including invoice finance, asset based lending, and term lending) who have indicated in correspondence with the Scottish Government:

“Ultimately it would be in the interests of both a party seeking finance and the prospective provider of finance to ensure that the registers present an accurate picture of current available security and we submit that these commercial incentives will be more effective in this respect than unnecessary additional bureaucracy”.

145. In other words, UK Finance do not favour compulsory registration of assignations, restrictions and discharges, but think that commercial pressures will normally lead parties to register these amendments to the RSP which will thus make the register more accurate. It will therefore be necessary to make enquiry of the registered statutory creditor as to whether they remain the statutory creditor and whether the registered pledge still affects the same property, because registration of events which might change the position in relation to these facts will be voluntary and the register will not therefore be comprehensive.

146. However, this will be counter-balanced by the fact that both a new secured creditor to whom a pledge has been assigned and a provider of a pledge which has been restricted or discharged will be able, if desired, to ensure the register is updated to reflect that fact (see paragraphs 232 and 234). There will also be a requirement for the register to be updated where a pledge has been enforced (see paragraph 217).

147. In addition, the Scottish Ministers are given a power to, by regulations, introduce rules about the duration of a statutory pledge. This would allow the register to be purged of old entries which are not discharged by the secured creditor. If, in practice, voluntary registration does not occur to such an extent that the register proves to be confusing for users, decluttering would allow redundant entries to be removed. It is considered that this fall-back option is preferable to introducing rules requiring all

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secured creditors to update their entry to reflect changes which have taken place off-register. A rule requiring the register to be updated any time the status of the pledge changes off-register may be considered to be unnecessary, but new secured creditors will wish an assignation in their favour to be registered or any expired pledge affecting the same asset to be removed from the register.

Security financial collateral arrangement

148. It had been the intention that the Bill should provide that incorporeal moveable property in the form of financial instruments would be capable of being used as collateral for a loan and, therefore, be able to be the subject of the newly created form of security, the statutory pledge.

149. As noted above in relation to the assignation of claims, financial instruments fall within the definition of financial collateral in the Financial Collateral Arrangements (No.2) Regulations 2003.

150. In order to comply with the Regulations, the Bill would have made provision for the application of the new rules in relation to the grant of statutory pledges. One of the ways in which it would have done so would have been to disapply the usual rules for execution or authentication in relation to the registration of a statutory pledge in the proposed new Register of Statutory Pledges, in accordance with the 2003 Regulations.

151. The Scottish Government has concluded that it cannot include the provisions which were included in the SLC Bill in relation to using financial instruments as collateral for a statutory pledge under the 2003 Regulations, but has asked the UK Government to grant an Order under section 104 of the Scotland Act 1998. The Order would have the same effect as if the provisions had been included in the Bill and would therefore complete the full extent of the reforms recommended by the SLC.

Insolvency

152. There is a qualification to the general rule that a statutory pledge can extend to assets acquired after the grant of the pledge. Where the provider becomes insolvent after the statutory pledge is granted and new assets are acquired after that, it is considered that providers should be entitled to a fresh start and not have new assets acquired by them taken away to satisfy pre-insolvency secured creditors.

153. Property acquired after the commencement of insolvency will therefore not be subject to the statutory pledge. Providers are in any case likely to have limited capacity to acquire new corporeal moveables or intellectual property after they become insolvent because they will not have funds for significant purchases. While the insolvency is ongoing, such assets would fall into the estate managed by the insolvency official.

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Debtor protections for providers who are individuals

154. The Bill will provide debtor protections for individuals who grant a statutory pledge over their personal property.

155. Where an individual consumer grants a statutory pledge, it will be a requirement that the property to be encumbered is specifically identified in the constitutive document of the statutory pledge (or if relevant an amendment document adding property to the statutory pledge). It will not therefore be permissible to grant a pledge over, for example, “my computers”. The act of any secured assets being identified clearly is intended to ensure the consumer realises what is at stake if they do not fulfil their obligations to the secured creditor. It is also intended to protect the consumer from granting a security which ends up being broader than they had anticipated.

156. In addition, individuals will not normally be able to grant a statutory pledge over an asset they have yet to acquire. An exception will be where an individual is supplied with credit for a purchase and the secured obligation in the pledge is the obligation to repay that credit. So where a car is to be acquired, for example, a statutory pledge can be granted over that vehicle, to secure funding for the purchase.

157. The property which is the subject of the pledge will, in the case of corporeal property, have to have a monetary value of more than £1,000 (or such sum as is prescribed by the Scottish Ministers). The policy intention is that it will not be possible for an individual to grant a statutory pledge over low-value but essential domestic items, such as clothing or furniture.

158. It will also be possible for the Scottish Ministers to make regulations preventing particular types of property from being the subject of a pledge, in case the setting of a monetary value proves insufficient by way of protection.

159. The above protections do not apply where the individual is a sole trader, and the pledge is over assets used wholly or mainly for the purposes of the trader’s business.

Property encumbered by statutory pledge: effect of transfer by provider

160. Registration of a statutory pledge will create the pledge, but with the provider retaining possession of the encumbered property. However, if the property is transferred by the provider, it will remain encumbered by the statutory pledge unless—

- the explicit written consent of the secured creditor has been obtained for the specific transfer in question, or
- the third party acquires it unencumbered under the anti-avoidance rule in section 50 or one of the protections for third parties acting in good faith provided for in the Bill.

Consent by secured creditor

161. The consent mechanism requires the consent to be to the specific transfer, and not to be subject to advance agreement, in order to avoid a more general undertaking being given which allows the pledge to operate essentially as a floating charge. There is also an anti-avoidance mechanism which provides that if the secured creditor allows the need for that consent to be bypassed then the statutory pledge will be extinguished.

Acquisition in good faith from seller acting in ordinary course of business

162. Further protections are provided for a person who acquires corporeal property in good faith. That person will acquire the property unencumbered by the statutory pledge, notwithstanding that the consent of the secured creditor has not been obtained, in certain cases.

163. Section 51 of the Bill provides that encumbered property transferred without the consent of the secured creditor will be acquired unencumbered by a statutory pledge if two requirements are met. First, the transferor must have been acting in the ordinary course of that person's business. Second, the acquirer must be in good faith at the time of the acquisition. The acquirer will not be protected if the acquirer knows that the property is subject to a statutory pledge. In this regard, the acquirer is not to be deemed to have constructive knowledge of a statutory pledge merely because it is registered. This is because commerce requires that transfer of moveable property should not be hindered by having to take the time (no matter how short) and expense (no matter how small) to check a register. Legislation on security over moveable property in other legal systems generally protects buyers in certain cases on the basis that they should not be expected to check a register.

