

Response ID ANON-NFZN-BRQ9-T

Submitted to Moveable Transactions Bill - Consultation
Submitted on 2022-09-05 17:26:49

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What is your name?

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Are you responding as an individual or on behalf of an organisation?

Individual

Questions (page 1 of 2)

1 Do you agree that the law covered by the Moveable Transactions Bill (raising finance on moveable property like cars, machinery or intellectual property) should be reformed?

Please provide your response in the box provided.:

Yes – we wholly agree with this and think that the reforms should be enacted without delay. Scots law in this area is outdated and reform is long overdue and clearly desirable. 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. Overall, the changes will make it easier to raise finance in Scotland, on more favourable terms, 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; H Patrick, "Moveable Transactions (Scotland) Bill: Some Funding Opportunities (2022) 6 *Journal of International Banking & Financial Law* 389.

Under the current law, parties in transactions often have to use "work-arounds" to achieve commercial purposes. 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, and such expense is often ultimately borne by borrowers. 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 moveable property. 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. However, this is not true for individuals (including sole traders) or partnerships. For these parties, non-possessory security is not generally available. It should be possible in Scots law for a sole trader or partnership seeking finance to grant a non-possessory security over corporeal moveables without having to incorporate. While it is not proposed that floating charges are available to these businesses, the new proposed form of security, the statutory pledge, is non-possessory and will assist with the raising of finance. Similarly, Scots law does not seem to allow for floating charges to be created over trust property (see ADJ MacPherson, "Floating

Charges and Trust Property in Scots Law: A Tale of Two Patrimonies? (2018) 22 Edinburgh Law Review 1). Trusts serve a wide range of purposes and should have a greater variety of financing options available. A new non-possessory security will be useful for the raising of finance by trusts, which will have a positive impact on their ability to undertake valuable activities.

More broadly, due to the (partial) reintroduction of HMRC's status as a preferential creditor in insolvency and the expansion of the maximum limit of the prescribed part for unsecured creditors, Scottish lenders are 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 changes just mentioned. As such, financing in Scotland has been negatively impacted upon, which also affects borrowers in terms of availability of finance and costs of borrowing, but the Bill will help to circumvent some of the difficulties arising.

The law would certainly benefit from being reformed. However, the Scots law "publicity principle" should be 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 by, and certainty for, relevant parties and may be considered 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 proposals for a Register of Statutory Pledges (RSP) and a Register of Assignations (RoA) are certainly suitable in this regard. A further point here 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.

2 Have difficulties raising finance on moveable property in Scotland affected you or your business? If so, what impact has this had for you?

Please provide your response in the box provided.:

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 moveables 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 work-around solutions available (see above) 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 assignations 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 letters to newspapers (see e.g. the Scotsman, 13 November 2018, p. 30); and in articles (see above). 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.

The current economic and financial climate also means that many businesses and individuals are struggling and will need to find ways to raise finance. In response to increased risks of default, lenders may be more reluctant to extend credit or will only do so on less favourable terms. As such, the reforms contained in the Bill are even more important in the current climate as they will support the availability of finance and will decrease costs of transactions, which will reduce borrowing costs.

3 Do you have any concerns about the proposed dual system for assignation of claims (for example, to repayment of a debt). This means it will be possible to assign claims either by intimation to the debtor (as at present) or by registration in the new Register of Assignations? This will provide flexibility, but will mean that the new Register will not be comprehensive.

Please provide your response in the box provided.:

We are generally comfortable with the approach adopted, and the prioritisation of flexibility over comprehensiveness. Assignations are used for a wide range of different transactions and assignation with intimation will remain suitable in various situations. We agree with the reasoning of the Scottish Law Commission on this point.

However, there may be more compelling reasons why a registration-only system is preferable for bulk transfers intended for financing purposes, such as securitisations, factoring and invoice discounting (for more detailed analysis, see CJ Emedosi, *The Transfer of Security Rights in Securitizations in Scotland, England and France: A Law and Economics Analysis* (University of Aberdeen, PhD Thesis) (2021), pp 185-187). Since a dual system would make the register inconclusive, a consultation with the debtor would be required to achieve comprehensive title verification. We consider that such a need for debtor consultation would increase the cost of title verification for transactions involving multiple debtors, prohibitively so in some cases. Therefore, it may be preferable to adopt a system where a registration-only approach is applied to bulk assignations intended for financing purposes, and the dual approach is applied to other assignations. We appreciate that a potential challenge facing such a system is how to form an appropriate definition of what transactions need to be registered and which do not. Helpful guidance in this regard may be found in existing policy documents that have addressed a similar definitional issue – see e.g. the Secured Transactions Law Reform Project's "Discussion Paper Series: Sale of Receivables" at pp 13-17 for relevant discussion in relation to England and Wales – <https://stlrp.files.wordpress.com/2017/01/beale-sale-of-receivables.pdf>.

