

ECONOMY, ENERGY AND FAIR WORK COMMITTEE

MOVEABLE TRANSACTIONS

SUBMISSION FROM ***A WORKING GROUP OF THE CENTRE FOR SCOTS LAW AT THE UNIVERSITY OF ABERDEEN. THE WORKING GROUP CONSISTS OF DR ALISDAIR MACPHERSON, MRS DONNA MCKENZIE SKENE AND DR EUAN WEST.***

Moveable Transactions

1. Have difficulties raising finance on moveable goods in Scotland affected your business or area of activity? If so, what practical impact has this had?

We have not experienced practical difficulties raising finance on moveable goods in Scotland, but that is unsurprising as we are academic lawyers. Nevertheless, it stands to reason that certain impracticalities of creating security over moveable property in Scots law impact upon the raising of finance. The general lack of non-possessory security over goods means that a debtor is unable to continue to use such property if a security is created over it. In many cases, the debtor will not want to give possession to the creditor and often the creditor will actually not wish to take possession. As such, a lender may refuse to provide finance or may offer it but on less favourable terms to the borrower, due to the greater risk of lending involved. The borrower may find the less favourable terms, such as higher interest rates, unduly onerous.

It is true that the floating charge is a limited exception to the difficulties in creating security over moveables in Scots law; however, only certain types of entity can grant floating charges and the floating charge is a security that has particular disadvantages. There are also workaround solutions available (see the next question) but these are problematic and can add costs to transactions, which again makes lending more expensive and thereby less favourable to the borrower (as the costs will ordinarily be borne by them).

In addition, the proposed reforms to the law of assignments and possessory pledge will clarify, simplify and modernise the law and will thereby make raising finance easier and cheaper.

We are aware that a number of practitioners have outlined practical difficulties they have experienced in the law of moveable transactions in Scotland. These views have been communicated in various contexts: in responses to Scottish Law Commission (SLC) consultations; in meetings of the Moveable Transactions Project Advisory Group; in evidence given to the Economy, Energy and Fair Work Committee in November 2019; in letters to newspapers (see e.g. *the Scotsman*, 13 November 2018, p. 30); and in articles (see below).

We would also like to stress that the Scots law of moveable transactions has been inadequate and outdated for a long time and reform is more desirable now than ever.

It is unacceptable that so many previous reform attempts have failed and it would be inexcusable if the same were to happen again now.

2. The Committee understands that there are various work-arounds used by Scottish businesses to enable access to finance on moveable goods. Are these sufficient, or would the law benefit from being reformed?

No, these work-arounds are not sufficient. The fact that work-arounds have to be utilised suggests that there are deficiencies with the existing law and that the law does not meet the needs of businesses and other market participants. Work-arounds can sometimes provide solutions; however, there are a number of difficulties with them. They often require parties to incur greater expense than would be the case if there were tailored options available. The effectiveness of work-arounds may not be wholly certain. An example is the use of trusts as a security device: their validity depends upon limited case law and there is conflicting authority. Work-arounds can also have unintended consequences, which is understandable given that they frequently involve the use of legal devices that were designed for other purposes. In addition, work-arounds often depend upon the use of ownership as security and because this cannot be split, it is not possible to create multiple security rights over the same property as would be the case with true security. This means that the financing potential of property is commonly not fully realised.

Instead of relying upon work-arounds, there should be a properly designed, modern system of security rights available over all types of property in Scots law, including goods. Work-arounds could still be available if the law was reformed but the business advantages of the new system would be identifiable by the fact that work-arounds would be relied upon much less.

Companies and certain other incorporated entities have the ability to create floating charges. Therefore, a “work-around” for a sole trader or a partnership seeking finance could be to incorporate a company to grant a floating charge to a lender. It should be possible in Scots law for a sole trader or partnership to grant a non-possessory security over corporeal moveables without having to incorporate.

The law would benefit from being reformed. However, the value of this to a large extent depends upon the Scots law “publicity principle” being honoured. This principle requires publicity of a party’s right in property so that others who may be affected by it have the ability to discover the existence of the right. It allows for more informed decision-making and certainty by relevant parties and may be considered as broadly favourable for the financing of businesses. The use of a register for moveable transactions is technologically possible (in a way that is more realisable than in the past) and would meet the requirements of the publicity principle. The SLC’s proposals for a Register of Statutory Pledges (RSP) and a Register of Assignations (RoA) are certainly suitable in this regard. A further point in this regard is that work-arounds often do not adhere to the publicity principle and therefore create more uncertainty for third parties dealing with the debtor, who may have an inaccurate perspective on the debtor’s finances and available assets.

3. The Scottish Government will have to invest money in creating the two new registers recommended by the Scottish Law Commission. Do you think there is sufficient demand to justify this? Do you have any evidence to support this?

Yes, there is sufficient demand to justify creating the two new registers. As already noted, there are certain types of business vehicle that do not have the ability to create a non-possessory security over goods. Statistics are available regarding the numbers of such businesses, which indicates that there is a substantial potential market. In fact, the statistics are skewed by the fact that these businesses are unable to grant floating charges, which would have encouraged the use of other types of vehicle like companies. It may be questioned why the use of companies (and certain other entities) should be incentivised in this way. Going some way towards levelling the playing field for different business vehicles would be advisable, so that parties can make a more balanced assessment as to which vehicle is most suitable for their business needs. We do recognise, however, that because floating charges will still only be available to some entities, those entities will remain somewhat more attractive for that reason.

In addition to the likely use of the new security right by certain business vehicles, companies and other incorporated entities will be major users of both the RoA and RSP. The SLC's consultations and research work indicate that these registers will be used to a notable degree and various parties have suggested this in other contexts too. The cost of setting up the registers will not be considerable and over time they will pay for themselves due to the fees involved.

