



FACULTY OF ADVOCATES

CONSULTATION RESPONSE BY THE FACULTY OF ADVOCATES

TO

THE SCOTTISH PARLIAMENT'S DELEGATED POWERS AND LAW REFORM COMMITTEE

ON THE SCOTTISH GOVERNMENT'S MOVEABLE TRANSACTIONS (SCOTLAND) BILL

Question 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?

- Yes. The Faculty of Advocates very much welcomes this Bill. The Bill seeks to modernise the law of Scotland in relation to moveable transactions to implement the recommendations of the Scottish Law Commission. This is an area of law much in need of modernisation. The Commission's work is detailed and thorough, and the Faculty considers that modernisation of the law would be of considerable benefit to Scotland.
- The Faculty of Advocates responded to the Scottish Law Commission's consultation, and the Commission referred to the Faculty's response at various paragraphs of its Report. The Faculty also responded to a request for comments on the draft Bill. Indeed, in its response, the Faculty said:

The Faculty of Advocates welcomes the Law Commission's consultation paper as a significant and positive contribution to the development of the law in an important field. We are conscious of the scholarship that informs the paper and agree with many of the proposals that it makes.



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This remains the Faculty's position in respect of the Commission's Report and the work that has led to the publication of the Bill.

- The Faculty notes that there are some differences between the draft bill proposed by the Scottish Law Commission and this Bill (for example, exclusion of application to financial collateral arrangements). The Faculty is not aware of the reasons for the Scottish Government's decision to depart from some of the Commission's recommendations.

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

- The Faculty of Advocates has no comment on this. In its response to the Scottish Law Commission, the Faculty suggested that empirical evidence from the business community would be useful to determine whether there is a commercial need for reform.

Question 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.

- No.
- The Faculty of Advocates supports the creation of Register of Assignations (that has been its position since its response to the Commission's Discussion Paper). The Faculty expressed some concern, however, that the scope of the Commission's project did not



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include consideration of insolvency law, and the Faculty did not specifically answer this particular question when it was posed by the Commission. Rather, in response to this question (and others), the Faculty said (editing out parts that are no longer relevant in light of the Commission dropping its proposals to create a new ‘floating lien’):

The Faculty is concerned that the report has not addressed the law of insolvency. Many of the practical questions raised in the report are more directly related to the policy choices appropriate to the law of insolvency. For example, questions concerning the role and effect of the proposed new register (such as whether registration should complete title and the effect of registration on third parties acting in good faith) ultimately depend on policy decisions related to insolvency. Insolvency is, after all, the context in which the effects of the register and the new security are most likely to be tested.

The absence of discussion of the preferred order of ranking is a substantial practical limitation of the paper...

The great majority of any new securities are likely to be granted in favour of banks and other financial institutions. If the policy is to give those institutions the benefit of a ‘strong’ security, exceptions to its effect should be narrow. Such a policy would suggest primacy should be given to the contents of any register as the determinant of the security’s effect. It would also suggest that an error in the registered details should not be fatal to validity if it would not mislead a reasonable person.

The obvious downside, however, is that consultation of the register would become a pre-requisite for any prudent person entering into a transaction. The effect could be significantly to inhibit the free movement of assets (whether commercial assets or



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otherwise). That is recognised by the paper in the number of exceptions it suggests to the effect of an entry in the register. There is a risk that the exceptions to the force of the register which would be necessary to maintain free movement of assets will call into question the value of the register and any new security dependent upon it. For example, publicly-traded shares might be considered an important potential source of collateral, but the register may well have no effect in relation to them. The balancing of these issues is a matter of policy.

We are sympathetic to the view that the law should have a coherent intellectual structure. However, a coherent structure assumes a clear policy line and this paper offers the conflicting choice of: (a) the integrity of the register providing a ‘strong’ or ‘dependable’ security in the event of insolvency and (b) free movement of goods and the protection of third parties acting in good faith. It is not for the Faculty to make that choice but the apparent lack of empirical evidence to suggest that businesses face difficulties in obtaining loan finance is noted (paragraphs 12.12 and 12.13), and therefore there is reason to question whether the reforms proposed to the law of security are commercially necessary. We also note the desire to make this reform project manageable. However, if the reforms are considered necessary, then we are of the view that any insolvency law issues that may arise should be addressed at the same time. That may make the project slightly more complex, but at the same time, that would be the way to ensure that any reform in this area of the law brings certainty within a coherent intellectual structure.

