

## ECONOMY, ENERGY AND FAIR WORK COMMITTEE

### MOVEABLE TRANSACTIONS

#### SUBMISSION FROM

#### THE LAW SOCIETY OF SCOTLAND

#### 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?

Members report that they have encountered situations where lenders would not let corporate groups incorporate Scottish companies because of difficulties taking securities over their shares but the same concerns did not apply to English and Channel Islands companies. On a similar basis, members report having advised companies to incorporate under English law using English Bank Accounts and writing contracts under English law because it is easier to raise finance using English assets than Scottish assets. Similarly, one member reported that a funder at a recent event said that they do not provide invoice finance to sole traders in Scotland but do in England Wales because of difficulty of taking security in Scotland.

We also note the importance of intellectual property within, for example, the games industry: these types of businesses do not have (or need) tangible assets and members report that under the current system it is cumbersome to grant security over it. The same is true of start-up companies at the mid stage of development.

These types of funding issues mean Scotland is currently less attractive as a place to set up these IP-rich businesses if they would be able to raise funds against their intellectual property more easily elsewhere. We note that for larger businesses, this may be less of an issue as security is less crucial from a credit risk perspective but in the SME space, this is a more acute problem.

Another sector where members report that the ability to take a fixed security over moveable property would be helpful is Scottish-made spirits held in bond warehouses. There has been a recent boom in whisky (and gin) start-ups recently. The need to have possession in order to grant a real right in security over corporeal moveable property causes difficulty in raising finance over these assets. In addition to the possessory requirements of the current law causing difficulties, we also consider that there is a difficulty with the unclear rule arising from case law<sup>1</sup> which provides that you need **actual** rather than constructive delivery to constitute a pledge. This is a particular problem for small producers where the spirit is held by a third-party custodian, as it means that such goods cannot be pledged without being physically delivered to the creditor. This rule would be effectively repealed by the Moveable Transactions Bill.

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<sup>1</sup> *Hamilton v Western Bank (1856) 19 D 152*

**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?**

All such work-arounds arise as a result of necessity and cannot be said to be sufficient at all. It is vital that the Scottish Law Commission's proposals are implemented.

***Security over moveable property***

We welcome the legislation relating to pledges and the creation of a statutory pledge.

At present, Scottish businesses are able to take advantage of floating charges over a changing class of assets (which may be all assets). Floating charges are not ideal for creditors as they provide, generally, fewer rights to the creditor and do not protect against disposal of assets by the chargor.

One of the main advantages of the proposed bill is that it would create a system whereby fixed security could be taken over intangible assets, such as intellectual property and shares as well as physical equipment and stock, for all of which only floating charges are currently practicable or, in some cases, outright transfers of ownership to the creditor (sometimes with complex arrangements for use of the assets by the borrower).

We agree that a statutory pledge effectively registered before the attachment of a floating charge should normally rank above that floating charge for the purposes of insolvency. We also support the creation of the statutory pledge as conferring a real right in security which should be included as a fixed security right for the purposes of insolvency law.

Furthermore, we welcome the introduction of a Register of Statutory Pledges.

***Assignment of claims***

We welcome the modernisation of Scots law relating to the assignment of claims, where the usual workaround is for a trust to be used to support an outright sale of the claims because of the practical difficulties in assigning them.

The alteration to the requirement of intimation to allow assignment to be given legal effect through registration provides a more practical mode of assignment which we consider is better suited to modern commerce. In addition to facilitating assignment, the electronic nature of the register should also allow records to be searched more easily. The issue of transparency is key and we would encourage the Scottish Government to take steps to publicise the changes which the new Register of Assignations would bring about.

Assignment of receivables is a commonly used funding tool for businesses, with property rights in the receivables being controlled by contract between assignor and assignee (with detailed arrangements covering the scenario where A is paid instead of B). The new regime would facilitate this and existing consumer protection legislation would continue to apply to protect consumers who are borrowing.

At present the debtor is protected when paying to the assignor until notified and is then protected by the notification and this sensible rule would appear to continue. Registration in

and of itself would be most useful between assignees and on assignor insolvency but in practice we expect that notification would be likely to take place in addition to registration if there were concerns about the management of debtor payments. Often this would not be the case as the assignor would commonly continue to manage collections from debtors on behalf of registered assignees anyway.

