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David McIntosh QC (Hon)
Chairman

20 June 2012

Mr. Paul Allen
Law Reform Division
Scottish Government
Area 2W
St. Andrew's House
Regent Road
Edinburgh
EH7 4HJ

Dear Mr. Allen,

Floating charges: Part 2 of the Bankruptcy and Diligence etc. (Scotland) Act 2007

I write to attach a hard copy of the response of the Financial Law Committee of The City of London Law Society (CLLS) to your letter of 14th March. A PDF copy of this letter and the response is also being emailed to you.

We welcome the opportunity to comment on the options set out in the Report of August 2011 of the Technical Working Party on registration of floating charges. We support the comments made in the Report about the commercial importance of floating charges in financing businesses in Scotland and elsewhere.

As recognised in the Report, it is common practice for English law debentures and other security documents which include a floating charge to be drafted in terms capable of covering all assets, present and future, moveable or immoveable, irrespective of their location. This requires only a single UK registration under current law. This permits the free movement of assets between England, Scotland or Northern Ireland. The position would change to the overall detriment of UK businesses if Part 2 was implemented.

If Option 1 was adopted, the creation of a separate register of floating charges under Part 2 would almost certainly lead to the practice of "double registration" as indicated in the Report. We estimate that the resulting additional costs to English companies could exceed £7 million per annum, as explained in paragraph 25 of the attached response. It would also give rise to a new Slavenburg-type problem for charging companies incorporated outside the UK, as explained in paragraph 26. We estimate that the resulting additional cost of this could exceed £2.5 million per annum. If Option 2 was

adopted instead, it would avoid the need for double registration by English companies but leave a problem for overseas companies. In addition to these costs, Part 2 would give rise to the legal complications and uncertainties referred to in the response. In our view, these factors far outweigh any potential benefits of implementing Part 2.

We strongly consider that floating charges should continue to be registerable under a unified UK registration regime of the kind contemplated in the new version of Part 25 of the Companies Act 2006 proposed by the Department for Business, Innovation & Skills. This would obviate the need for a separate Scottish registrar of floating charges under Part 2.

If it were decided to implement or amend Part 2, further consultation with interested parties would be essential. Members of our Committee would be glad to participate in a conference call or attend a meeting with you and your colleagues to discuss the issues identified in the response.

If you wish to arrange a conference call or meeting to discuss any aspect, please contact Geoffrey Yeowart (Tel no. +44 20 7296 5368 or geoffrey.yeowart@hoganlovells.com).

Yours sincerely

pp. Alasdair Douglas
Chairman
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Encl.

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Consultation by the Scottish Government on the options for implementation of Part 2 of the Bankruptcy and Diligence etc. (Scotland) Act 2007

Information about the respondent

1. The City of London Law Society (CLLS) represents approximately 15,000 City lawyers, through individual and corporate membership including some of the largest international law firms in the world. These law firms advise a variety of clients from multinational companies and financial institutions to Government departments, often in relation to complex, multi-jurisdictional legal issues.

2. The CLLS responds to consultations on issues of importance to its members through its 17 specialist Committees. A working party of the CLLS Financial Law Committee, made up of solicitors who are experts in their field, has prepared the comments below from the English Law perspective on the options (the "Options") set out by the Scottish Government in its letter of 14th March 2012. Details about the membership of the Committee are set out on page 15 below. Two members of the Committee assisted in the preparation of the Report of August 2011 of the Technical Working Party on the registration of floating charges (the "Report"). The Report sets out the legal and practical issues fairly fully and we do not attempt in this response to carry out a fresh legal analysis.

Wider UK implications

3. We welcome the opportunity to comment on the Options. We support the comments made in the Report about the commercial importance of floating charges in financing businesses in Scotland and elsewhere[1].

4. In its report of June 2004[2] which led to the enactment of Part 2 of the Bankruptcy and Diligence etc. (Scotland) Act 2007 (the "B&D Act"), the Scottish Law Commission (the "SLC") focused on domestic legal issues without addressing fully the wider UK, EU and international implications or whether these matters might themselves impact on the Scottish economy in any way. In our view, the implementation of Part 2 of the B&D Act would have serious legal and practical consequences outside Scotland.

5. Innumerable businesses established in the UK trade throughout the breadth of the UK and do not currently seek to control the movement of their assets across the different jurisdictions within the UK. If they create a floating charge, it will apply to all assets in the UK which it is intended to cover and under current law requires only a single UK

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1 The Report, pages 4 and 5.