In any event, it is important that parties using the Register of Assignations should understand that it is not comprehensive, and that further enquiries and

due diligence may be required. Albeit that if the change above in relation to bulk transfers is made, it will be comprehensive as regards assignments of that type. More broadly, an educational campaign regarding the reforms and their implications, particularly in relation to the roles of the registers, is desirable.

4 Do you have any concerns about the interaction between the new security over moveable property – which will be created by registration in the Register of Statutory Pledges – and traditional pledge, which involves delivering moveable property to the creditor? Are there any circumstances in which businesses or individuals might wish to continue to use existing methods of raising finance over moveable property?

Please provide your response in the box provided.:

If there is a possessory pledge and a statutory pledge over the same property, the rules on ranking (outlined in the Bill) will apply to resolve the issue. We do not consider this to be a problem.

We think that in the majority of cases parties who have the ability to use a statutory pledge will opt for this over a possessory pledge, as the former will usually be more advantageous to both the debtor and creditor. However, if the pledgor does not require to retain/use the property and the creditor is keen to have possession (to e.g. more closely monitor the item), possessory pledge will be more suitable.

Overall, the statutory pledge will give a further option to transaction parties and will fulfil a desire for a pledgor to retain property that they may wish to use.

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5 The Bill contains detailed provisions on how the registers will be set up and searched. Do you have any suggestions for improving the approach set out in the Bill?

Please provide your response in the box provided.:

We do not have any particular suggestions regarding this matter.

However, we note that there is likely to be 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 real 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 will 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.

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. Considering the number of "charges" registered by Scottish companies at Companies House in recent years may be of some assistance in ascertaining the levels of usage that could materialise for the new registers – for some details regarding figures for registered charges, including floating charges, see J Hardman and ADJ MacPherson, "The Empirical Importance of the Floating Charge in Scotland" in J Hardman and ADJ MacPherson (eds), *Floating Charges in Scots Law: New Perspectives and Current Issues* (Edinburgh University Press, 2022). In addition, the cost of setting up the registers will not be considerable and over time they will likely 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, the RSP is going to be used by acceptable numbers of parties. 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.

6 The proposals in the Bill would apply to consumers as well as businesses. Do you think there are enough protections in place for consumers?

Please provide your response in the box provided.:

The provisions on consumers, like other provisions in the Bill, have been through a number of consultations already and have been widely supported, subject to appropriate protections being included. The Bill already contains substantial protective measures that were carefully considered by the Scottish Law Commission and have been consulted on; however, we shall provide some further suggestions for protection of consumers below. We strongly support the inclusion of consumers within the Bill and consider it would be misguided to exclude them entirely. Consumers are not a homogenous group and some consumers will benefit from the reforms proposed by the Bill (as identified by the Scottish Law Commission and recognised by others). The important question is how more vulnerable consumers can best be protected.

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. It is clearer and more consistent for the law to be reformed for all parties at the same time. We consider that consumers should be able to use the statutory pledge, albeit with protections in place. Like other parties, consumers should benefit from the greater availability of finance and lower borrowing costs that secured lending provides, in comparison to unsecured lending. Consumer law and financial rules

(e.g. through the FCA) are used to regulate lending to consumers and parties already have the ability to lend on an unsecured basis to consumers in Scots law, where the interest rates are significantly higher than secured lending. Thus, the law already allows for a form of lending that costs more for a borrower and is more likely to lead to financial distress and/or insolvency. The law also allows for possessory pledge, which can be an inconvenient form of security for both the lender and the borrower. Furthermore, the law allows for functional non-possessory security arrangements such as hire-purchase and sale and leaseback transactions. These involve the lender retaining or acquiring ownership, and using its corresponding powers for security purposes. They are often a work-around solution and a statutory pledge will often better represent what the lender and borrower actually want to achieve. With a statutory pledge, the consumer will own the property, with the lender having merely a secondary property right of security.

We think it is odd that the law facilitates consumer transactions in the form of unsecured lending, possessory security over moveables, non-possessory security over land (including buildings) and certain non-possessory functional security equivalents over moveables (in some situations) but does not allow consumers to grant proper non-possessory security over moveables. This restriction on non-possessory security had more justification historically when a publicity mechanism such as registration was not feasible for corporeal moveables; however, a registration system is now deliverable and would be adequately provided for by the Bill.

The proposed legislation is facilitative and would give new rights to consumers to create a new type of security right in Scots law. If consumers were to be prohibited from creating a statutory pledge, it may validly be wondered what the logic would be in saying to a consumer who has an expensive item (e.g. a painting, jewellery, an antique or a musical instrument) that they wish to use as collateral to raise needed finance, that they cannot do so unless they are willing to give possession of the item to a lender. If the borrower wished to use the item and/or the lender did not wish to take possession, secured lending would not be possible and unsecured lending, with its higher interest rates, might need to be relied upon. There is no obvious reason why more expensive or inconvenient forms of raising finance should be made available but consumers are not given the ability to use a more convenient solution such as a statutory pledge. Many other countries around the world have no difficulty in allowing consumers to grant non-possessory securities, so long as there are appropriate protections in place.