164. It is appreciated that when encumbered property is sold on to a good faith acquirer without the consent of the secured creditor, there are two innocent parties who have suffered at the hands of a third party. There are two arguments as to why the acquirer should be protected rather than the secured creditor. First, if the seller of the property is acting in the ordinary course of that person's business then the acquirer should be entitled to acquire the property if they are acting in good faith. It would be contrary to economic efficiency to expect every good faith acquirer to check the register if the seller is acting in the ordinary course of that person's business. The SLC quoted one view that "the protection of buyers in the ordinary course of the seller's business is universally accepted".²⁴

165. Second, in the vast majority of cases, the secured creditor will be a major financial institution and will be well able to pursue the provider of the statutory pledge for fulfilment of the obligation, usually by suing for the debt. The contract under which the statutory pledge was created may also provide for additional penalties in the event of

²⁴ https://www.scotlawcom.gov.uk/files/9215/1361/1360/Report_on_Moveable_Transactions_-_Volume_2_Report_249.pdf para 24.16

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the provider causing the property to be acquired unencumbered by the statutory pledge in this way.

Acquisition in good faith for personal, domestic or household purposes

166. Further protections are provided for individuals to acquire property for private or related purposes.

167. An individual who acquires encumbered corporeal property which is transferred without the required consent of the secured creditor will acquire it unencumbered by the statutory pledge if:

- the property is wholly or mainly acquired for personal, domestic or household purposes (business purchasers are therefore not protected),
- the acquirer gives value for the property acquired,
- the value does not, at the time of acquisition, exceed the amount prescribed by Scottish Ministers (if a limit has been set), and
- at the time of acquisition, the acquirer is in good faith.

168. Once again, the individual does not need to search the RSP before acquiring the property in order to be considered to be in good faith.

169. The intention is that individuals should be protected even when they are buying from another individual or from a business operating outside its normal area. This is because individuals do not have the weight of a business behind them and should not be expected to be aware of the RSP when making purchases for personal use of items (particularly if this is subject to a financial cap).

Acquisition in good faith of motor vehicles

170. Specific protections are set out in the Bill for any person who acquires a motor vehicle that is encumbered property, even where this is acquired from an individual rather than a business seller. They are similar in effect to the measures in section 27 of the Hire-Purchase Act 1964 in respect of motor vehicles hired under a hire-purchase contract, or purchased under a conditional sale agreement.

171. A statutory pledge over a motor vehicle would be functionally similar to hire-purchase or conditional sale. The customer would have possession of the vehicle. But rather than it being owned by the finance company, the customer would grant a statutory pledge over it which would be registered in the RSP. Good faith private purchasers should be protected under the same principles as in the 1964 Act.

172. If the encumbered property is to be acquired unencumbered, despite the consent of the secured creditor to the transfer not having been obtained, then, first, the purchaser must be in good faith – they will again not be required to search the register. Second, the purchaser of the encumbered property cannot be carrying on a business

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described in section 29(2) of the 1964 Act (namely a business which consists of: (a) purchasing motor vehicles for the purpose of offering or exposing them for sale, or (b) providing finance for purchasing motor vehicles for the purpose of hiring them under hire-purchase agreements or selling them under conditional sale agreements). As such, if the purchaser is a motor dealer or financier, they will be expected to search the RSP when doing things such as accepting a vehicle as a trade-in against a new purchase.

173. A secured creditor will be entitled to a limited right of compensation against a motor dealer who transfers a vehicle in a way that means that, under this section, it is transferred unencumbered by the pledge.

174. It is hoped that the statutory pledge will provide a new and simple means of financing the sale of motor vehicles and the intention is that occasional users of the statutory pledge for this purpose (i.e. purchasers of vehicles), or those simply buying a car (whether from a business or from a private seller) without doing so under a statutory pledge, are protected. It is not thought incongruous to hold repeat players in the car industry (i.e. trade or finance purchasers) to a higher standard of care by expecting them to check the RSP for the following reasons.

175. First, this can be done online and search fees will be insignificant in view of the value of the asset which will be the subject of the pledge. Second, it is in the best interests of trade or finance purchasers to ensure that a vehicle which they are purchasing is unencumbered and a search of the RSP has the potential to save their business significant sums of money. Third, the Bill largely replicates arrangements to which car dealers have been subject for nearly 60 years.

Acquisition based on inaccuracy in the Register

176. The Bill also provides for property to be acquired unencumbered by a statutory pledge – by the statutory pledge being extinguished – where the register contains a supervening inaccuracy which is seriously misleading (or where the entry has been erroneously removed from the register) and the purchaser has relied on the register. There is no need for equivalent provision in relation to initial inaccuracies because where there is a seriously misleading inaccuracy at the point of registration then the registration will be ineffective, so the property that is acquired by the third party would not be encumbered property anyway.

177. This protection applies only to property which does not have a unique identifying number which is used in accordance with RSP Rules. This is because it is expected that the use of such numbers will be required in appropriate cases (such as motor vehicles) and it is considered that, as those numbers do not change, a supervening inaccuracy should not arise in respect of the number. Any supervening inaccuracy is likely to be in, for example, the name of the provider (due to a change of name since the date of registration). In a case where the property has a unique number, it is reasonable to expect searches to be carried out by reference to it and so an inaccuracy in respect of the provider's name should not result in the statutory pledge being extinguished.

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178. This rule applies only where the third party acquires the property during the period of the register being wrong and is acting in good faith, giving value for the property, and exercising reasonable care. What is reasonable will depend on the circumstances, but it will always require a search of the register to have been carried out (as otherwise its accuracy – or lack thereof – would be irrelevant). It also only applies where the property that is being acquired is affected by the error.

Acquisition based on provision of incorrect information

179. There is also a protection for those who avail themselves of a right to request information under the Bill (see paragraphs 245 to 249 below) and are advised that the property about which they have enquired is not encumbered property. In order for that information right to be valuable, the person requesting it needs to be able to rely upon the response they receive. As such, if they then in good faith acquire the property that they have been told is not encumbered, they will acquire it unencumbered by the statutory pledge, provided that the acquisition takes place within 3 months of receiving the response on which they are relying.

Assignment, amendment or restriction of statutory pledge

180. Assignations, restrictions and discharges of statutory pledges will take effect legally off-register, as proposed by the SLC.

181. A statutory pledge may be assigned by means of a document duly executed or authenticated by the secured creditor. A pledge is a security rather than a claim, so Part 1 of the Bill does not apply to the assignation of a pledge. A statutory pledge may be restricted or discharged by means of a written statement by the secured creditor.

182. Registration in the RSP of these events will not be compulsory, as discussed at paragraphs 143 to 147 above. The policy is that it should, however, be possible for assignations, restrictions and discharges to be registered on a voluntary basis (via an application for a correction) and it is hoped that an online and very straightforward system of registration – and low registration fees set by Ministers after consultation – will encourage the registration of these events.

183. As noted above, this approach is supported by UK Finance who represent a large number of bank and non-bank finance providers providing a range of lending products to businesses, including invoice finance and asset based lending.

184. Where a statutory pledge is being amended other than by being assigned, restricted or discharged, it must be done by an amendment document executed or authenticated by the secured creditor and the provider. An amendment document that relates to the addition of property to the encumbered property, or to a variation that increases the extent of the secured obligation (where that is determinable from the statutory pledges record), is amended only on registration of the amendment document. Added property must be identified in the amendment document and may, as in the case of the constitutive document for a statutory pledge, be property to be acquired by the

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provider (although this remains subject to the special rules for providers who are individuals).