2 Report on Registration of Rights in Security by Companies (Scots Law Com No 197).

registration.[3] As recognised in the Report, it is common practice for English law debentures and other security documents which include a floating charge to be drafted in terms capable of covering all assets, present and future, moveable or immoveable, irrespective of their location.[4] This permits the free movement of assets between England, Scotland or Northern Ireland. The position will change to the overall detriment of businesses if Part 2 is implemented.

6. If Part 2 is implemented, it is likely to have a greater impact outside Scotland than in Scotland itself (see paragraphs 25 to 28 below). The creation of a separate register of floating charges ("RofFC") under Part 2 would lead to extra filings and extra cost, particularly in cases where:

   (a) a non-Scottish chargor has existing Scottish assets or, even if it does not, the possibility of it acquiring Scottish assets in the future cannot be ruled out, including in cases where the assets are intangible in nature and there is legal uncertainty as to where they should be treated as situated; and

   (b) failure to register the floating charge would result in it being ineffective against Scottish assets.

7. We strongly consider that floating charges should continue to be registerable under a unified UK registration regime of the kind contemplated in the new version of Part 25 of the Companies Act 2006 ("CA 2006") proposed by the Department for Business, Innovation & Skills ("BIS"). This would obviate the need for a separate register of floating charges over Scottish assets under Part 2 of the B&D Act. The reasons for our view are explained below.

8. Although England and Wales is likely to be the jurisdiction most affected, implementation of Part 2 would also affect floating charges created under the laws of other jurisdictions, including (within the UK) Northern Ireland, (within the European Union ("EU")) the Republic of Ireland, Gibraltar,[5] Malta and Cyprus and (outside the EU) many Commonwealth countries with legal systems based on English law, as well as the Isle of Man and the Channel Islands.

Current registration regime

9. The current law relating to Scottish floating charges is contained in Part XVIII of the Companies Act 1985 ("Part XVIII") and, with respect to registration, Chapter 2 of Part 25 of the CA 2006 ("Part 25"). Section 878 of Part 25 requires that, where a company registered in Scotland creates a floating charge, it must file particulars of that charge with the Registrar of Companies, Edinburgh, within 21 days after the date of the creation of the charge. Registration is not required to create the charge but only to perfect it. The sanction for failure to file particulars within the 21 day period is that the floating charge becomes void against any liquidator, administrator and creditors of the company.[6]

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3 A single charging document can be taken and registered at Companies House, Cardiff, where the chargor is an English company, or at Companies House, Edinburgh, where the chargor is a Scottish company or at Companies House, Belfast, where the chargor is a Northern Irish company.

4 A floating charge is capable of being used in relation to a range of asset types. It is commonly used in particular to obtain security over moveable physical assets, bank accounts, shares, bonds and other securities, book debts and other intangible assets. Floating charges are important in enabling banks to provide working capital finance to businesses of all types, especially privately owned business. They are also used as a back up in factoring arrangements and are an essential component in securitisation asset based financings for businesses of all sizes and types. In the UK financial markets, floating charges over cash and securities are also particularly important in providing financial collateral for the smooth operation of those markets.

5 Gibraltar is in the EU as a UK dependency.

6 See 890 CA 2006. The amount secured by the floating charge also becomes immediately due and the company and its directors are liable to a fine for every day of default.

Section 892 requires the company to keep a copy of the instrument creating the charge available for inspection by any person.

10. In its report of 2004, the SLC regarded it as an unsatisfactory feature of the then current law that the existence of a floating charge would not be publicly ascertainable by a search at Companies House for a period of up to 21 days after a charge had been created (the "invisibility period"). This was considered to be inconsistent with the general principle in Scots law that the creation and transfer of a real right, including a right in security, should be attended with publicity. The SLC recommended that registration in a register of floating charges should be essential in order to constitute a valid floating charge. Floating charges should rank inter se and with other forms of security by date of registration and not date of execution. The SLC also recommended that it should be possible to register an advance notice of the floating charge which, if registered within 21 days, would be deemed to have been registered on the date of registration of the advance notice. Part 2 is intended to implement these proposals and to repeal Part XVIII.