There are already various useful protections for consumers in the Bill, such as: the inability of a party to assign wages or salary claims (s 7); protection for debtors who perform in good faith (s 10); the requirement for property to be over £1,000 in order for it to be encumbered by a statutory pledge (s 48(3)); acquisitions in good faith (ss 51-53); and the necessity of a creditor obtaining a court order before enforcing a pledge against a consumer (s 64), which requires consideration of a number of factors. These provisions (and others) seek to give protection to consumers without being too paternalistic and offer some freedom to consumers to decide the most appropriate course for themselves. However, it should be acknowledged that since the SLC proposed the £1,000 figure as a straightforward mechanism to exclude many household items, five years have passed and there have been inflationary pressures, particularly in recent times. As such, the figure could usefully be adjusted to make sure that the types of items that the SLC sought to exclude are, in fact, excluded. A simple way to do this would be to raise the limit to £3,000, which would also have the advantage of equalising the amount with the figure for vehicles that are excluded from bankruptcy and the diligence (debt enforcement mechanism) of attachment (Bankruptcy (Scotland) Amendment Regulations 2010 (SSI 2010/367, reg 4). Alternatively, there could be different threshold figures for different types of property, e.g. a general £1,000 figure and a £3,000 figure for vehicles. Of course, a higher figure of e.g. £5,000 could be selected, but it would need to be properly justified. It would be possible instead to have an index-linked threshold; however, this would be more complicated than the alternative approaches.

If a basic threshold figure is chosen, it is important that it is reviewed periodically. Where a review of the equivalent figures for bankruptcy and diligence takes place, a review of the statutory pledge figure should also be undertaken. To avoid the possibility that the threshold figure for the statutory pledge is not reviewed or amended for a considerable period of time, a provision could be added to the Bill requiring that it be reviewed periodically, e.g. every year or every two years. It should be noted too that ministers will have the ability in future to amend the limit (s 48(5)(a)). The Bill also provides (at s 48(5)(b)) that ministers can exclude certain types of property, so if, for policy reasons, it is considered suitable for particular items of property should not be subject to a statutory pledge (e.g. sofas or beds), they can be excluded.

An alternative approach to using a threshold figure for consumer property would be to tie the excluded items directly to those that are excluded from the diligence of attachment and bankruptcy (under the Debt Arrangement and Attachment (Scotland) Act 2002, s 11 and Part 3 and the Bankruptcy (Scotland) Act 2016, s 88(1)). However, it should be noted that the SLC rejected this approach for sound reasons. Using a threshold figure can also provide more protection as some types of excluded items from attachment and bankruptcy depend upon showing that a debtor reasonably requires the relevant items (for discussion, see D McKenzie Skene, *Bankruptcy* (2018), paras 11-55-11-62) which is not true for a simple monetary figure. Of course, it would also be possible to combine the excluded items in attachment and bankruptcy and a monetary limit for extra protection in relation to items that can be subject to a statutory pledge; however, we do not think this is necessary and would be more complicated than other approaches.

We consider suggestions that provisions of the Bill would reintroduce warrant sales (in a comparable form to those abolished by the Debt Arrangement and Attachment (Scotland) Act 2002, s 58) are misconceived and misleading. A creditor under a statutory pledge will only have the ability to enforce in relation to property the debtor has agreed to grant the security over. This contrasts with enforcement by an unsecured creditor or in the context of bankruptcy, which are much wider in their scope. The proposed statutory pledge is not equivalent to a diligence that can cover any (non-excluded) property in a general fashion and which allows for an array of household goods to be auctioned off even though the debtor has not agreed for that property to be subject to a security. It should be noted that Scots law currently allows for enforcement against consumers in a wide range of scenarios, including standard securities for land, possessory pledges, diligence, and bankruptcy, as well as under functional securities such as hire purchase. With many arrangements, such as possessory pledges and hire purchase, there are not the same limitations on the types of property that can be covered as will exist for statutory pledges.

It would also be irrational to prohibit consumers from granting statutory pledges generally as unsecured creditors already have the ability to enforce against property that the statutory pledges would cover (based upon the Bill's provisions). This is particularly true given that statutory pledges will likely generate lower interest rates in comparison to equivalent unsecured lending, which means there is less likelihood of default and insolvency. In addition, 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.

7 Do you have any other comments on the Bill or this area of policy?

Please provide your response in the box provided.:

We note that, unlike the Scottish Law Commission's Draft Bill, the Bill in its current form will not allow for a statutory pledge to be created over financial instruments, including shares. However, we understand that the intention is for a statutory instrument to extend the coverage of the security to such property, using s 44(3) of the Bill, in combination with statutory instruments at UK level (including under s 104 of the Scotland Act 1998). We strongly support allowing the statutory pledge to cover financial instruments and urge that the relevant statutory instruments are enacted and brought into force as soon as possible. Assuming that 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.

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 Bill's provisions 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.

We have some minor technical points of drafting regarding the Bill but can provide these separately.

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