Ranking of pledges

185. The SLC noted that: “The facilitation of access to finance by modern secured transactions laws depends on their ability to enable competing creditors to know clearly what their ranking is”.²⁵

186. The Bill therefore makes it clear that the priority in ranking of any two pledges, or a pledge and a right in security other than a pledge, will be determined according to their creation with the earlier created having priority over the later, as is the usual rule on ranking of securities. This rule will also govern the priority between a statutory pledge and a possessory pledge.

187. The issue of after-acquired property is of importance to the question of ranking. In a case where a statutory pledge is granted over assets not yet owned by the provider, a statutory pledge will only be created when the relevant property becomes identifiable as encumbered property, perhaps by being identified in a schedule sent by the provider to the secured creditor. For example, where a statutory pledge is granted and registered over “computers to be acquired by the company”, the point of creation may differ for each computer according to its acquisition date. The SLC commented that if a statutory pledge were to be created in this way over property acquired after the registration of the pledge, it would be important for the parties to keep careful records.

188. Where a provider grants two or more statutory pledges over property which, as at the time the pledges are granted, is not the provider’s, the priority in ranking of any two of the pledges will be determined according to the dates on which they are registered – with the earlier having priority over the later. This adheres to the same general principle in terms of favouring the earlier arrangement, but recognises that in this case the rule cannot be based on creation as both will be created at the same moment (when the final requirement for creation is met which, in this case, would be the property becoming the provider’s).

189. The priority in ranking of a pledge will be the same irrespective of whether the secured obligation is an obligation owed or is an obligation which will or may become owed.

190. It is open to the parties to enter into a ranking agreement which will make different provision from the default rules.

²⁵ https://www.scotlawcom.gov.uk/files/9215/1361/1360/Report_on_Moveable_Transactions_-_Volume_2_Report_249.pdf para 26.1

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Enforcement of pledge

191. The SLC described the rationale for their proposals on enforcement of pledge²⁶ thus: “where the debtor defaults on the secured obligation, the secured creditor will normally wish to recover what is due to it by enforcing the security right. This is the reason for taking the security right in the first place. The secured creditor is able to proceed against the encumbered property rather than simply having to rely on its rights under the debt contract. Such contractual rights are of little avail if the debtor has become insolvent or has disappeared without leaving a forwarding address.”²⁷

192. The Commission pointed out: “so far as possible, enforcement of the new security right should be swift and inexpensive. The longer it takes to enforce a security right and the more expensive that process is, the less effectively the security right works. Debtors themselves consequently suffer because delays in enforcement tend to result in more accumulated interest and the expenses of the process will usually fall on the debtor.”²⁸ The Bill seeks to achieve the result of swift and inexpensive enforcement.

193. It will not be possible to enforce a pledge by any method not provided for in the Bill. Subject to any agreement to the contrary between the parties, a pledge will be enforceable by the secured creditor where there has been a failure to perform the secured obligation. In enforcing it, the secured creditor must conform to reasonable standards of commercial practice – for example, not taking an unreasonably long period to complete an enforcement procedure.

194. The secured creditor will require to serve formal notice on the provider and (if different) the debtor before being allowed to enforce the new security right over moveable property. The pledge enforcement notice will also be served on holders of other rights in security in the encumbered property or creditors who have executed diligence against it, to let them know that enforcement is to take place, but only in so far as the secured creditor knows, or can be reasonably be expected to know, of the other right in security or the diligence.

195. The SLC considered the question of whether a court order should be required to enforce a pledge, noting that requiring judicial involvement increases costs and lengthens the enforcement process, but that the involvement of the court also protects the provider from a secured creditor who may be trying to enforce illegitimately.

196. The Bill strikes a balance by providing that a court order should not generally be required to enforce a pledge, but such an order will be required where the provider of a pledge is an individual unless:

²⁶ A pledge under the Consumer Credit Act 1974 (described in that Act as a “pawn”) falls to be enforced under the enforcement regime in respect of loans by pawnbrokers under that Act.

²⁷ https://www.scotlawcom.gov.uk/files/9215/1361/1360/Report_on_Moveable_Transactions_-_Volume_2_Report_249.pdf para 27.1

²⁸ https://www.scotlawcom.gov.uk/files/9215/1361/1360/Report_on_Moveable_Transactions_-_Volume_2_Report_249.pdf para 27.2

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- after the pledge becomes enforceable, the provider and the secured creditor agree in writing that it may be enforced without such an order, or
- the provider is a sole trader and enforcement is against property used wholly or mainly for the purposes of the provider's business.

197. A court order will also be required in the rare cases where the moveable property against which it is to be enforced is an individual's sole or main residence (which might be the position in the case of a caravan). This applies regardless of whether the individual is the provider of the pledge. Similar to the position above, it is possible for this requirement to be dispensed with by agreement in writing, but only where that agreement is given after the pledge has become enforceable (i.e. it is not just a hypothetical question).

Secured creditor's right to take possession of, or immobilise, corporeal property

198. For a possessory pledge, the secured creditor does not need to take possession of the property in order to realise the collateral for the obligation because it is already in their possession. But for a statutory pledge it will be the provider who would normally be in possession and there therefore requires to be a mechanism by which the secured creditor can take hold of the asset, while providing some protection to the debtor. The general rule will be that, once the secured creditor has served a pledge enforcement notice, there will be an entitlement to take possession of the encumbered property. For some assets such as machinery it may be more convenient for the secured creditor to immobilise the property or take other reasonable steps to ensure that it is not disposed of or used in an unauthorised way.

199. The secured creditor will be able personally (or through authorised persons or employees, if the secured creditor is an entity and cannot act personally) to take possession of, or immobilise, the property with the consent of the provider as well as of any third party such as a warehouse who is holding the property. That consent, if given, will require to be given after default, otherwise the risk is that it is written into any security agreement that the provider consents. Where consent is not forthcoming, the secured creditor will have to obtain a court order to take action personally in relation to the property. The court may wish to set down conditions as to how possession is to be taken or immobilisation carried out. An "authorised person" (through whose agency possession can be taken) will be a messenger-at-arms or sheriff officer, or such other person as the Scottish Ministers by regulations specify in order to ensure regulated standards of practice.

200. Where another creditor has a higher or equal ranking in relation to the encumbered property, it will not be possible for possession to be recovered as of right from that other creditor because that creditor has a higher or equal entitlement to the property and should be entitled to realise the asset. It will, however, be possible for possession to be taken with the consent of the other creditor (subject to also having the provider's consent). Alternatively, there will be a right to take possession of the property or immobilise it with the authorisation of the court. This will be capable of being done

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either personally or via authorised persons, depending on what the court has authorised. Depending on the precise circumstances, the court may be willing to authorise the taking of possession if the other creditor is unreasonably delaying in realising the value of the property.

Secured creditor's right to sell

201. The standard remedy for the secured creditor following service of a pledge enforcement notice (and, where appropriate, the obtaining of a court order) will be to sell the property at the best reasonably attainable price. The secured creditor will need to be able to convey the encumbered property to the purchaser and may first require to take possession of the property. The secured creditor may purchase the encumbered property themselves, but only by sale in a public auction and, broadly speaking, for market value.