With the proposed statutory pledge, registration in the RSP is the means by which the security is to be created. So, given that there is demonstrable demand for the availability of such a security, then the RSP is going to be used by acceptable numbers.

The transfer of claims would be made easier by the RoA and it would facilitate the transfer of future claims, which is often not possible under the current law. The law at present therefore creates significant difficulties for future flow securitisation transactions (a major source of finance for companies).

Beyond economic arguments, it is desirable for Scots law to have a coherent and logical system in this area. And this is true even in the highly unlikely event that only a small number of parties actually sought to utilise the new registration system.

4. The proposals in the Scottish Law Commission's draft bill would apply to consumers as well as businesses. Do you think there are enough protections in place for consumers?

Yes, the protections seem reasonable to us. There are various useful provisions such as: the inability of a party to assign wages or salary claims (s 8); the requirement for property to be over £1,000 in order for it to be encumbered by a statutory pledge (s 52(3)); and the necessity of a creditor obtaining a court order before enforcing a pledge against a consumer (s 70(1)). These provisions (and others) strike the right balance by giving protection to consumers without being too

paternalistic and give some freedom to consumers to decide the most appropriate course for themselves.

If consumers were to be excluded from the ability to grant a statutory pledge, this could create uncertainty regarding the validity of such a security if it was purportedly granted by an individual. That is because there will be circumstances in which it is not clear if the relevant property is property used for business purposes. As such, lenders may have some wariness about providing finance to individuals which could impact upon their lending to such persons, including sole traders.

A useful question to pose is 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 (see also the discussion in the SLC's *Report on Moveable Transactions* (2017), paras 19.36 et seq). This will enable them to continue to use and enjoy the property in a way that is not possible under the current law.

If more time is required to consider the application of the proposed reforms to consumers, then this should not delay the introduction of the changes for non-consumer cases. However, we consider that it would be clearer and more consistent for the law to be reformed for all parties at the same time.

5. Do you have comments on any of the other proposals contained in the draft bill?

We would like to emphasise the desirability of an order being made under s 893 of the Companies Act 2006 to avoid the requirement for companies to register in both the RSP (or RoA for assignments in security) and the Companies Register when granting security. This would transmit information from one register to the other and thus avoid dual registration. Such an order would also be desirable in relation to standard securities, which have to be registered in the Land Register of Scotland and the Companies Register. We appreciate that s 893 orders are outwith the powers of the Scottish Parliament and Scottish Ministers. However, we urge that serious efforts should be made to lobby for the utilisation of the powers given by s 893.

The SLC's proposals would bring much needed clarity to the law of possessory pledges and the law of assignments. Much of the current law is archaic and/or uncertain and the reforms would help to provide clarity, lower transaction costs and support the raising of finance.

If the statutory pledge is to be introduced, we think it is desirable for there to be continued consideration to extending the statutory pledge's ambit to cover additional types of incorporeal moveable property, notably claims.

6. Do you agree with the Scottish Law Commission's view that the law relating to moveable transactions should be changed?

Yes – we wholly agree with this and think that the reforms should be enacted without delay. The points we have made above support the desirability of reform in this area. Reforming the law would improve Scotland's law of moveable transactions relative to other jurisdictions, in comparison to which it is currently lagging behind. Our view is that the English law in this sphere is currently preferable to Scots law; however, implementing the SLC's recommendations would mean that the Scottish regime is more modern and advantageous than the English system in various respects. The outlined changes would also potentially boost Scotland's notional score in the World Bank's Ease of Doing Business rankings for the "Getting Credit" measurement. Overall, the changes will make it easier to raise finance in Scotland and will make it a more attractive place to do business.

Reforming the law on moveable transactions is supported in the Scottish legal academic and practitioner communities. See e.g. ADJ MacPherson, "The Future of Moveable Security in Scots Law? Comments on the Scottish Law Commission's *Report on Moveable Transactions*" 2018 *Juridical Review* 98; J Hardman, "Three Steps Forward, Two Steps Back: A View from Corporate Security Practice of the Moveable Transactions (Scotland) Bill" (2018) 22 *Edinburgh Law Review* 266; R Caldwell, "Enterprise Goes into Reverse for Floating Charge-holders" 2019 *Juridical Review* 103.

Given the impending changes (now due in December 2020) to partially reintroduce the status of HMRC as a preferential creditor in insolvency and to expand the maximum limit of the prescribed part for unsecured creditors, Scottish lenders will shortly be at a further disadvantage compared to their counterparts under English law. This is because under English law, various non-possessory fixed security rights are available over e.g. goods as an alternative to floating charges, while Scottish lenders will often be reliant upon floating charges and floating charges are the form of security right being most significantly affected by the upcoming changes. As such, financing in Scotland may be negatively impacted upon in the near future but enacting the SLC recommendations will help to circumvent some of the difficulties arising.

7. Do you have any other comments?

We consider that the expedited parliamentary procedure for implementing Scottish Law Commission reports should be used to reform the law of moveable transactions. We believe that there is a wide degree of consensus amongst key stakeholders about the need for reform and the approach recommended and we do not view the financial implications as substantial. Our view is that the proposals are not controversial and unless the current consultation identifies particularly divisive issues then the use of the expedited procedure is valid and appealing. The appropriateness of introducing the reforms as soon as possible has already been stressed above and the procedure would be a suitable way to realise the reforms quickly.

In the interests of full disclosure, Dr Alisdair MacPherson was on the Scottish Law Commission's Advisory Group for its Moveable Transactions Project and Mrs Donna McKenzie Skene assisted the Scottish Law Commission with the interface between that Project and insolvency law.