ENTERPRISE AND CULTURE COMMITTEE

Tuesday 13 June 2006

Session 2

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ENTERPRISE AND CULTURE COMMITTEE
17th Meeting 2006, Session 2

CONVENER

*Alex Neil (Central Scotland) (SNP)

DEPUTY CONVENER

*Christine May (Central Fife) (Lab)

COMMITTEE MEMBERS

*Shiona Baird (North East Scotland) (Green)
*Richard Baker (North East Scotland) (Lab)
*Susan Deacon (Edinburgh East and Musselburgh) (Lab)
*Murdo Fraser (Mid Scotland and Fife) (Con)
*Karen Gillon (Clydesdale) (Lab)
Michael Matheson (Central Scotland) (SNP)
*Mr Jamie Stone (Caithness, Sutherland and Easter Ross) (LD)

COMMITTEE SUBSTITUTES

Mark Ballard (Lothians) (Green)
Donald Gorrie (Central Scotland) (LD)
Fiona Hyslop (Lothians) (SNP)
Margaret Jamieson (Kilmarnock and Loudoun) (Lab)
David McLetchie (Edinburgh Pentlands) (Con)

*attended

THE FOLLOWING ALSO ATTENDED:

Mr Kenny MacAskill (Lothians) (SNP)
John St Clair (Scottish Executive Legal and Parliamentary Services)
Allan Wilson (Deputy Minister for Enterprise and Lifelong Learning)

CLERK TO THE COMMITTEE

Stephen Imrie

SENIOR ASSISTANT CLERK

Douglas Thornton

ASSISTANT CLERK

Seán Wixted

LOCATION

Committee Room 5

Scottish Parliament

Enterprise and Culture Committee

Tuesday 13 June 2006

[THE CONVENER *opened the meeting at 14:01*]

Bankruptcy and Diligence etc (Scotland) Bill: Stage 2

The Convener (Alex Neil): I welcome everyone to the 17th meeting this year of the Enterprise and Culture Committee and ask everyone to switch off their mobile phones and BlackBerries.

Before we continue, I should tell members that this is Seán Wixted's last meeting before he joins the external liaison unit. On behalf of the committee, I thank Seán for his sterling work. Let us hope that he nominates us all for some of the more exotic visits that he will be organising.

Christine May (Central Fife) (Lab): You can go on those, convener.

The Convener: I welcome Shiona Baird back from her recent absence. We have received apologies from Michael Matheson, and Christine May has indicated that she has to leave the meeting at about 3.15pm.

At this point, I welcome to the meeting Allan Wilson, his team of officials and Kenny MacAskill for our stage 2 consideration of the Bankruptcy and Diligence etc (Scotland) Bill.

I move,

That the Enterprise and Culture Committee considers the Bankruptcy and Diligence etc. (Scotland) Bill at Stage 2 in the following order: part 2, part 14, part 1, parts 3 to 13, parts 15 to 16; and that each schedule is considered immediately after the section that introduces it.

Motion agreed to.

The Convener: I take it, then, that Richard Baker does not dissent.

Richard Baker (North East Scotland) (Lab): No.

The Convener: We now move on to consideration of amendments. The marshalled list of stage 2 amendments has been circulated to members and we will go through it in the normal way.

Section 31—Register of Floating Charges

The Convener: Amendment 1, in the name of the minister, is grouped with amendments 2, 3, 4, 6 and 13.

The Deputy Minister for Enterprise and Lifelong Learning (Allan Wilson): Before I begin, I, too, wish Seán Wixted all the best in his new post. I know that my officials have been very pleased with the way in which he has co-operated with them during his time on the committee and, like the convener, I hope that he does not forget his friends when he moves to the external liaison unit.

This group of minor and technical amendments is intended more to clarify the meaning of the legislation than to change it substantially. In lodging the amendments, we have listened to stakeholders' suggestions on how the provisions in this part of the bill might be clarified.

Amendment 6, the main amendment in the group, seeks to bring together provisions on ranking agreements. Ranking becomes important when a company becomes insolvent and has to determine the order in which competing secured lenders are paid out. Some of the amendment is drawn from provisions that are already in the bill, while other parts of it seek to spell out the rules on ranking agreements. I intend to go through each of the proposed new subsections in turn.