202. Where the secured creditor sells encumbered property on enforcement, the purchaser will acquire the property unencumbered by the pledge and any right in security or any diligence ranking equally with, or lower than, the pledge. In relation to any right in security or any diligence which has priority in ranking over the pledge, the property will only be acquired free of it if the holder of that right in security, or the creditor who executed the diligence, consented to the sale.

203. The proceeds of the sale will be held in trust by the secured creditor until applied towards the satisfaction of the secured obligation. This ensures that if the asset sells for more than the value of the debts secured on it (plus the expenses of enforcement), it is paid over to the provider.

Secured creditor's right to let

204. Where a pledge is being enforced, it will also be possible for the secured creditor to let all or any of the encumbered property. The secured creditor will require to take all reasonable steps to ensure that the rental income obtained is the best reasonably obtainable and such income will be held in trust by the secured creditor until applied towards the satisfaction of the secured obligation.

Secured creditor's right to grant licence over intellectual property

205. Where a statutory pledge over intellectual property is being enforced, the secured creditor will be able to grant a licence over all or any of that property (but only if and to the extent that the provider is entitled to grant such a licence, since the provider may have already granted an exclusive licence to another party). This rule will also be subject to any written agreement by the parties prohibiting the granting of a licence in these circumstances. The secured creditor in granting a licence will require to take all reasonable steps to ensure that the licence income obtained is the best reasonably obtainable. The income obtained will again be held in trust by the secured creditor until applied towards the satisfaction of the secured obligation.

Secured creditor's right to protect and manage the encumbered property

206. The secured creditor will be entitled to have management powers in relation to the encumbered property, thus ensuring that they can protect, maintain and manage the property and take steps to preserve its value, particularly as certain assets may require to be stored under particular conditions pending realisation or they may deteriorate.

Appropriation

207. In other jurisdictions, including Australia and New Zealand, a secured creditor can appropriate an asset, post-default, in satisfaction of the secured obligation if there is no objection from the provider and other creditors. Sale will usually be the primary remedy because it may well fetch more money and therefore the provider and other creditors may veto appropriation. But in some circumstances, where the asset has an objectively verifiable market price, a sale will not achieve more and all with an interest may be content for the secured creditor to appropriate at that value. The SLC recommended therefore that, subject to restrictions, appropriation should be a remedy that is available to the secured creditor. A creditor who appropriates property becomes the owner of the property.

208. The secured creditor will be entitled to appropriate any or all of the encumbered property in total or partial satisfaction of the secured obligation. It will not, however, be possible to appropriate:

- the property of an individual unless that person is a sole trader and the appropriation is of assets used wholly or mainly for the purposes of the person's business,
- corporeal property unless it is in the possession of the secured creditor, or
- property where the value of it is greater than the amount remaining due under the secured obligation (including reasonable expenses) unless the secured creditor holds the excess amount on trust to be applied as if it were proceeds.

209. The Bill provides for appropriation without, and with, an agreement to the use of appropriation by the secured creditor as a remedy on default.

210. Where there is no agreement, the provider is entitled to object in principle to the use of appropriation in respect of the particular encumbered property. Any appropriation must be for an amount which bears a reasonable relationship to the market value of the property. Notice of the intended appropriation must be given to the parties it will affect. The notice of intended appropriation must identify the property to be appropriated and specify both the amount owing to the secured creditor and the amount expected to be obtained by the appropriation. The Bill gives the parties to whom the notice is served a right to veto the appropriation, provided they do so within 14 days of receipt of the notice of the intended appropriation. They may, for example, consider that sale may achieve a greater amount. A higher ranking creditor may wish to preserve its priority in relation to the asset.

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211. The provider and the secured creditor may, however, agree in writing, in advance of any default in or enforcement of the secured obligation, that the creditor may appropriate the encumbered property subject to certain conditions. This means that there is less risk of property being appropriated below value and prejudice caused to the provider. The provider and other parties are given notice of the intended appropriation in the same manner as for appropriation without agreement, but the provider (and the debtor if a different person to the provider) is not entitled to object.

212. An agreement to appropriate may only have effect in relation to property in respect of which the agreement sets out a method of easily determining a reasonable market price. That might include, for example, an agreement in relation to appropriation of used cars which states that an average of the prices listed in a specified used car guide is to be used to determine the value on appropriation.

Application of proceeds arising from enforcement of pledge

213. The Bill provides for the distribution of any proceeds received by the secured creditor as a result of enforcing a possessory or statutory pledge. The secured creditor must first pay the expenses of the enforcement and then pay the sums due to secured creditors, or to creditors who have executed diligence, in accordance with the priority of their claims. Any residue is paid to the provider. Payments are to be abated in equal proportions as against others with the same ranking where full payment is not possible.

214. No payment will be made to creditors with a higher ranking security or diligence than the pledge being enforced unless they have consented to the enforcement. This is because if they have not consented then their right still subsists and that will affect the marketability of the encumbered property. This may in turn mean that it is only practicable for the secured creditor to lease the encumbered property rather than selling it.

215. Where it is unclear who is to be paid (perhaps because a secured creditor cannot be traced), the secured creditor must consign an amount in court for the benefit of the person who appears to have the best right to the payment. The SLC thought that this scenario was likely to be uncommon.

216. The secured creditor must, as soon as practicable, provide statements to relevant parties as to how the proceeds have been distributed.

Removal of entry from the statutory pledges record

217. A duty is imposed on the secured creditor in a statutory pledge to apply for its removal from the RSP where the pledge is extinguished by any of the enforcement of the pledge, enforcement of any other secured right, or the use of diligence. Leaving the entry in place would otherwise prejudice the provider.

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Liability for loss suffered by virtue of enforcement

218. A provider will be entitled to be compensated by the secured creditor for any loss suffered as a consequence of the secured creditor failing in any duty imposed by the Bill on the creditor in relation to the enforcement of a possessory or statutory pledge. This will, however, be subject to an exception where the loss could reasonably have been avoided, or was not reasonably foreseeable.

Register of Statutory Pledges

219. The new Register of Statutory Pledges (“RSP”), like the RoA, will be a public register under the control of the Keeper of the Registers under the auspices of the Registers of Scotland. The RSP is also principally likely to be used by banks and other institutions.

Structure

220. The new statutory pledges regime is a move away from the requirement for delivery or transfer of an asset in the course of granting security over that asset. Given that marked change, it is considered that a central repository is required to document and evidence the existence of statutory pledges. The RSP will therefore be a register of statutory pledges created under the new regime; these records will be held in the statutory pledges record. Unlike the RoA where an alternative route is available to complete an assignation – namely intimation – and there is also nothing to preclude the registration of an assignation document which has already been intimated, a statutory pledge will only be created once it is registered in the RSP. However, although registration will be fundamental to the creation of a statutory pledge, it may not always be the final step in the creation of one – for example, where the pledge that is registered covers assets to be acquired in the future. In line with the position in the Land Register of Scotland and the RoA, there will also be an archive record, though the archive record will be of more significance in the RSP since it will contain discharged statutory pledges (or those that have otherwise been extinguished) in cases where the bringing to an end of the pledge has been registered as a correction.