- The Scottish Law Commission considered these observations and concerns (which were shared by other consultees), and responded in Chapter 18 of its Report. The Commission, in particular, set out the considerable practical difficulties that would be raised by expanding the project to consider questions of insolvency law too. In short, the



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Commission's fear was that by seeking to expand the project, the likely consequence would be to prevent needed reform of the areas of law focused in the report.

- The Faculty remains concerned, however, about an approach which involves the reform of part of the law without fully considering its impact in other areas of the law, as it is always difficult to predict what issues might arise in future cases, and the consequent risk of unintended consequences. As the Faculty highlighted, the matter of the 'integrity of the Register' is an important policy one. That said, the Faculty recognises and understands the Commission's reasons.
- On balance, on the basis that the project does not consider the wider insolvency implications, the Faculty supports maintaining the common law provision for completion of an assignation by intimation as an alternative to registration. The Faculty notes the Commission's explanation for its view at paragraphs 5.7 - 5.22 of its Report.

Question 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?

- With respect to the first part of the question, the Faculty of Advocates has not identified any concerns about the interaction between the two. Moreover, the Faculty welcomes the proposed changes in section 45 (delivery) of the Bill and the sections concerning enforcement which would apply to both the traditional pledge and the new security right. The Faculty was not in favour of a codification of the law of the pledge, and remains of the view that the common law is sufficient other than insofar as the Bill will alter it. The



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Faculty agrees with the Commission's assessment at paragraphs 25.22 – 25.24 of its Report.

- The second part of the question is better answered by those who have experience of raising finance over moveable property.

Question 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?

- The Faculty of Advocates does not have any particular comments on, or objections to, what is proposed. As noted above, the status of the Register and how that sits with insolvency law is a matter of concern but, as noted at paragraph 8, the Faculty understands and recognises the Commission's reasons for its proposals.
- In relation to section 93, the Faculty expressed some concern about this, in particular that an arbitrary time limit may leave short-term securities on the register for longer than is needed, and be an inconvenient administrative burden for securities intended to last longer, leading to the unintentional loss of securities due to oversight. It suggested instead that the registration document be required to specify the duration of the security required by the parties.

Question 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?

- In its response to the Scottish Law Commission's consultation, the Faculty said:



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The discussion paper poses a number of questions which raise the issue of treatment, or protection, of consumers. The choice is between: (a) protecting banks and other lenders in the event of insolvency and (b) protecting consumers. The treatment of consumers is primarily a matter of social and legislative policy on which the Faculty as a body has no views, beyond noting that any encroachment on consumer protection in favour of promoting the interests of financial institutions would need persuasive justification, which is undermined by the lack of empirical evidence supporting a need for change in order to stimulate the economy (paragraphs 12.12 and 12.13).

This remains the Faculty's position.

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

- The Faculty offers the following additional comments:
 - a. Section 2 – the Faculty is concerned about the practical effect of a rule which enables transfer on the happening of an uncertain event, which may be unknown to the debtor (such as delivery of a schedule listing invoices). This is not conducive to certainty in business.
 - b. Section 10 – plainly this protection is necessary, but the Faculty wonders if it would be useful to define what is meant by “person last known to the debtor”.
 - c. Section 13 – the Faculty was not in favour of permitting waiver-of-defence clauses. The Faculty's concern is that if they are to be permitted, they would doubtless become pro forma terms in all institutional lending transactions resulting in the diminution of the rights of third parties. The Faculty notes that consumers will be



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protected, but this protection would not apply to protect small businesses. Ultimately however this is a question of policy: protection of small businesses as against the marketability of claims.

- The Faculty is happy to assist the Committee in any way which would be useful.