Proposed new subsection (1) is a reproduction of section 34(7), which amendment 3 seeks to delete. Subsections (2) and (3) clarify that the rule that floating charges rank by their date of creation, as set out in sections 34(1) and (2), may be displaced by a ranking agreement.

The subsections also clarify that capping provisions can be altered by ranking agreement. A capping provision allows the holder of a second, later floating charge or later fixed security to protect the value of their security by giving notice—sometimes known as a capping notice—to the holder of the earlier floating charge, in which event the priority ranking of the earlier floating charge is restricted to the amount of the debt then outstanding, plus any further advances that the holder of the earlier floating charge was contractually obliged to make. Amendment 6 clarifies that a capping provision can be altered by a ranking agreement.

Subsection (2)(b) makes it clear that a ranking agreement cannot displace the rule set out in section 34(4) that a fixed security arising by operation of law has priority over a floating charge.

Subsection (4) makes provision for requiring the consent of the holder of an existing floating charge or fixed security, where its position would be adversely affected by the provisions of a ranking agreement. The provision replaces section 34(8), which amendment 3 seeks to delete. It does not require the floating charge holder to subscribe to the actual document that grants the floating charge. In practice, it may often be impractical to

require the lender to grant consent by becoming a party to the floating charge document itself. As a result, subsection (5) provides that the lender may give consent in a separate document of consent, which may be registered by the borrower. As registration will be in the interests of the borrower—after all, it makes it clear to third parties that consent has been duly obtained—there is no need to impose a requirement to register.

The other amendments in the group are either minor or consequential. Amendment 1 specifies that such documents of consent are registrable in the register of floating charges. Amendments 2, 3, 4 and 13 are consequential.

I move amendment 1.

The Convener: Before I open up the discussion, I should remind members that this is not a question and answer session per se. The minister will answer any questions that you might have when he winds up.

Christine May: I am grateful to the minister for clarifying the matter. I would also be grateful if he could give me an example of how the provision makes it more difficult for, say, the owner of a property to dispose of it in order to get out of paying his lawful dues.

Moreover, I want to know whether the provision makes it easier for creditors—who, as we have heard in evidence, might be many—to get back as much as possible of what they are owed, in as clear a way as possible, and that that is registered and perfectly clear to anyone else who might have a claim against an individual.

Allan Wilson: The amendments have nothing to do with those matters. Instead, they deal with the ranking of creditors when liquidation occurs.

John St Clair (Scottish Executive Legal and Parliamentary Services): Creditors—

The Convener: I am sorry—only the minister may speak. You may advise him, sotto voce.

Allan Wilson: I am advised that there is the equivalent of a pecking order among respective creditors. That response does not address Christine May's question, which no doubt will be raised again in the fullness of time.

Amendment 1 agreed to.

Section 31, as amended, agreed to.

Sections 32 and 33 agreed to.

Section 34—Ranking of floating charges

Amendments 2 to 4 moved—[Allan Wilson]—and agreed to.

The Convener: Amendment 5, in the name of the minister, is grouped with amendments 10 and 11.

Allan Wilson: Amendments 5 and 10 simply correct the same erroneous statutory reference in sections 34 and 38 by replacing the references to section 176 of the Insolvency Act 1986 with references to section 176A. Amendment 11 is a technical amendment.

There are different events that trigger the attachment of a floating charge. Section 38 deals with the attachment of the floating charge on a winding up. A floating charge can also attach on the appointment of a receiver or the delivery of a notice by an administrator. The way in which attachment works on the appointment of a receiver or administrator is laid out in the Insolvency Act 1986. The policy is that the reforms that are provided for in section 38 should not affect the relevant provisions in the Insolvency Act 1986.

As section 38 stands, it already provides that there is no effect on sections 53(7) and 54(6) of the Insolvency Act 1986, which deal with the appointment of a receiver. There is also no effect on section 175—or 176A, as provided by amendment 10—on the process for the payment of preferential debts by the receiver or administrator.