221. The data in the RSP will need to be sufficiently complete so as to allow accurate information to be gleaned from it so that reliance may be placed on the records as necessary. It will contain similar data to that in the assignations record in the RoA, but rather than the details of the assignor and assignee there will be details of the provider of the statutory pledge and the secured creditor. And rather than a copy of the assignation document there will be a copy of the constitutive document of the statutory pledge and a copy of any amendment document adding property to the encumbered property or increasing the extent of the secured obligation.

222. The encumbered property will be described in the manner required by the rules of procedure for the RSP. This may be by reference to classes of property rather than specific items. Some encumbered property will have a unique number which could be required in the entry, such as the vehicle identification number of motor vehicles. The

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reason that this is likely to be required is because it provides a convenient, and stable, reference point for the carrying out of searches.

Applications for registration

223. Applications for registration of documents constituting a statutory pledge will be made by the statutory creditor. It will normally be the act of registration which creates the statutory pledge – although in some cases (such as where the encumbered property is not yet owned by the provider), the statutory pledge will be registered before all of the elements required to create the pledge are satisfied. Registration will usually be completed online. It will, in general, be automated like the RoA and require minimum human intervention by Registers of Scotland staff. As with the RoA, this will satisfy commercial demands by ensuring that the registration process is as fast and efficient as possible. It also removes the potential for human error in the information being transferred from an application form to the register.

224. Applications for amendments to a statutory pledge will be made in similar fashion, with a copy of the amendment document being submitted for registration along with all the other required details, except that a registration number will be allocated to the original entry for the statutory pledge in the statutory pledges record and it is expected that the RSP Rules will require that this would have to be quoted for the registration of an amendment.

Verification statement and date and time of registration

225. Verification statements confirming the date and time of registration and the registration number for the entry will be sent to both the provider of the statutory pledge and the secured creditor by email, and for this purpose the applicant should provide up to date email addresses for both. It is assumed that the secured creditor as applicant will be able to provide their own email address, but if they fail to provide the email address of the provider then the provider will not receive a verification statement and may request a copy of the statement from the secured creditor. These rules also apply where an amendment document is registered and a separate verification statement will be issued for that.

Effective registration

226. To ensure the accuracy and reliability of the RSP, the registration of a document constituting a statutory pledge, or an amendment thereto, will be ineffective if:

- the entry made up for it does not include a copy of the constitutive document (or, as the case may be, the amendment document),
- that document is invalid (possibly because it is a forgery), or
- there is an inaccuracy in relation to the data registered which, as at the time of registration, is seriously misleading.

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227. However, if an inaccuracy is seriously misleading in relation to only part of the encumbered property, that does not affect the validity of the rest of the entry. Likewise, if it is seriously misleading in relation to one provider but not another, the registration is only ineffective in relation to the provider in respect of whom the entry is seriously misleading. The intention is only to negate the effect of registration to the extent that is necessary in order to avoid users being seriously misled.

Seriously misleading inaccuracies

228. There is not a closed list of cases where an inaccuracy will be treated as being seriously misleading. There are a number of cases where an inaccuracy will conclusively be deemed to be seriously misleading but, outwith these cases, it will still be possible for the seriously misleading threshold to be reached based on an objective reasonable person test (which will be informed by the cases specified in the section). This non-exhaustive approach has been taken in order to avoid inadvertently setting the parameters for what is seriously misleading too narrowly in a way that would not allow all the circumstances of a particular case to be considered.

229. The policy is that if a registration contains an inaccuracy that prevents the entry being disclosed by a properly formatted search using the specified criteria, that inaccuracy should generally be regarded as being seriously misleading. The rules are formulated accordingly. The criteria are: the proper name of the provider; if the provider is an individual, their proper name and month and year of birth; the unique number of any provider that is required by the rules of the RSP (for example, a company registration number); and any unique number for encumbered property (such as vehicle identification number). However, where the provider is a company or other body with a unique identifying number, it will not matter if its name contains an inaccuracy as long as the number is correctly recorded, as the policy is that searches should be carried out by reference to that number (since it will not change in the way that names might). In addition, although it is not a means by which the Bill provides for the statutory pledges record to be capable of being searched, incorrectly recording the type of property encumbered can also result in the entry being seriously misleading.

230. Further, an entry will be seriously misleading if the secured creditor's name is wrong in a way that would seriously mislead the reasonable person (meaning that a simple typo is unlikely to meet this threshold). However, unlike with providers, this rule is not formulated by reference to searching since the policy is that, for reasons of commercial sensitivity, it should not be possible to search by secured creditors. In addition, although it is not a means by which the Bill provides for the statutory pledges record to be capable of being searched, incorrectly recording the type of property pledged will also result in the entry being seriously misleading if RSP Rules consider this a sufficiently important aspect that they require it to be listed.

231. An inaccuracy in an entry in the statutory pledges record may be seriously misleading irrespective of whether any person has been misled: what matters in relation to searching is what results a search would return if it were done. Beyond that, what matters is whether the reasonable person would be misled. In determining whether an inaccuracy is seriously misleading no account would be taken of the document which

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constitutes the statutory pledge (or the amendment to it) as the search is not made against that document and the register entry is considered more important as it will provide more readily accessible information.

Corrections to the RSP

Overview

232. The Bill will enable the secured creditor to apply to the Keeper for correction of an entry for a statutory pledge in the statutory pledges record. The policy is that the secured creditor need not for that purpose require to be the party identified as such in the entry in the statutory pledges record. There are a number of reasons why the creditor might not be so identified, including an error at the time of registration, a change of name, or an assignation of the pledge. An assignor of pledge, as well as an assignee (as a successor in title to the right of the secured creditor) may apply for correction. A correction can be sought in respect of an inaccuracy which has existed in the register since the entry was made up, or where it was correct at the time but subsequent events have meant that it no longer remains accurate.

233. The Keeper must on accepting an application correct the entry (and note in the entry that this has been done). The Keeper must also issue to the applicant and the provider a verification statement in the form required by RSP Rules (provided that the email addresses for those persons have been supplied to the Keeper in the application).

234. It will also be possible for a person identified in the record as the provider or a co-provider of the pledge, or a person with a right in the property identified as the encumbered property, to demand that the secured creditor apply to the Keeper for a correction of the record if that person asserts that they are not the provider or the property is not encumbered property. The policy is that the application route should exist primarily via the secured creditor, since the secured creditor is the person who benefits from the secured pledge and it should not be removed from the register without their knowledge. However, it is also considered appropriate that there should be a route for the provider or owner of the relevant property to be able to have the register corrected (either because it has always been wrong or because it has become out of date) because otherwise it may affect their credit rating or their ability to grant another pledge over the property.

235. As such, if no application is made within the period specified in the demand (which must give the secured creditor at least 21 days to act), that person will be able to apply directly to the Keeper for the correction to be made. In such a case, the Keeper must serve a notice on the secured creditor intimating that the record will be corrected on a specified date, though the secured creditor may apply to the court before that date opposing the making of the correction and notify the Keeper of having done so. If that happens then the Keeper will not be permitted to make any correction until the application to the court has been determined.