We also note that issues could arise with double assignation of claims. However, this would require fraud on the part of the double assignor; it is a known risk of the existing system. The risk of multiple assignation fraud could in fact be reduced in comparison to the current position by the practicalities of registration if this succeeds in facilitating searches which would identify prior registrations of rights.

The current system is therefore insufficient for the needs of business and we strongly support the need for reform

**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?**

We believe there would be sufficient demand to justify this. Empirically, studies have shown that the easier it is to take security, the more debt finance will be available within a jurisdiction. Accordingly, not only would existing debt finance arrangements use the registers, it is likely to attract further investment into Scotland. Lenders will be very keen to use the new registers.

At the moment, in order to create non-floating security over corporeal moveable property, the property has to be delivered to the creditor. As noted above, this causes issues in that security cannot be used for machinery (work-arounds are used which are sub-par). The reforms will enable this, which will revolutionise machinery finance.

In addition, the ability to take security over IP lends itself to use by start-ups, including fintech companies and other innovative businesses. Allowing this type of security could therefore bolster the attractiveness of establishing these types of businesses in Scotland as it would be possible to raise finance against the IP which is likely to be their main asset in the initial stages.

We anticipate that industry bodies may be able to provide data on this. However, anecdotal experience suggests that we could anticipate a high volume of uptake.

**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?**

We consider that existing protections are sufficient as consumer legislation such as the Consumer Credit Act 1974, the Consumer Rights Act 2015 and various financial services

based regulations, each of which applies across all sectors would also be applicable in the context of creating the kind of security envisaged.

The ban on assigning salaries and restriction on granting a statutory pledge over goods worth less than £1000 seem to offer sensible consumer protections, in addition to the continued application of consumer protection legislation mentioned above.

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

We note that there are points of detail which will need to be included in the statutory instruments in respect of the registers, and we would appreciate being involved in those discussions.

As referred to above, we welcome the introduction of a Register of Statutory Pledges. However, some practitioners have also voiced concerns that statutory pledges granted by entities registered with Companies House would need to be registered in the Companies House register – both in the interests of transparency and to ensure that the Companies House register contained all relevant information – and further as to the eligibility of this new type of “pledge” for registration with Companies House.

Furthermore, we note that it is preferable to have a fixed security over all property for certainty of ranking.

As a point of detail, we note that the proposed Scottish legislation will interact with the UK legislation on registered intellectual property rights, especially the Patents Act 1977 and the Trade Marks Act 1994<sup>2</sup>. However, we note there may be a transparency issue if a Scottish statutory pledge of a registered intellectual property right were to be registered in the Register of Statutory Pledges but did not appear in the UK Register of Patents or, as the case might be, Trade Marks. The ideal situation would be one in which registers are able to “talk to” each other but this may need to be a longer-term objective and should not delay the implementation of this much-needed legal reform.

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

We strongly agree with the Scottish Law Commission’s view. Change to the law to enable modern and flexible financing and assignation of moveable property along the lines envisaged is long overdue. The proposed changes would provide opportunities to all types and sizes of business but in particular we note the potential importance to nascent and smaller businesses, which may have fewer traditional assets but could usefully leverage valuable intellectual property to finance development and growth.

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<sup>2</sup> Section 25

## 7. Do you have any other comments?

We are aware that there is strong support for these changes across the profession and would encourage the Scottish Government to bring forward legislation in this area in line with the Commission's recommendations. The time dedicated by many legal professionals to the Commission's reform project further evidences the importance of the reforms to ensure that the Scottish legal system is fit for purpose and reflects modern commercial realities, in particular in relation to the increasingly electronic nature of communications and commercial transactions.

We consider that the Bill as a whole presents a modern, balanced and practical set of reforms that should provide benefits to Scottish businesses - including, and perhaps especially, SMEs - while protecting consumers. We also welcome the making of specific provision for entities actually or potentially subject to insolvency proceedings.

In a wider context we consider it would be helpful to be able to create a fixed security over both heritable and moveable property, including incorporeal property, in a single document. This would simplify the lender financing system and benefit all stakeholders.

### ***Agricultural charges***

Practitioners report that agricultural charges under the Agricultural Credits (Scotland) Act 1929 are not frequently used in practice. Accordingly, we have no objections to the repeal of this legislation as proposed.