For completeness, amendment 11 adds a reference to paragraph 115(3) of schedule 81 of the Insolvency Act 1986, which provides for the attachment of a floating charge on delivery of a notice by an administrator.

This amendment ensures that all provisions in the Insolvency Act 1986 for the attachment of a floating charge are unaffected by the reforms.

I move amendment 5.

Murdo Fraser (Mid Scotland and Fife) (Con): I do not necessarily want to oppose amendment 5 or the other amendments in this group but I would like to ask the minister for a little clarity with regard to Executive policy. I am a little concerned that we have missed an opportunity to remove an existing problem in the law. The amendments merely exacerbate an existing problem relating to the interaction between preferential creditors, floating charge holders and secured creditors. I wonder whether the Executive might look again at the policy.

Under section 34(2), a floating charge will be paid before a fixed security that is created after the floating charge is registered. That is the case even if the debtor company agreed to grant the security before the floating charge was registered.

For example, on day 1, a company—we shall call it Alpha Ltd—might enter into a contract to grant a standard security to the Royal Bank of Scotland but, on day 2, it could grant a floating charge to the Bank of Scotland. If the floating charge is registered before the standard security is

registered and if Alpha Ltd goes into liquidation, the Bank of Scotland will be paid after the Royal Bank. That is the position at the moment when creditors in floating charges insist on the use of negative pledge clauses that regulate ranking.

14:15

However, a problem arises if we consider preferential creditors and the preferred debt under section 176A of the Insolvency Act 1986. At common law, a secured creditor will be paid before either of those preferred creditors. Therefore, if Alpha Ltd has a mortgage with the Royal Bank of Scotland and unpaid employees, the mortgage will be paid before the unpaid employees, but preferred creditors, such as unpaid employees or the preferred fund under section 176A, will be paid before floating charge holders as a result of section 34(9). Therefore, if Alpha Ltd has a floating charge with the Bank of Scotland and unpaid employees, the unpaid employees will be paid first. However, section 34(2) already provides that where there is a floating charge and a secured creditor, the floating charge will prevail if the floating charge is registered first. So Alpha Ltd's Bank of Scotland floating charge will rank above the Royal Bank of Scotland's standard security.

We have a problem if we add those three rules together. Where Alpha Ltd has unpaid employees or a creditor who forms part of the preferred fund under section 176A of the 1986 act, a floating charge in favour of the Bank of Scotland and a standard security in favour of the Royal Bank of Scotland that was registered after the floating charge, who should be paid first? The employees will be paid before the Bank of Scotland, the Bank of Scotland will be paid before the Royal Bank of Scotland and the Royal Bank of Scotland will be paid before the unpaid employees. There is a circle of priorities. That is an odd result. It is odder still that the Executive has not considered the matter as part of its reforms in introducing the bill. In such circumstances, how can a liquidator or receiver make adequate payment arrangements?

There has been case law in England and Wales on similar problems—in re Portbase Clothing Ltd and other cases—but no conclusive decision has been reached. It would be unfortunate if we enshrined in legislation that is made under Scots law a problem that could be resolved only by litigation. Will the Executive consider the problem and perhaps come back with a proposal at stage 3 to remedy it and ensure that the ranking of creditors is properly assessed?

The Convener: I had spotted that problem too.

Karen Gillon (Clydesdale) (Lab): After I did.

The Convener: Are there any comments, debating points or questions? I am sure that the minister will need a minute or two before answering that question.

Allan Wilson: In all seriousness, it is impossible for me to answer such a question in the detail that it deserves without having had advance notice of it. I hope that our future deliberations will be guided by that remark.

Obviously, we have considered the general matter of the ranking of creditors. It is worth noting that the Scottish Law Commission thought that problems to do with competition in ranking were among the most difficult in insolvency, diligence and securities legislation, which is an important consideration for our current and future deliberations.