236. The Keeper may also correct a manifest inaccuracy in the statutory pledges record in certain cases. This will only occur where what is needed to correct the

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inaccuracy is also manifest: if it is not, the Keeper will note any inaccuracy that cannot be corrected. It is, however, intended that this procedure will be restricted to use for dealing with frivolous or vexatious registrations or where the record has been affected by a computer malfunction, and the Keeper's duty is limited accordingly. As such, this route will not be available to corrections which could reasonably be dealt with by an application for a correction.

237. Corrections will, in general, be online, automatic and will require minimum human intervention by Registers of Scotland staff, but will attract a fee. As with applications for registration, this will satisfy commercial demands and also reduces the potential for human error.

Requirement or otherwise for registration of a correction

238. A statutory pledge will be created only by registration in the RSP. Any amendment to the statutory pledge which adds property to the encumbered property will also be effected by registration. These registration events will be compulsory in order to have legal effect – i.e. the statutory pledge will not be created without registration and an amendment adding to the encumbered property (or increasing the secured obligation in certain instances) will not have effect without registration. This is appropriate because such amendments are equivalent to the creation of a pledge. Such an amendment will not be a correction, because the change only takes effect after it is registered.

239. It will remain possible (subject to the rules for individuals – see paragraphs 154 - 158) for it to be anticipated at the time of the original registration that the statutory pledge will apply to future-acquired property (for example “computers to be acquired by the company”) and an amendment to the RSP would not be necessary to add such property to the property encumbered by the statutory pledge.

240. As noted above at paragraphs 143 to 147, assignments, restrictions and discharges and other changes to the detail of statutory pledges will take effect legally off-register, as proposed by the SLC. Registration of these events in the RSP will not be compulsory. It will, however, be possible for assignments, restrictions and discharges and other changes to be registered as “corrections” on a voluntary basis and it is hoped that an online and very straightforward system of registration – and low registration fees set by Ministers after consultation – will encourage the registration of these events.

Searches and extracts

241. The SLC noted that almost identical considerations applied in relation to searches and extracts in the RSP as in the RoA, and they therefore recommended the same approach. The logic of paragraph 107 above therefore applies equally here. Searches will be carried out electronically under an automated system and will not require the involvement of the Keeper's staff.

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242. Any person will be able to search the assignments record, but only:

- by reference to any of the following data in the entries contained in that record:
 - the names of providers,
 - the names and month and year of birth of providers who are individuals,
 - the unique numbers of providers required by RSP Rules to be identified in the statutory pledges record by such a number,
- if RSP Rules require or permit the encumbered property to be identified by a unique number, by reference to that number,
- by reference to registration numbers allocated to entries in that record, or
- by reference to some other factor, or characteristic, specified for these purposes by RSP Rules.

243. The Keeper will be required to provide a search facility allowing searching as set out in paragraph 242.

244. As in the Land Register, it will be possible for an application to be made to the Keeper for a formal extract of an entry.

Information duties

245. The SLC noted that: “The information which appears in entries in the Register of Statutory Pledges may not be up-to-date”.²⁹ The secured creditor may have discharged the pledge by means of a written statement but the discharge may not have been registered. Equally, the pledge may have been assigned or its effect restricted. Neither the assignment nor the discharge may have been registered. A number of other events may have happened too: for example, the encumbered property could have been destroyed by fire, its ownership could have been transferred with the secured creditor’s specific consent, or despite the lack of such consent it could have been acquired by a third party in good faith in one of the situations where the Bill provides for unencumbered acquisition. It should therefore be possible to seek information as to the current state of play for a specific statutory pledge.

246. As with the RoA, the SLC therefore recommended that that there should be limited statutory information duties owed to a limited number of third parties.

247. The information which can be requested falls into three categories—

- The first type of information which can be sought is whether a particular item of property is still encumbered by the statutory pledge. As with the RoA, the SLC did not think that it should be possible to “fish” for a list of all the encumbered property. The party making the request will therefore have to

²⁹ https://www.scotlawcom.gov.uk/files/9215/1361/1360/Report_on_Moveable_Transactions_-_Volume_2_Report_249.pdf para 35.2

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specify particular property about which they are enquiring. However, this information right is important as the pledge may have been restricted off-register.

- The second type of information which can be sought is a description of the secured obligation. This is because this may well not be fully apparent from the entry if it is described in the constitutive document by reference to off-register documentation.
- The third type of information which can be sought is information as to the holder of the statutory pledge. Thus where the person identified in the entry as the secured creditor receives a request as to whether certain property is encumbered and that person has assigned the statutory pledge, the person identified in the entry will be required to supply the details of the assignee and indeed, if known, any subsequent assignee.

248. Only a limited category of persons will be entitled to make a request, including those who have the consent of the provider (for example, a prospective secured creditor). In addition, any person with a right in the encumbered property will be entitled to request information (for example, another secured creditor).

249. The person identified as the registered creditor in the entry in the RSP will then have 21 days to comply with the request. The registered creditor will be entitled to recover costs reasonably incurred in providing the information to the requester. If the registered creditor provides details of someone else who they believe to now be the holder of the statutory pledge, the information right can then be exercised against that person as well.

250. The policy is that parties should be entitled to rely on this information where they do so promptly. As such, if they are provided with incorrect information on which they rely in good faith, this can result in the statutory pledge being extinguished in whole or in part (see paragraph 179 above for further details).

Entitlement to compensation

251. It is considered that a person should be entitled to be compensated by the Keeper of the Registers of Scotland for loss suffered in consequence of an inaccuracy in the record to the extent that it is attributable to the Keeper in the making up, maintenance or operation of the RSP (including in an attempted correction of the register). This liability to compensation also arises where loss is suffered due to applications being processed in the wrong order, being accepted or rejected in error, or being unable to be submitted due to an error with the Keeper's systems. It is considered appropriate that there should be liability in the event that such a situation were to arise because it might allow another secured creditor in respect of the same property to register their competing statutory pledge first, meaning that they have an earlier ranking pledge. There is also a right to be compensated where certain materials produced by the Keeper are incorrect.

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252. In addition, it is considered that there should be a right to be compensated where the fault is caused by someone other than the Keeper and who fails to take reasonable care. As such, where a person suffers loss in consequence of an inaccuracy in an entry in the RSP which is not caused by the Keeper, the person is entitled to be compensated for that loss by the person who made the application which gave rise to the inaccurate entry, or who caused an incorrect “correction” to be made, if that person failed to take reasonable care in doing so. In addition, where a person suffers loss in consequence of a failure to respond to a request for information under the information duty provisions, or the provision of information in which there is an inaccuracy, the person is entitled to be compensated for that loss by the person who failed to supply the information if that failure was without reasonable cause or if, in supplying it, that person failed to take reasonable care.

253. In both cases, the rules are limited to cases where the loss could not reasonably have been avoided and do not cover cases where the loss was not reasonably foreseeable. Non-patrimonial loss is also not covered.