11. Part 2 would involve a major departure from the current registration regime in three respects:

(a) First, under current law, the lack of visibility on the public register at Companies House does not affect the legal validity of the floating charge. It is only if particulars of the charge are not filed with the Registrar of Companies within 21 days of its creation, that the lack of registration has legal consequences for the chargee, and then only in the event of the chargor entering into administration or liquidation. Under Part 2 a floating charge would not be legally effective until it had been registered in the RofFC. Unless so registered, a floating charge would not be recognised in Scotland even though validly created under its governing law.

(b) Secondly, under current law, registration is required with the Registrar of Companies, Edinburgh, only if the floating charge is created by a Scottish company. It is immaterial where the charged property is situated. In contrast, Part 2 will apply to any company (whether incorporated in Scotland or in any other jurisdiction) which creates a floating charge over property situated in Scotland.

(c) Thirdly, the priority of a floating charge under Scots law commonly runs at present from the date of execution and delivery, since section 464 of Part XVIII gives statutory effect to ranking provisions and negative pledges.[7] Hence the date of registration is generally not crucial as the law relating to priority currently stands.

The whole essence of a floating charge is that it "hovers" over a shifting pool of assets, so that enforcement is generally against a different set of assets from those in existence at the date of the charge's creation. In contrast, a fixed charge effectively "freezes" the charged asset at the time it is created or takes effect. The priority to be given by Part 2 to floating charges in relation to Scottish assets would differ substantially from the priority of other floating charges over assets elsewhere, as these will generally follow the same concept as currently applies throughout the UK. It would frequently be impossible to know whether a floating

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[7] Section 464(1) provides that under Scots law an instrument creating a floating charge over all or any part of a company's property may contain (a) provisions prohibiting or restricting the creation of any fixed security or any other floating charge having priority over, or ranking pari passu with, the floating charge, or (b) with the consent of the holder of any subsisting floating charge or fixed security which would be adversely affected, provisions regulating the order in which the floating charge will rank with any other subsisting or future floating charges or fixed securities over that property. Where an instrument creating a floating charge contains any such provision, the general rule is that this provision will be effective to confer priority on the floating charge over any fixed security or floating charge created after the date of the instrument. Such ranking provisions or negative pledges are routinely included.

charge ought to be registered under Part 2 at the time when the charge is created, even if at the time the chargor has few or no assets in Scotland.

Proposal to move from company based registration to asset based registration

12. Part 2 would not only create anomalies for businesses trading throughout the UK, but would be out of step with the approach to registration taken in other jurisdictions. Property or business based systems are unsatisfactory and expensive in relation to universal charges. As one leading commentator has observed of this model:

> "The desire to protect local creditors means that it is necessary to check registration and filing in all jurisdictions where any of the company's property may be situated. This is absurd for aircraft and ships and is impracticable for universal charges created by corporations with many assets in many different countries – in each case one would have to check whether there is a sufficient local business. In addition the location of many assets is constantly changing. The principle is out-of-date in the modern era. Unsecured creditors dealing with a foreign company can easily search at the place of incorporation to see whether any charges are filed and the idea that they can only be expected to search in their own jurisdiction is no longer tenable." [8]

Floating charges are, of course, the archetypal universal charge.

13. In contrast, it is relatively easy to identify where the charging company has its registered office and/or under what system of law it is incorporated. Where other jurisdictions have adopted a property based approach, they have done so differently. For instance, we understand that registration in Germany is based on the place of location of the asset rather than place of incorporation of the chargor but registration applies only to certain asset classes such as land and intellectual property, the title to which is entered on a register. Other types of security, such as pledges over bank accounts, pledges over shares in a company, assignment of receivables, transfer of movables etc. cannot be registered, although notification to third party debtors might be required for perfection. Further, the US Uniform Commercial Code ("UCC") provides for the perfection of security in different ways. Many security interests are not "registered" in the way that a charge would be registered under English or Scots law.[9] We understand that, where it is necessary under the UCC for a US company to file particulars of a security interest, it is in general required to file them at the filing office of a specified US State and not in all US States. Where it is necessary under the UCC for a foreign company to file particulars of a security interest, the law governing the filing, and the place of filing, depends on whether the debtor's home jurisdiction has a filing system similar to that in the US. If it does, then the law of the debtor's home jurisdiction is deemed to govern perfection. If it does not, then the laws of the District of Columbia are deemed applicable.