We would be perfectly happy for Mr Fraser, any other member of the committee or the committee as a whole to write to us about the hypothetical situation that Mr Fraser has described, and we would be prepared to respond in equal detail on the current legal provisions and the changes that we have considered. I give an assurance that our minds are entirely open if Mr Fraser, any other member of the committee or the committee as a whole wants to show that there is a better way of proceeding and that we would be more than happy to lodge amendments at stage 3 that would bring clarity to the process, improve it in a consensual manner or would otherwise improve the current draft of the bill. That is an important point of principle.

We have no objection to participating in that process but we would require greater notice in order that we can respond in detail to the complex scenario that Mr Fraser has outlined, in which case we would be happy to discuss the matter with him and other committee members. However, with due respect, I submit that the matter has no consequential bearing on amendments 5, 10 and 11, which are to correct an erroneous statutory reference.

Amendment 5 agreed to.

Section 34, as amended, agreed to.

After Section 34

Amendment 6 moved—[Allan Wilson]—and agreed to.

Section 35 agreed to.

Section 36—Alteration of floating charges

The Convener: Amendment 15, in the name of Kenny MacAskill, is grouped with amendments 16, 7 and 8. I should point out that if amendment 16 is agreed to, it pre-empts amendments 7 and 8.

Mr Kenny MacAskill (Lothians) (SNP): Amendments 15 and 16 are being sought by the Law Society of Scotland and have been lodged on its behalf as opposed to on any party political basis.

If I cast my mind back some 30 years, to when I studied Scots law 1 and commercial law, the purpose of floating charges was to facilitate commercial actions to grant some security without the burdens that can go with standard securities and other matters. The intention of the amendments is to retain the ethos of floating charges and to add, not detract, from what the Executive is correctly trying to do in the bill. At the same time, it is to facilitate a more entrepreneurial society.

The bill unamended would require registration of an alteration of a floating charge for even a relatively minor reason. Clearly, minor matters may take place that present no great difficulty or danger to a ranking creditor or a security holder; therefore, the intention of amendment 15 is to prohibit or restrict the creation of a fixed security or any other floating charge having priority over or ranking pari passu with the original floating charge, or increasing the amount secured by the floating charge. Clearly, in those instances it is vital that any change is registered so that all parties and others are aware of it. However, there are other circumstances of a relatively minor nature where the free movement of commerce in entrepreneurial society would simply be inhibited by registration.

The further amendments relate to that in terms of a blanket requirement for the registration of any property from the charge in all cases. Again, there are minor matters that may be of limited consequence, so it is a matter of bearing it in mind that we must ensure that the cases in which there is a clear consequence to others are registered. In those cases in which there is little impediment to others, we should allow the free movement of business without making floating charges unduly burdensome. The whole ethos of a floating charge is that it is not as burdensome as, say, a standard security.

I move amendment 15.

Allan Wilson: The principle underlying the creation of a public register of floating charges—that is the important consideration that has been referred to by Kenny MacAskill—is that third parties dealing with companies should be able to rely on what is published in the register. That is why the bill provides that alterations to the terms of the charge must be registered. The bill does not prescribe deliberately what is to be included in the document registering the charge. As is the practice with standard securities, there is no need for the floating charge security documentation to contain all the details of what might be a voluminous contract. In the case of standard securities, a short form is all that is registered. However, in so far as the parties choose to put details into the floating charge document, we believe that it is right that third parties should be able to rely on what is on the register. There would be no point in having a register if what was on it was not a true and current record of the position.

Another problem with the amendments is the practical consequences that could flow from them. For example, a floating charge need not extend to all the assets of the company that grants the floating charge; it may be confined to specific assets or a class of assets—for example, a fleet of cars. The amendments would make it possible for the scope of a floating charge to be extended to cover additional assets by private, unpublished agreement. That, too, would undermine public confidence in the register as a correct public record of what was covered by the charge.

The Convener: Okay. Thank you. Christine May.

Christine May: I listened carefully to Kenny MacAskill's explanation of why he lodged the amendments and it sounded perfectly reasonable. However, it concerned me that there were no examples of the minor issues that would not need to be registered. If one of the purposes of the bill is to give greater certainty to those who are owed money as to what charges are in place, I am more inclined to accept what the minister says. Although it might be an irritation, it is better to have all the details there than not to have elements there because somebody has decided that they are minor. They may not be minor to those who are affected by them.