RSP Rules

254. The detailed rules of procedure for the RSP will be set out in secondary legislation which will be brought forward by Scottish Ministers following consultation with the Keeper.

Part 3: General provision

255. This Part includes provision in relation to matters including subordinate legislation, interpretation and commencement.

Alternative approaches

256. While there are issues of detail on how the new systems would work where different approaches could be taken, the position is that if the law on moveable transactions (both assignation of debt and security over corporeal and incorporeal moveable property) is not reformed in Scotland then individuals and businesses will continue to operate at a disadvantage to other countries where modern systems governing these matters have been put in place.

Assignation

257. As noted above, the Federation of Small Businesses has indicated that 3,500 small businesses in Scotland fold each year because their invoices remain unpaid. Reform of the law relating to assignation of debt in Scotland will permit businesses to more easily transfer to a bank or other financial institution its unpaid customer invoices (claims to payment) by means of an assignation and thus obtain immediate finance.

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258. If no action is taken, assignation of debt in Scotland will remain governed by legislation dating from 1862 which makes the process cumbersome and expensive and which makes it impossible to assign future debt. This places Scottish businesses at a commercial disadvantage to the rest of the world.

Statutory pledge

259. The state of the law on security over moveable property makes it difficult for businesses and individuals to use their moveable assets to raise finance.

260. If no reform is undertaken, Scotland will continue to fall behind modern practice in competing jurisdictions, with an adverse impact on businesses here. Under the proposals in the Bill, corporeal assets, such as equipment and vehicles, or incorporeal assets, such as patents or other intellectual property, will be able to be used to secure a loan, rather like a house being used for mortgage finance.

Individual consumers

261. Consideration is given earlier in this memorandum to various points of detail on which alternative approaches would be possible (such as whether the RoA should exist alongside the option to complete an assignation by intimation). However, in terms of broader issues, an alternative approach was considered in respect of the application of the Bill to individuals.

262. Citizens Advice Scotland (CAS) raised concerns relating to some lenders charging high interest rates and being able to assign debt to more unscrupulous debt collectors. CAS initially therefore expressed a preference for the Bill to apply to businesses only, excluding individual consumers.³⁰

263. The Bill will not, however, place consumer credit debtors in a worse position. It will lead to more options for mainstream lenders who are in fact likely to charge lower interest rates if they have the comfort of a security fixed on the asset which provides the collateral for a loan. Moreover, restricting the effect of the Bill to businesses only would mean that private individuals would not benefit from the new possibility of being able to use their moveable assets as collateral in order to raise finance.

264. In addition, there are numerous protections for individuals under the Bill. For example, paragraphs 154 to 158 above discuss the limits that are placed upon the items which an individual can make subject to a statutory pledge. In addition, the rules about enforcement of a pledge are more stringent where an individual is the provider. For example, a court order will usually be required in a way it would not otherwise (see paragraph 196) and the enforcement mechanism of appropriation is not available (see paragraph 208).

³⁰ [EEFW-S5-20-MT-12-CAS.pdf \(parliament.scot\)](#)

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265. Moreover, although it will be rare for the pledged property to be anyone's home (given that the Bill is concerned with moveable rather than heritable property), it is recognised that a caravan might on occasion be someone's home. As such, protections are put in place to cover this eventuality. The Bill makes adjustment to legislation governing matrimonial homes to afford comparable protection for relevant statutory pledges. The Bill's enforcement provisions also afford protections to those who have the pledged property as their home even if they are not the person who granted the pledge (see paragraph 197).

266. There are also special protections for individuals who are interacting with the statutory pledge regime as a third party: see paragraphs 166 to 169 above.

267. The Law Society of Scotland³¹ and the judges of the Court of Session³² both indicated, in written evidence to the Economy, Energy and Fair Work Committee in the last Parliament, that they thought that the consumer protections in the Bill were adequate.

268. In addition, academics at the University of Aberdeen posed the question: "Why should a consumer not be able to grant a non-possessory security over their moveable assets? They can grant non-possessory security over land subject to various protections, and the same should apply to security over moveable property. The SLC protections appear adequate to justify allowing consumers to grant statutory pledges. The statutory pledge may be usefully created by consumers to enable them to access finance (on better terms) than is currently the case. This will enable them to continue to use and enjoy the property in a way that is not possible under the current law."³³

269. The Scottish Government has engaged with CAS and, in light of the further background information provided to them, they advised that they would seek to withdraw their previous comments to the Economy Committee in the last Parliament. They also acknowledged the strong support that exists for the reforms. CAS also noted that the current development of the consumer duty applicable to creditors by the Financial Conduct Authority should ameliorate many of their concerns at the product design stage.

Consultation

270. The SLC published a Discussion Paper on Moveable Transactions (Discussion Paper 151)³⁴ in June 2011, followed by a three month consultation period. Over 40 responses were received and the project received support from stakeholders including the Asset Based Finance Association, the Finance and Leasing Association, CBI Scotland, the Committee of Scottish Clearing Bankers (as they were then known) and the Federation of Small Businesses. A small advisory group of expert practitioners and academics was formed to assist and this was later enlarged to 19 people. A

³¹ [EEFW-S5-20-MT-09-LawSocietyScotland.pdf \(parliament.scot\)](#)

³² [EEFW-S5-20-MT-08-SenatorsCollegeJustice.pdf \(parliament.scot\)](#)

³³ [EEFW-S5-20-MT-03-CentreScotsLaw-UniversityAberdeen.pdf \(parliament.scot\)](#)

³⁴ <https://www.scotlawcom.gov.uk/files/6113/1057/2523/dp151.pdf>

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symposium was held at Edinburgh University and numerous meetings were held with respondents to the Discussion Paper and various other stakeholders. The SLC also engaged with a number of businesses through various representative bodies. A full account of the SLC engagement with interested parties is set out in its Business and Regulatory Impact Assessment for the Bill³⁵.

271. A draft Moveable Transactions (Scotland) Bill was published on the SLC website for comment in July 2017. Responses were received from various stakeholders including the Law Society of Scotland, the Faculty of Advocates and the Institute of Chartered Accountants of Scotland.

272. On 26 November 2019, Professor (as he now is) Andrew Steven and Emeritus Professor George Gretton, the Commissioners responsible for the SLC Report on Moveable Transactions, gave evidence to the Economy, Energy and Fair Work Committee of the Scottish Parliament along with members of the SLC's advisory group. Bruce Wood CVO, a member of the SLC advisory group and then a consultant at Morton Fraser, Solicitors, indicated that:

“We [the SLC and its advisory group] think that we have done all the consultation that can be done... We have spoken to UK Finance, the Federation of Small Businesses, the Law Society of Scotland, the Consumer Credit Trade Association, the Finance and Leasing Association and the banks. They are the people who have the principal interest in the matter. We have also spoken to the chartered accountants and we have consulted widely. We have reported on the consultation that we have done. We think that we have done all the consultation that is actually required.”³⁶

273. The Government's Programme for Government published in September 2019 indicated that officials would conduct a focussed consultation on the SLC proposals for legislation. Officials met with the Federation of Small Businesses in Scotland, Scottish Enterprise, the Law Society of Scotland (and, separately, several firms of solicitors who work in these areas of law), R3 (the Association of Business Recovery Professionals which is an organisation for insolvency, restructuring and turnaround specialists in the UK) and the Committee of Scottish Bankers. Views were also sought from UK Finance (which now incorporates the Asset Based Finance Association) and Citizens Advice Scotland.