14. Moveable assets need to be able to move freely around the globe without the validity of security over them being called into question. In the case of intangible assets such as debts and contractual rights, there is often doubt as to where they are to be regarded as located (older rules concentrated on the place of domicile or residence of the debtor, while more modern ones, including the rules on applicable law in the Rome 1

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8 Comparative Law of Security Interests and Title Finance by Philip R Wood, 2nd edition 2007, at para 39-052, Sweet & Maxwell.

9 Security interests over many types of asset are perfected under the UCC without filing, whether the debtor is domestic or foreign. These include: promissory notes, instruments, documents of title and certificated securities (perfected by possession); deposit accounts, securities accounts and commodities accounts (perfected by three-party controlled agreements); uncertificated securities (perfected by notations on the books of the issuer and certain control arrangements); letter of credit rights (perfected by certain agreements with the LC issuer). Registration does commonly apply to mortgages of real property and to aircraft, vessels, railroad cars and motor vehicles.

Regulation[10] (which is directly applicable in Scotland), appear to link most aspects of legal assessment to the governing law of the contract or other instrument under which the right arises). Systems in which the location of the asset is crucial are increasingly limited to land, while registers for ships and aircraft more and more depend upon the law of the register and its recognition in other jurisdictions.

15. As intellectual property rights become internationalised (eg the new European Patent will not give rise to rights governed by any national law but to a right under EU law), it will also be increasingly difficult to determine the national jurisdictional location of such rights. Even under current UK law, it may be difficult to know in which jurisdiction of the UK, such rights are located. To add to these problems, floating charges almost invariably include future assets which, by definition, cannot yet have a location. The effect therefore of using a "location of asset" registration test, is not simply to require UK parties to register all their floating charges in Scotland, in case they turn out to include Scottish located assets at the time of enforcement, but to require all users of floating charges anywhere in the world to do so, unless they are content specifically to exclude the application of the charge to Scottish assets (in which case they may possibly also want to restrict the chargor from trading with consumers and businesses in Scotland).

Option 1: Commencement of Part 2 of the B&D Act without amendment
Benefits

16. It is stated in the Report[11] that the intended benefits of Part 2 include:

(a) priority of ranking from the date of registration;

(b) the removal of the "invisibility period" of up to 21 days between creation and registration of the charge;

(c) the full text of the floating charge deed to be included on the register; and

(d) an option for an "advance notice" to guarantee the priority of a floating charge before registration of the charge document.

It appears to us on close analysis that several of these potential benefits offered by Part 2 are somewhat marginal.

17. **Ranking by registration:** If priority were based on ranking by reference to date of registration, this would have two complications:

(a) It would lead to the problem recognised in the Report that the priority of a floating charge created under English law would run from different dates in relation to different assets depending on their location – i.e. the date of creation of a charge over assets located outside Scotland would generally be the date on which the charging document is executed and delivered by the chargor and the date of creation of a charge over assets located in Scotland would be the date on which the charge was registered under Part 2.

(b) The great majority of lenders would almost certainly be unwilling to advance funds until the floating charge had been registered if it comprised Scottish assets of significant value. At present lenders are able to advance funds as soon as the charging document has been executed and delivered by the chargor. Admittedly, a chargee could, if Part 2 is implemented, file an advance notice in order to obtain

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10 Regulation (EC) No 593/2008 on the law applicable to contractual obligations.
11 The Report, page 2.

priority, but it is questionable whether lenders would welcome the extra administration and costs involved in having to do this in all cases. It might also delay, in certain cases, the advance of emergency or rescue funding to business in Scotland and elsewhere where it is necessary for floating charges to be created over Scottish assets as part of the financing arrangements.

18. **Removal of "invisibility period":** Although it is theoretically desirable to remove the 21 day "invisibility period", experience indicates that the "invisibility period" is not a serious practical problem. This is partly because of the brevity of the registration period and partly because the vast majority of debtors would not seek to mislead a potential creditor as to the charges already created. Normal practice is to present particulars of a charge at Companies House well within the 21 day period because of the severity of the consequences of filing out of time.[12] It will be possible to do so even more quickly when the new version of Part 25, CA 2006, comes into force to permit filing at Companies House by electronic means. We note that both the Committee of Scottish Clearing Bankers and the British Bankers' Association have also expressed the view that the "invisibility period" is not a significant problem in practice.

