

ECONOMY, ENERGY AND FAIR WORK COMMITTEE**MOVEABLE TRANSACTIONS****SUBMISSION FROM****SENATORS OF THE COLLEGE OF JUSTICE****Moveable Transactions: draft response to the Call for Views from the Economy, Energy and Fair Work Committee**

The Economy, Energy and Fair Work Committee of the Scottish Parliament has issued a Call for Views in relation to the reform of the law of moveable transactions, in accordance with the recommendations of the Scottish Law Commission: *Report on Moveable Transactions* (Scot Law Com No 249; December 2017). The Committee has already taken evidence from several of those involved in assisting the Scottish Law Commission in its work on the project. They argued that the law in this area needed updating. It was difficult in Scotland for businesses to raise money using moveable assets, for example plant, whisky in cask, intellectual property rights, or debts due from customers. A number of other countries, including England, have clearer and more modern legal regimes. That made raising business finance easier.

The SLC recommended creating a new type of loan security using moveable property, known as a statutory pledge. It also recommended the creation of two official registers. The first is a Register of Statutory Pledges, which would provide details of moveable goods used as security for a loan, and would also apply to intellectual property rights and certain financial obligations. The second is a Register of Assignations, which would provide information about obligations transferred to a new owner, including the assignation of debts. Registering a transfer in that Register would remove the need to give notice to the debtor, and would thus make raising finance on security of debts easier.

The Committee then asks seven questions about the issue. We answer those questions as follows:

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?

This question is better answered by those involved in business or by solicitors and others who advise businesses. We observe, however, that the defects in the existing Scots law are serious and well-known, and it would be surprising if these did not have an impact on business activity.

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?

It is correct that work-arounds are extensively used to circumvent the defects in the existing law. These take various forms. In some cases it is possible to make use of English law, which has more effective means of transferring or providing security

over moveable (personal) property. An example of this is found in *Tay Valley Joinery Ltd v C.F. Financial Services Ltd*, 1987 SLT 207. That case involved an invoice discounting agreement (broadly similar to a factoring agreement) where a finance company lent money to a trading company and wished to have security over the debts due to the trading company by its customers. The agreement was governed by English law, and it was held that the finance company had an effective security over the debts due by customers to the trading company, in preference to the other creditors of the trading company. That security extended to sums paid by customers.

Had the agreement not been governed by English law, it is likely that the security would have been ineffective, at least in the absence of the trust arrangements that were subsequently developed in Scotland to deal with the problems raised by that case. The security provided under English law in cases such as *Tay Valley* takes the form of an equitable interest, which is a concept unknown to Scots law (and every other system that is not based on English law). The cost of raising finance will normally be significantly reduced if an effective security can be provided. Consequently Scots law is currently at a significant disadvantage by comparison with English law. Anecdotal evidence suggests that English law is regularly used to facilitate the provision of security in commercial financing arrangements. This of course leads to a serious loss of legal business to Scotland, and is scarcely a mark of confidence in Scots law in this area.

The other work-around that is in common use involves fairly elaborate arrangements based on the creation of trusts over debts. These are used in relation to factoring, invoice discounting and securitization agreements. The basic method was devised in the late 1980s, when the deficiencies of Scots law in this area became obvious. Trust-based arrangements have never been challenged. Consequently they proceed on the basis of a series of counsel's opinions dating from the period between approximately 1988 and 1991.

Trust-based securities are of considerable commercial importance. Today a typical company carrying on business is likely to rent its premises, to lease its plant and equipment on finance leases, and to acquire stock-in-trade subject to retention of title arrangements. That means that the traditional forms of security assets – heritable property, plant and trading stock – are not available as security for the company's borrowings. What the company does have, however, is a debtors' ledger, representing debts due from customers. From about 1990 onwards debts have regularly been used as security for a trader's borrowing, using trust arrangements. What happens is that the agreement governing debt factoring or invoice discounting contains an express declaration of trust over Scottish assets, in the form of debts due in Scotland and subject to Scots law. It is necessary to ensure that intimation of the trust is properly made, but that is simply an intimation to the finance company. With traditional assignation of debts in security, by contrast, it is necessary to effect intimation to each of the individual debtors each time a new debt is created. That is

universally regarded as commercially impracticable in factoring and other commercial finance arrangements.

Trusts are also used in securitization agreements. Securitization is a form of finance used by banks and other companies engaged in consumer finance. As with debt factoring and invoice discounting, it involves using the debts due to the bank or other consumer finance company to provide security for borrowings. Securitization is regarded as an efficient means of raising funds at relatively low cost. Provided that the debts sold are of suitable quality, it has the advantage that many individual debts are bundled together. This provides a form of insurance against bad debts. In Scots law, the use of trusts is essential to provide adequate security in such cases.

Although trusts can be used in the manner described above to provide security in Scots law, it cannot be said that this is truly satisfactory. The arrangements that have to be used to provide security are essentially artificial, and somewhat convoluted. Certain formalities are essential, such as intimation to the beneficiary of the trust. Those formalities are much less obvious to the uninitiated than simple registration. So far as we are aware no other legal system makes use of trusts as commercial securities in the way that has become relatively common in Scots law. This in itself indicates that the use of trusts is a device rather than a sensible form of security.

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?

This is better left to solicitors, business organizations and others who are in direct contact with those who would make use of the registers. The evidence taken by the Scottish Law Commission, however, clearly indicates that such demand exists. The consultation exercises carried out by the Commission are detailed and wide ranging, and for our part we would be content to rely on their assessment of demand.