Allan Wilson: Convener, I had not concluded my remarks. I had still to speak to the Executive's amendments.

The Convener: I am sorry. My apologies.

Allan Wilson: I was about to invite Mr MacAskill to withdraw amendment 15 on the ground that the parties are free to prescribe what is registered in the floating charge document.

I turn to amendments 7 and 8. Some of our stakeholders have suggested that the section as it stands would require the registration of other events, such as the sale of property covered by the charge, or an alteration in the rates of interest. The essence of the floating charge is its flexibility. Unless or until the company goes into liquidation or a receiver is appointed, the company should be able to deal with its secured assets as usual by, for example, selling them. It is not intended that normal business events of that kind should be registered. Amendments 7 and 8 are avoidance of doubt provisions. Property that is disposed of

during the normal course of business does not have to be registered as an alteration to the floating charge. However, when the scope of a floating charge is altered so that a particular asset, or assets, or type of asset is removed from the scope of the floating charge, that must be registered.

With those assurances and the proviso that we are happy to engage in discussion around that in the interim, I ask Mr MacAskill to withdraw amendment 15.

The Convener: Is that you finished, minister?

Allan Wilson: Yes.

14:30

Murdo Fraser: I had better draw the committee's attention to my entry in the register of members' interests. I am a member of the Law Society of Scotland, although I do not agree with it about everything. I was interested to hear what Kenny MacAskill had to say and what the minister had to say in response.

The Law Society seems to be trying to protect legal practitioners from excessive work—as a former lawyer I have to say that that is never a bad ambition—by ensuring that we do not end up with a lot of minor amendments to documents registered for a floating charge. My experience of such documents is that they are always extremely light in detail. To that extent, I would back up what the minister said.

However, I see that the Law Society's briefing note says that documents containing floating charges might contain provisions that regulate the contractual relationship between the company and the lender, such as the rate of interest payable on the loan. That might be the case, although my experience is that those provisions tend to be in separate side documentation and the terms of the actual documentation that is registered to support the floating charge are fairly sparse.

So, I wonder whether the minister's position might be counterproductive. The intention is to have as much disclosure as possible, but if things are left as they currently stand, will the consequence be that documents that create floating charges will be as sparse as possible, and parts of the contractual relationship will be contained in a side letter that the parties can amend without reference to the principal document? That would mean that we would end up with a very sparse register of public information. I am interested to hear the minister's comments on that, although I am minded to support his position.

Mr MacAskill: I have listened to Murdo Fraser and taken on board what the minister said, and we are not that far away from consensus. The minister's amendments address some matters, although it might be that the Law Society will still have some further points that it will wish to be clarified, but given that the minister has undertaken to discuss those, I will seek to withdraw amendment 15 and either I or the Law Society will deal directly with the minister to see if we can reach a final agreement.

Amendment 15, by agreement, withdrawn.

Amendment 16 not moved.

Amendments 7 and 8 moved—[Allan Wilson]—and agreed to.

Section 36, as amended, agreed to.

Section 37 agreed to.

Section 38—Effect of floating charges on winding up

The Convener: Amendment 9, in the name of the minister, is grouped with amendment 12.

Allan Wilson: Amendment 12 is the main amendment in the group. It covers an issue that was raised by the law firm Tods Murray it its evidence to the committee. It seeks to remedy a problem that was created as a result of a European Commission regulation on insolvency proceedings. The terms of the Commission regulation say that a Scotland-registered company can be wound up in other non-EC countries—other than Denmark, which is not a party to the regulation—if it has its main centre of interest in that country or, in limited circumstances, if it has an establishment there.

Amendment 12 will mean that such liquidations will trigger attachment as well as liquidation in Scotland. Amendment 9 is a consequential amendment that will tidy up section 38.

I move amendment 9.

The Convener: Does anyone want to say anything on the amendments?

Murdo Fraser: Are we considering amendment 12 in this group?

The Convener: Yes.

Murdo Fraser: Has the minister spoken to amendment 12?

The Convener: Yes, he has.

Allan Wilson: Amendment 12 is the main amendment in the group.