19. We are aware of one reported Scottish case[13] where a creditor who was granted a floating charge and negative pledge gained priority over another creditor who was granted a standard security on the same date (the standard security being "created" only on being recorded in the Register of Sasines).[14] However, since 1 October 2009, there has been a public right to inspect the instrument creating the charge at the office of the charging company from the instant of its creation.[15]

20. **Full text filing:** Although Part 2 of the B&D Act would enable the full text of the charging document to be placed on the RofFC, the new version of Part 25, CA 2006, is expected to permit the e-filing of the full text in any event.

21. **Advance notice:** The option for an advance notice might have been useful, but this is only available on the basis that priority runs from the date of registration, which would have the complications referred to in paragraph 17 above. There are also significant extra costs, both in administration and for business, involved in using the advance notice procedure (which is essentially equivalent to double registration.)

Disadvantages

22. Part 2 of the B&D Act has a number of serious disadvantages which are identified in the Report. The following points give rise to particular concern.

23. **Conceptual approach:** Under Part 2 it is intended that registration of a floating charge will become part of the formation process of a charge over Scottish assets regardless of its governing law, so denying the existence of unregistered charges. This runs counter to the modern trend in private international law to look to the chosen or objectively determined applicable law to decide such matters. Private international law is a matter within the competence of the EU, not national governments (although the UK has certain limited rights on limited occasions to opt out of EU law)[16]: these issues are discussed further in paragraphs 24 and 38 to 43 below. The present UK wide scheme of registration

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12 Paragraph 9 above.

13 *AIB Finance Ltd v Bank of Scotland* 1995 SLT 2.

14 *Archibald Campbell, Hope & King Ltd* 1967 SLT 83 is sometimes quoted as a reason for reform but this is a case about an application for an extension of time in which to register a disposition to secure a subsequent loan or to rectify the register of charges to disclose the subsequent loan.

15 Ss 874(3) & 889(2) CA 2006.

16 The UK temporarily opted out the the Rome 1 Regulation but subsequently opted in to the negotiated form.

does not affect the formation of a charge, but is ultimately directed to establishing whether it can be enforced on the insolvency of the chargor where the chargor is a company formed under the law of any part of the United Kingdom. This aspect remains, at least partially, under UK competence.

24. **Double registration costs:** If Part 2 is brought into force in its current form, a floating charge created under English law would not be effective under Scots law in relation to Scottish assets unless and until registered on the RofFC. This would almost certainly lead to the practice of registering a floating charge taken from an English company, both at Companies House, Cardiff, and at the RofFC, if it is possible that Scottish assets might fall within the scope of charge. This would involve a substantial extra cost for English, Northern Irish, Irish, Isle of Man and Channel Island companies, many of whom are likely to become aware of the process. Those from more distant jurisdictions who took floating charges would also be at a disadvantage in the same way, assuming that they were aware of the process. If a secured creditor were not so aware, the impediment to enforcement resulting from failure to register would affect the creditor himself and the insolvency practitioner dealing with the administration or winding up of the company where assets were located in Scotland.

25. We agree with the view expressed in the Report that the volume of registrations on the RofFC would be much higher than the estimate of 10,000 per annum originally given in the Financial Memorandum relating to the B&D Act. The number of charges registered by companies at Companies House, Cardiff, was 93,234 during the year ended 31st March 2012, compared with 6,315 charges registered in Scotland and 1,780 charges registered in Northern Ireland during the same period.[17] The number of charges registered in England is therefore more than fourteen times higher than in Scotland. The statistics do not indicate what proportion of these charges are floating charges but the proportion is certain to be substantial. If we assume that at least one third of all registered charging documents include floating charges and that these also had to be registered on the RofFC, then this would involve an extra cost of £7.14 million per annum for English companies (based on an assumed registration fee of £30[18] and average solicitors' costs of £200 per filing[19]). The actual costs could be higher or lower. These costs are likely to be passed to borrowers.

26. **New "Slavenburg problem" for overseas companies**: The impact on foreign incorporated companies must also be considered. Although charges created by foreign companies have ceased to be registrable at Companies House under Part 25 of the CA 2006, a floating charge created by a foreign company over assets located in Scotland would be registrable under Part 2 of the B&D Act. We agree with the warning in the Report that this might create a new "Slavenburg problem"[20], and so give rise to substantial extra costs (in addition to the estimated costs referred to in paragraph 25 above). As noted in the Report,[21] 35,000 charges were registered by overseas companies in the last year of operation of the "Slavenburg register" at an estimated total cost (including solicitors' fees) of £11 million per annum. If we assume that one third of these charging documents included floating charges capable of extending to Scottish assets, then, using the same assumed figures as in paragraph 25 above, the total cost of registering them on the RofFC would be in the order of £2.68 million per annum.