274. Stakeholders contacted by officials were almost universally supportive of the Bill. It was conceded that there may be issues of technical detail on which some individuals have different views (see for example the discussion above about alternative approaches), but the broad thrust of the SLC proposals enjoys strong support in view of the potential benefits to business and the wider economy.

³⁵

https://www.scotlawcom.gov.uk/files/7415/1359/9231/Business_and_Regulatory_Impact_Assessment_-_Report_on_Moveable_Transactions_Report_No_249.pdf

³⁶ [Official Report - Parliamentary Business : Scottish Parliament](#)

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Effects on equal opportunities, human rights, island communities, local government, sustainable development etc.

Equal opportunities

275. An Equality Impact Assessment (EQIA) has been carried out and will be published on the Scottish Government website at <http://www.scotland.gov.uk/Publications/Recent>.

276. The EQIA concluded that the Bill's provisions are neither directly or indirectly discriminatory on the basis of age, disability, race, religion or belief, sex, sexual orientation or gender reassignment.

Human rights

277. The Scottish Government has assessed the effects of the Bill on human rights and is of the view that its provisions are compatible with the European Convention on Human Rights (ECHR).

278. In particular, sections 29 and 101 of the Bill have been analysed for their compatibility with Article 6 of the ECHR, which provides for the right to a fair trial. Section 29 of the Bill provides that the Keeper is entitled to appear and be heard in any civil proceedings in which either (i) the accuracy of the assignments record; or (ii) what is needed to correct an inaccuracy in the record, is put in question. Any such proceedings would need to be in accordance with the Keeper's Article 6 rights. Section 29 is considered to be compatible with those rights because it expressly provides that the Keeper has a right to appear at any proceedings concerning the accuracy of the assignments record.

279. This assessment applies equally to section 101 of the Bill, albeit that the proceedings in question will relate to the accuracy of the statutory pledges record.

280. Sections 10 to 14 of the Bill provide for the protection of debtors in the course of the assignment of claims. The effect of these provisions is that a debtor is protected in the event they continue, in good faith, to perform to the original creditor. Conversely, the Bill does not similarly seek to protect the rights of the assignee to whom the debtor ought to perform in the terms of the assignment. The Scottish Government has therefore considered the potential effect of sections 10 to 14 of the Bill on the assignee's rights pursuant to Article 1, Protocol 1 (A1P1) for the protection of property. Its conclusion is that those rights would not be affected because the assignee would retain a claim against the assignor for any receipts under the circumstances envisaged by sections 10 to 14.

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281. Sections 49 to 53 of the Bill provide that, in certain circumstances, the purchaser of property encumbered by a statutory pledge will take that property free from the encumbrance. Pursuant to section 49(1)(a) of the Bill, property will transfer unencumbered upon receipt of consent from the secured creditor. Absent that consent or one of the good faith protections in the Bill (or the anti-avoidance rule at section 50) applying, the property will transfer encumbered and the A1P1 rights of the secured creditor are protected, whilst the purchaser would have a claim in breach of warranty against the provider of the statutory pledge.

282. Sections 51, 52 and 53 of the Bill protect, respectively, purchasers of goods in the ordinary course of business; personal, domestic or household products; and motor vehicles. In the event that secured property does transfer as a result of these sections, the secured creditor will maintain a right of action against the provider.

283. By way of sections 55, 56 and 57, a statutory pledge may be assigned, amended, restricted or extinguished. However, such steps will require the consent of the secured creditor, in which case the secured creditor's rights pursuant to A1P1 remain protected.

284. Article 8 ECHR protects against arbitrary interference with private life. Information about an individual, such as their name and address, is protected by the Article 8 right, such that an individual may legitimately expect that such details are not published without their consent. Furthermore, it is necessary that safeguards are in place to prevent the use of any personal data as would be inconsistent with the rights afforded to individuals pursuant to Article 8.

285. The RoA and RSP will require that certain information is recorded. In accordance with section 20(1) of the Bill, such information will, in relation to the RoA, include the assignor's name and address, the assignor's date of birth and the assignee's name and address. However, the Bill does provide for safeguards in relation to that personal information. In accordance with section 37(2) of the Bill, provision may be made for the identification of a person in the RoA; the nature of the address of the assignor or the assignee; whether a signature used in an assignment document is to be included in a copy of that document when submitted; and what information, though contained in the register, is not to be available for searching or included in any extract of the register entry (issued in accordance with section 33 of the Bill). Similar requirements for the registration of certain data (section 81(1)) and corresponding safeguards (section 109(2)) are set out in relation to the RSP. There is also provision requiring the Keeper of the registers to protect the registers from interference, unauthorised access and damage (by sections 18(4) and 79(4)).

286. The Scottish Government does not, therefore, anticipate any significant impact on privacy. Furthermore, discussions have taken place with the Information Commissioner's Office about the data which will be submitted for registration in the new registers and what information, though contained in the registers, will not be available to persons searching the registers in order to protect confidential information. The detail of this provision will be set out in the rules of procedure for the two new registers which will

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be contained in regulations to be brought forward by Scottish Ministers after consultation with the Keeper.

Islands and rural communities

287. The Scottish Government does not anticipate any significant impact on island or rural communities. The provisions of the Bill apply equally to all communities in Scotland.

Local government

288. The Scottish Government does not anticipate any significant impact on Local Government. The Scottish Government contacted the Convention of Scottish Local Authorities (COSLA) to draw their attention to the SLC proposals on moveable transactions, but they did not believe that these were a particular issue for Councils. COSLA commented that it was unlikely that Councils would seek to grant or take security over movable property and, even if a Council did, the intent of the legal change was to make the process more straightforward.

Sustainable development

289. The Scottish Government does not anticipate any significant impact on the environment. It is anticipated that the proposed new registers will be primarily online operations and so will not give rise to the printing of lots of papers.

290. The Bill will, however, have an impact on sustainable development in terms of sustainable economic growth. The then President of the Law Society of Scotland wrote to the Cabinet Secretary for Justice in August 2019 to emphasise the need for legislation on moveable transactions:

“this is a critical piece of legal infrastructure. It is required to enable small and growing businesses in Scotland to thrive and stay here and to ensure that Scotland is an attractive investment destination in the future for relevant businesses coming from abroad”.

291. Goal 8 of Scotland’s sustainable development goals is to promote sustained, inclusive and sustainable economic growth. In relation to target 8.1 (which relates to numbers of businesses), the Bill will assist in retaining businesses in Scotland and in permitting them to thrive by making it easier for them to raise finance and investment.

292. The Bill will also assist with Goal 9 on industry, innovation and infrastructure since its provisions will contribute to growing competitive and innovative businesses.

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Policy Memorandum

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