Murdo Fraser: I am sorry—I got confused there.

The Convener: You should not let Karen Gillon make you take your eye off the ball.

Murdo Fraser: I will comment on amendment

12, if I may.

The Convener: Of course.

Murdo Fraser: I note that the Law Society of Scotland objects to amendment 12 and I ask for the minister's comments on that. I think, having read the Law Society's objection, that as with amendments that were lodged by Mr MacAskill, amendment 12 is intended to assist practitioners, but also creditors in some circumstances.

The Law Society objects to the lack of a provision to ensure that persons who deal with a Scottish company are made aware that, as a result of insolvency proceedings' having been opened in another country, the company's floating charge has crystallised. Any third party who deals with the company could be prejudiced by an event of which he is unaware or of which his legal practitioner is unaware, and will have no means of discovering it before loss occurs. Normally, searches are conducted through Companies House to establish whether crystallisation has occurred. Anyone seeking to deal with a company would expect to get a clear search, particularly when dealing with the conveyancing of property.

As we know—as the well-known case of Sharp v Thomson confirmed—if crystallisation occurs before conveyance is completed, the purchaser will lose his right to the land, although he will have a claim against the company for repayment of the price, although that will probably be worthless in cases of insolvency.

The Law Society is concerned that, if amendment 12 is agreed to, a provision will need to be included in the bill to the effect that the floating charge will attach or crystallise only in circumstances in which it refers only to the registration of a prescribed notice in the appropriate register, be that Companies House or the register of floating charges. I hope that the Executive will be prepared to consult further on that matter with a view to lodging an amendment at stage 3.

Allan Wilson: The short answer to Mr Fraser's question is that we are prepared to lodge such an amendment. As I have said on a couple of occasions during our consideration of the bill, this is not an entirely straightforward matter. Liquidations that take place here will not need to be registered for crystallisation to take effect. We must consider whether it is correct or practicable to insist on a different rule for liquidations that take place abroad. As we were discussing earlier today, we accept that there might be a substantial point here. In matters of technical law reform such as this, it is essential that we get the correct answer, as members would agree. I therefore propose to ask my officials to hold further discussions on the matter with the various parties. If necessary, we will lodge an amendment at stage 3 if we can secure agreement that that would be the correct thing to do.

Amendment 9 agreed to.

The Convener: Amendment 17, in the name of Murdo Fraser, is grouped with amendments 18 and 19.

Murdo Fraser: Amendments 18 and 19 are consequential on amendment 17. The amendments are intended to reverse the decision of the first division of the Court of Session in the 1977 case of Lord Advocate v Royal Bank of Scotland. The case involved a competition between the Lord Advocate, who had carried out an arrestment of funds for unpaid tax, and the Royal Bank, as creditor in a floating charge. The court had to consider whether the arrester would take priority over the floating charge. That involved considering the term "effectually executed diligence." Unfortunately, that term has never been defined in floating charge legislation. In the 1977 case it was held that where there was an arrestment without furthcoming, there could not therefore be effectually executed diligence and, consequently, the floating charge prevailed and the Royal Bank of Scotland was paid first.

I am sure that the minister is aware that that case generated considerable controversy. Numerous commentaries that have been critical of the decision have appeared in various Scottish law reports. I am happy to write to the minister, if he wishes, to quote my sources.

There are three principal bases for the criticism. First, the interpretation of "effectually executed diligence" that was made by a majority in the first division deprives the term of any effect. That is because if an arrestment was not effectually executed until furthcoming had taken place, there would be no need for the rule, because the effect of furthcoming would be to transfer the arrested fund from the debtor company to the creditor who was carrying out the arrestment. The floating charge could therefore no longer attach the fund.

Secondly, the approach that was adopted by the first division in the Royal Bank case contradicts the approach of other courts in interpreting other aspects of the law of floating charges and creates various absurdities, including a circle of priorities in certain cases. Examples of that are cases in which a company has previously granted a floating charge and the company's bank account is arrested, followed by an assignation of the company's bank account intimated to the transferee, and the appointment of a receiver attaching the floating charge. The order of ranking in such cases is irresolvable. The arrester takes priority over the transferee, because the arrestment was before intimation of the

assignation; the transferee takes priority over the receiver, because intimation removes the fund from the scope of the floating charge; and, as a result of the case of the Lord Advocate v Royal Bank of Scotland, the receiver takes priority over the arrester. Of course, the arrester takes priority over the third party—and so we go around in a circle.