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17 Based on statistics provided by the Companies Registration Office.

18 In the briefing provided to MSPs on Part 2 of the B&D Bill, the fee for registering a floating charge at the RofFC was expected to be £30 per record.

19 This is the estimated figure referred to in footnote 33 of the Report used when estimating the potential saving derived from abolition of the "Slavenburg register".

20 The Report, page 8 and footnote 28.

21 The Report, footnotes 31 and 33.

27. **Different dates of creation:** A charge created by a non-Scottish UK company would have two separate dates of creation: one under the law of England and Wales (or of Northern Ireland) and one under Scots law. Generally, under English law, a floating charge is created on the date on which it is executed and delivered by the chargor. In contrast, a floating charge would be treated as created under the B&D Act only on the date registered at the RofFC. This inconsistency would be an unhelpful complication.

28. **Interaction with other registers:** The interaction with international and national registries for ships and aircraft, where such charges may be registered already, does not seem to have been explored: for example, the effect of the adherence of the EU (but not the UK) to the Cape Town Treaty on transactions involving moveable property does not appear to have been examined. EU recognition affects the ability of Member States to adopt a different approach on any matter within EU competence under the EU Treaty and may require the UK (including Scotland) to recognise the existence of a charge registered in any international register established pursuant to the Treaty. This would cut across an asset based requirement to register in Scotland to obtain recognition in Scotland, as proposed by the B&D Act.

29. **Asset location uncertainties:** As stated in paragraph 11 above, Part 2 applies to floating charges created over Scottish located assets, regardless of where the chargor is incorporated. The adoption of an asset based test is a fundamental change to the current statutory position where registrability depends on where a company is incorporated. At present if a company is incorporated in England and Wales, its charges are registrable under section 860, CA 2006. If a company is incorporated in Scotland, its charges are registrable under section 878 of the CA 2006. This current approach provides a high level of legal certainty. A switch to a location test would create considerable uncertainty. As a floating charge extends to present and future assets, the floating charge could capture Scottish assets acquired by the chargor in the future. Further, as recognised in the Report[22], there are serious legal uncertainties in determining where intangible property (broadly similar to incorporeal property under Scots law) is actually located. These uncertainties could lead to floating charges being registered at RofFC on a "just in case" basis.

30. **Security financial collateral arrangements:** In order to comply with EU law[23], it would be necessary to make clear that Part 2 of the B&D Act did not require registration on the RofFC of a "security financial collateral arrangement" (within the meaning of regulation 3 of the Financial Collateral Arrangements (No 2) Regulations 2003) where taken in the form of a floating charge.

31. **The Banking Act 2009:** A floating charge which is exempt from registration under section 252 of the Banking Act 2009 should also be excluded from registration under Part 2 of the B&D Act. Given that several of the UK's major banks are headquartered in Scotland, it would be essential that this was done so that they could, if a further need arose, obtain appropriate central bank support.

32. **Potential insolvency law uncertainties:** Part 2 would mean that no floating charge would be effective in relation to assets located in Scotland unless the floating charge had been registered on the RofFC. If a floating charge was ineffective over Scottish assets, this could give rise to a number of potential legal questions (particularly where the floating charge was governed by the law of another part of the UK) which would need to be considered further, including:

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22 The Report, page 12.

23 Council Directive 2002/47/EC on financial collateral arrangements.

(a) whether the charge holder would be the holder of a "qualifying floating charge" and eligible as such to appoint an administrator under paragraph 14(1), Schedule B1 of the Insolvency Act 1986 ("IA 86") or, where permitted by sections 72B to 72GA, IA 86, an administrative receiver;

(b) whether a "prescribed part" of net realisations derived from Scottish floating charge assets would still have to be made available for the satisfaction of unsecured debts under section 176A, IA 86, in the event of the administration, receivership or winding up of the charging company;

(c) whether preferential debts of the charging company could still be paid out of floating charge assets in Scotland under sections 40 and 175, IA 86, in the event of the receivership or winding up of the charging company;

(d) whether an administrator of the charging company would still be able to pay his remuneration and expenses out of floating charge assets in Scotland under paragraphs 70(1) and 99(3) and (4), Schedule B1, IA 86;

(e) whether the expenses of winding up the charging company could still be paid out of floating charge assets in Scotland under section 176ZA, IA 86.