We would also emphasize that systems of registration have been set up in many other jurisdictions in recent years. Thus in the United States all of the individual states (which are responsible for the law in this area) have adopted chapter 9 of the Uniform Commercial Code (UCC). The security arrangements in the UCC are register-based. The UCC was followed by the Canadian provinces, which enacted a series of individual Personal Property Security Acts (PPSAs), based on the UCC. Once again registers were set up in the individual provinces. Canada was followed by New Zealand, which enacted its own PPSA and set up the appropriate register. More recently, the UCC has been followed by the Australian states, which have likewise set up registers. We understand that the registers in all of those jurisdictions are extensively used, and are regarded as an essential part of the general structure of the law governing commercial finance. The information required in those registers, and the effect of registration, differ materially in some respects from those under the proposed Scottish system. Nevertheless, the fact that registers are used extensively

and successfully lends strong support to the view that the two proposed registers would be extensively used, and would be of great utility in practice.

We should also emphasize that the system of registration in the two Registers that is proposed by the Commission would in many cases be easier to use than the existing system of assignation to be debtor. That applies to the proposed Register of Assignations in cases of simple assignation, and to the Register of Statutory Pledges in relation to security over moveable property, both tangible and intangible. In this connection, two points should be emphasized. First, the amount of intangible property in existence is extremely large, and growing, and the ability to provide effective security over such property is likely to be of great commercial importance. Secondly, it is in relation to securities over intangibles, such as debts and intellectual property rights, that the deficiencies of the existing law have become very obvious. The Register of Statutory Pledges should avoid the need to set up and intimate elaborate trust arrangements; those will be replaced by a simple act of registration. We think it likely that this will prove attractive in the commercial world.

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?

In our opinion adequate protection exists for consumers in this area. At the outset we would note that consumer protection has, for obvious practical reasons, developed into a distinct area of law that is subject to extensive legislation. The relevant legislation includes the Unfair Contract Terms Act 1977, the Unfair Terms in Consumer Contracts Regulations 1999, Part 8 of the Enterprise Act 2002, and the Consumer Protection from Unfair Trading Regulations 2008. The existing legislation, which is kept under review and periodically updated if problems emerge, provides effective protection for consumers.

The legislation proposed by the Scottish Law Commission, by contrast, is primarily concerned with the effective transfer of moveable property and the creation of effective securities over such property. To the extent that consumer contracts are involved, they will be subject to the general consumer protection legislation. The protection of consumer interests should be the subject of consumer protection legislation. If additional provisions are inserted in legislation governing property rights, unnecessary complexity will be introduced, and there is a danger that the resulting legislation will prove confusing and difficult to apply in practice. For this reason we would oppose any attempt to use the proposed legislation to provide additional consumer protection.

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

We have no further comments on the other proposals contained in the draft bill.

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

We agree with the Scottish Law Commission's view that the law relating to moveable transactions should be changed. The present law is manifestly unsatisfactory. Complicated work-arounds involving trusts are required to provide security in Scots law. Such devices should not be necessary if proper legislation is enacted. This is evidenced by the widespread use of the PPSAs in Canada, Australia and New Zealand. There is no doubt that the legislation in those countries provides a simple and approachable form of security. While the PPSAs differ in important respects from the Commission's proposals, they share the common objective of providing methods for the transfer of moveable property and for granting security over such property that are straightforward and easy to use. We believe that that is a great merit of the Commission's proposals. Furthermore, the present unsatisfactory state of Scots law is well known, and we understand that it has become commonplace for commercial concerns to make use of English law in preference to Scots law simply because of the well-known problems with the Scots law of moveable property and moveable securities.

We would also emphasize the value of such property. Intangible (or incorporeal moveable) property includes debts of every sort, shares and other securities, and intellectual property rights. Economic evidence indicates that these comprise most of the property that is now in existence in developed economies. Consequently it is of vital importance to any modern legal system to have rules and institutions governing rights in moveable property, and especially intangible property, that are effective and modern, and perceived as such.

It is also clear that this area of law is of great economic importance at a practical level. If security can be provided, the cost of borrowing is reduced. We have already noted that in modern conditions many trading companies find that the asset over which security can most easily be granted is the debtors' ledger. Other forms of security can also be important, however. We understand that stocks of whisky in bond could provide effective security for borrowings, but this is extremely difficult under the existing law. Likewise, farms find it difficult to grant security over their moveable assets under the existing law. We consider that there would be widespread benefits if the law in this area were reformed along the lines proposed by the Commission.

7. Do you have any other comments?

We would make two additional comments.

First, the system proposed by the Commission is voluntary. The old law can be used if that is thought desirable. We think it unlikely that this will happen frequently, except possibly in low-value transactions, but the possibility is there.

Secondly, we think that it may be a false premise to base reform of the law exclusively on perceived present demand. When a new legal facility is provided, perceptions of its advantages develop over time, and the use of the facility may grow accordingly. In this connection, we think that the best comparator is probably the legislation available in countries such as Canada, Australia and New Zealand. These are at a comparable stage of economic development to Scotland, and the structure of their economies is not fundamentally different, apart from perhaps the greater importance of mineral extraction in Canada and Australia. In all of these countries the PPSAs and the accompanying registers have been extensively used. That, we think, demonstrates the importance of the Commission's reforms very clearly.