Thirdly, the interpretation of the expression "effectually executed diligence" ignores the use of the term in other statutes, including the Bankruptcy (Scotland) Act 1985, and is contrary to the policy that was enunciated in the Westminster Parliament when the expression was introduced into legislation on floating charges. The expression was introduced in section 1(2)(a) of the Companies (Floating Charges) (Scotland) Act 1961. That section was introduced by Alexander Forbes Hendry, the then Conservative MP for Aberdeenshire West, through an amendment. When he was questioned by Bruce Millan MP about the effectiveness of diligence against the floating charge, Forbes Hendry confirmed his approach. Millan asked:

"Whether it would be competent to effect a diligence on property which was already subject to a floating charge. Will the courts allow diligence to be effected when the whole of the property is subject to a floating charge?"

Forbes Hendry replied:

"If one has done one's diligence more than 60 days before liquidation, one very properly stands to benefit … Those diligences are not affected by the floating charge because a floating charge does not take effect until the winding up actually starts, that is, the bankruptcy axe has fallen."—[*Official Report*, *House of Commons*, Scottish Standing Committee, 20 June 1961; c12-16.]

The original cross-party parliamentary intention was not taken into account by the courts.

It has been argued regularly that the decision in the Lord Advocate v Royal Bank of Scotland case is unsatisfactory, but it is not possible to leave it to the courts to overturn it, because any decision of the courts to overturn a case is retrospective in effect. Overturning the case in a higher court would therefore risk reopening distributions of monies in insolvencies and receiverships. If the case is to be overturned, it must be overturned by legislation.

Amendment 17 proposes to reinstate the original parliamentary intention and has been prepared because the original wording of the amendment to the amendment in schedule 5 to the bill proposed an amendment to section 61 of the Insolvency Act 1986, which appeared to partly reverse the Lord Advocate v Royal Bank of Scotland decision, but did not go far enough. The expression "effectually executed diligence" appears in section 38 of the bill and in sections 60 and 61 of the Insolvency Act 1986. Surely a uniform approach to such expression should be taken in the various provisions; consequently, amendments 18 and 19 have been lodged in similar terms. Such a definition needs to take into account the fact that diligence covers more than just arrestment; it also includes attachments, land attachments and inhibitions.

Furthermore, a definition that simply provides that arrestments or other diligences will always prevail over the floating charge is unsatisfactory. That is because section 37(4) of the Bankruptcy (Scotland) Act 1985, which will not be affected by the bill, provides that diligences that are carried out in the 60 days before sequestration are struck down as ineffectual. The section is applied to company liquidations by section 185 of the Insolvency Act 1986. If it was provided that all diligences prevailed, a diligence could be struck down in liquidation, but still beat a floating charge. That would be absurd and it was not the intention of Parliament when the floating charge legislation was first introduced in 1961.

14:45

Instead, it is proposed that if diligence is carried out before the floating charge attached and is not struck down by section 37(4) of the 1985 act, as applied by the 1986 act, the diligence should prevail, even if there has been no furthcoming for arrestments, or sale for attachments or land attachments. However, if a diligence has been struck down by virtue of section 37(4) of the 1985 act, it should not prevail. That would serve to allow individual creditors that were doing diligence to prevail over the floating charge holder, who typically has priority in relation to the bulk of a company's asset base.

I hope that the minister will see that amendments 17, 18 and 19 are necessary, in that they would resolve an anomaly in the law and a decision of the Court of Session that has caused practical difficulties. However, I am happy to treat the amendments as probing amendments if the minister is prepared to consider the matter further and to lodge amendments at stage 3 that would address the problem.

I move amendment 17.

The Convener: Before calling the minister, I must give members an opportunity to speak. To be fair, I will give everyone else the same amount of time as Murdo Fraser had.