There might well be similar issues in applying insolvency laws in jurisdictions outside the UK where a floating charge may be created including, for instance, where a floating charge is created in the Republic of Ireland.

33. In the case of issues referred to in paragraph 32(b) to (e) above, these issues might not greatly matter if the Scottish floating charge assets were unencumbered and formed part of the insolvent estate. The position could be different if another creditor had acquired a fixed security interest over the same assets or had obtained an attachment order over them, or (in the case of 32(d)) those assets were treated as not being in the custody or control of the administrator or liquidator[24].

34. **Potential application to charges recharacterised as floating charges:** We confirm that it is also necessary to take into account the possibility of a charge described as a fixed charge being recharacterised as a floating charge. To give one example, many purported fixed charges over book debts taken under English law are likely to be recharacterised as floating charges where the charge holder fails to control the book debt proceeds[25]. Recharacterisation risk is not limited to book debts but also extends to other types of asset. It is understood that the Scottish courts would probably not at present recognise as a floating charge (to the extent that they relate to assets considered Scottish by the court) a charge not expressly created as a "floating charge", but the legal position is not free of doubt.

35. Uncertainty on this issue could lead to charges being registered on the RofFC even though described as fixed charges, just in case they might be recharacterised by a court in the future as a floating charge (in which event they might otherwise be treated as ineffective under Scots law and lose priority).

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[24] Where a floating charge created under English law extends to property of the charging company in another jurisdiction, the English court may enforce it in personam (even if it is not recognised as an effective charge by the lex situs), with the result that the charge may in general attach to the sale proceeds of the charged property but only if and when repatriated to England and Wales: *Re Anchor Line (Henderson Brothers) Limited* [1937] Ch. 483. It is unclear whether the decision would still be followed in a case where a floating charge was ineffective in Scotland for want of registration under Part 2.

[25] *Agnew v Commissioner of Inland Revenue* [2001] BBC 259, PC and *Re Spectrum Plus Limited* [2005] UK HL 41.

36. **EU Issues:** There are four areas of EU competency which give rise to concern about the proposals in the B&D Act:

(a) the Financial Collateral Arrangements Directive;[26]

(b) private international law relating to debts;

(c) private international law relating to moveables;

(d) the extent to which the Regulation on Insolvency Proceedings[27] and the Directives dealing with winding up or reorganisation of credit institutions and insurance undertakings[28] may limit the ability of national law (including the law of any jurisdiction within a Member State) to decline to recognise a charge on the basis of non-registration in a national registry.

37. **Financial Collateral Arrangements Directive:** As previously mentioned, floating charges which fall within the scope of the UK implementing regulations are exempt from registration. This is a requirement of the Directive and, in consequence, the proposed registration scheme under Part 2 could not be comprehensive in its effect.

38. **Private international law relating to debts:** The EU has competence in the field of private international law and all Member States are bound to give effect to the Rome 1 Regulation dealing with this subject. Article 14 deals with assignment of debts, including by way of charge, and therefore questions relating to the recognition and effect of a floating charge relating to debts appears to be governed by the rules in Article 14. As between the original debtor and the assignee (chargee), this is a matter for the law applicable to the contract between the debtor and the original creditor. As between the assignor (chargor) and the assignee (chargee), it is a matter for the law applicable to the assignment. Recital 38 provides that proprietorial matters as between assignor and assignee should be governed by the same law, where they would be considered separately.

39. Thus, if a charge relates to debts, its existence and effect should be governed by the law applicable to the assignment. If, for example, the applicable law was French or Irish law, Scots law would seem bound to recognise the charge without further formality, so that a Scottish registration requirement would not be effective to prevent recognition of the charge, unless it were a mandatory law applicable in the forum of any dispute (which may well not be Scotland). If the law of the original debt were Scots law, then it would apply in the case of enforcement against the debtor in Scotland, but if it were the law of another jurisdiction (as would often be the case) the fact that the debt had some connection with Scotland would not change that conclusion.

40. In deciding which law is applicable and where action can be brought, the Rome I Regulation and the Brussels I Regulation would give importance to the choice of the parties and, in the absence of choice, the place of payment or other essential performance. If the charge holder obtains a judgment abroad, it must be recognised by the Scottish Courts unless it is manifestly contrary to public policy or other very limited grounds apply (Brussels I Regulation, Article 34). It is unclear whether the Part 2 of the B&D Act could be regarded as a mandatory or public policy rule, such that a foreign judgment could be blocked.