Mr Jamie Stone (Caithness, Sutherland and Easter Ross) (LD): The trouble is that I have not taken my tablets.

The Convener: Over to the minister.

Allan Wilson: I say at the outset that amendments 17, 18 and 19 should be seen in the

general context of diligence, rather than the smaller context of floating charges, which we are considering today. That is because the amendments are about deciding on trigger events in the diligence process. Our consideration of the amendments has implications for other matters.

My understanding of the amendments, which has been supplemented by what Mr Fraser said in their support, is that they seek to put it in statute that, with limited exception, when a diligence is executed, its ranking with floating charges is decided. If that were the case, the diligence would not need to be completed by a furthcoming. As has been said, that would reverse the decision in the case of Lord Advocate v Royal Bank of Scotland and would give preference to the arrester over the holder of the floating charge.

I say with respect—which Murdo Fraser is due after his exposition—that I do not think that the amendments would achieve their intention. Paragraph (a) of amendment 17 seems merely to state the obvious. Moreover, the reference to the Bankruptcy (Scotland) Act 1985 is flawed, since that act deals with personal bankruptcy and not corporate bankruptcy.

That aside, in "Report on Diligence on the Dependence and Admiralty Arrestments" in 1998, the Scottish Law Commission accepted that the rules on the preferential position of the arrester should be replaced by properly formulated principles. Its conclusion was:

"We consider that the fictional litigiosity theory of the arrester's preference should be abandoned and replaced by properly formulated principles. In our view however it would be preferable if this result were to be achieved by judicial development of the law rather than by legislation. We therefore make no recommendations for statutory reform of the theory of arrestment."

Murdo Fraser: Will the minister give way?

Allan Wilson: I will conclude by giving the member what I think he is looking for. Until today, we have been unaware of new concerns about that area of diligence since the publication of the commission report from which I just quoted. We have not been lobbied for the legislative reform that is suggested. If the member has concerns about the issue, I am of course happy to consider them carefully. Perhaps he would be good enough to write to me with those concerns. We will also study the *Official Report* of today's meeting with interest.

In the interim, perhaps Murdo Fraser will seek to withdraw amendment 17, with the assurance that, on his writing to me, I will be happy to consider the matter further.

Murdo Fraser: The minister referred to a Scottish Law Commission report from seven years ago. I point out to him that law commissioners come and go. The newly appointed law commissioner, Professor Gretton—my erstwhile colleague in the law—wrote on the subject in edition 26 of the *Journal of the Law Society of Scotland* in 1981 and recommended that the case of the Lord Advocate v the Royal Bank needs to be addressed. If asked today, the Scottish Law Commission might take a different position than it took in its previous report on diligence.

That said, in light of the minister's comments and his undertaking to reconsider the matter, I would be happy to withdraw amendment 17.

Amendment 17, by agreement, withdrawn.

Amendments 10 to 12 moved—[Allan Wilson]—and agreed to.

Section 38, as amended, agreed to.

Section 39—Repeals, savings and transitional arrangements

Amendment 13 moved—[Allan Wilson]—and agreed to.

Section 39, as amended, agreed to.

Section 40 agreed to.

Section 41—Formalities as to documents

The Convener: Amendment 14, in the name of the minister, is in a group on its own.

Allan Wilson: Amendment 14 is a minor drafting amendment that will improve the wording of section 41(2)(b). By reordering and simplifying the wording, the amendment spells out that the aim of the section is to ensure that section 46 of the Conveyancing (Scotland) Act 1924 applies in relation to a document that is registered in the register of floating charges in the same way that it applies to documents that are registered in the register of sasines.

Section 46 of the 1924 act ensures that the annulment of deeds and other documents, for matters like fraud or want of capacity, does not take effect against third parties unless an extract of the court decree annulling them is registered and is, therefore, a matter of public record. I hope that members will see the merit in this proposition and will support it.

I move amendment 14.

Amendment 14 agreed to.

Section 41, as amended, agreed to.

Section 42 agreed to.

The Convener: That concludes consideration of amendments for today. It also concludes our meeting.

Meeting closed at 14:53.

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