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26 Directive 2002/47/EC as amended by Directive 2009/44/EC.

27 Regulation (EC) No 1346/2000.

28 Directive 2001/24/EC and Directive 2001/17/EC.

41. The effectiveness of the scheme in the B&D Act to ensure registration in Scotland of all floating charges over Scottish assets seems to be limited by the application of the Rome 1 Regulation and the Brussels I Regulation.

42. **Private international law relating to movables:** We have referred in paragraph 28 above to the EU's adherence to the Cape Town Treaty which inter alia establishes an international register for interests in moveables, including charges. The Treaty has been adhered to fully by over 50 countries including major jurisdictions such as the USA. The UK has not independently adhered. However, the effect of EU adherence, given its competence in matters of private international law, would seem to be that the UK is bound to recognise charges registered in the relevant register even if not registered in the UK and may not be able to insist on further registration in any part of the UK for the purpose of formation or recognition of such charges.

43. **Insolvency law:** The primary purpose of the current system of registration of charges against UK companies under the Companies Act 2006 is not concerned with recognition of the valid formation of a charge or other registrable security interest, but with its recognition for the purpose of enforcement as a charge in the event of the insolvency of a chargor which is a UK company. This remains within the UK competence. However, the scheme of the B&D Act appears to deny the existence of a floating charge which could apply to Scottish assets unless and until registration has occurred. As explained above, this arguably conflicts with the rules of private international law laid down in the Rome 1 Regulation and other areas of private international law within the competence of the EU, not national governments. As regards insolvency law, the UK is bound by the Regulation on Insolvency Proceedings, which provides for insolvency proceedings to be conducted according to the law of the jurisdiction in which a company has its centre of main interests (COMI), except to the limited extent of any secondary proceedings.

44. The UK may expect to control insolvency processes over UK COMI companies (which will include nearly all companies incorporated under the Companies Acts or with a UK registered office). Under Article 4 of the above Regulation, the UK can expect to apply the relevant national law to the admissibility of claims in insolvency proceedings. This works well with the current system for the registration of charges. However, it works less well with the scheme of the B&D Act, which would deny recognition of the existence of a floating charge under Scots law for all purposes. While Article 5 would allow effect and priority to be given to "rights in rem" of creditors in respect of assets situated in another Member State, this does not seem to allow for local law to decline to recognise a charge which is recognised under the law of the main insolvency proceedings – which would be the effect of Part 2. It would be necessary to consider whether Scots law should be amended to ensure that a charge recognised by the law of the main proceedings would also be recognised in Scotland even if it was not registered in Scotland.

45. **Priorities**: The effect of the B&D Act would seem (without an additional rule of priority or, in the case of outright disposals, an express limitation of rights) to make registered floating charges always rank ahead of other floating charges, as their priority would run from date of registration, while floating charges not registered in the RofFC, but perfectly valid under the law of the place of the insolvency process, would be disregarded completely, even if the floating charge holder was the only person raising a claim for payment. This is a complicating factor for foreign insolvencies without seeming to achieve much practical protection for local creditors.

46. **Changing law:** The Brussels I Regulation, Article 14 of the Rome I Regulation and the Regulation on Insolvency Proceedings are already in various stages of periodic review by the EU Commission. One purpose of the review of the Regulation on Insolvency

Proceedings is to consider difficulties that have arisen in its application alongside the Rome 1 Regulation. There is a real possibility that the B&D Act might go beyond the competence of the UK in denying recognition to agreements validly formed under the rules of the Rome 1 Regulation and charges duly registered in international registers. In this complex area, we would urge the Scottish Government to avoid adding to the burdens for business and administration by implementing these changes.

Option 2: Commencement of Part 2 of the B&D Act, subject to amendment by subordinate legislation

Benefits

47. The benefits would be broadly the same as those in Option 1 (see paragraph 16 above), coupled with the removal of the double registration problem for English companies (but not overseas companies) because under Option 2 a charge registered at Companies House would be treated "as if registered" on the RofFC.

Disadvantages

48. **New "Slavenburg problem" for overseas companies:** The carve out proposal in paragraph 5.1.1 of the Report would not remove the need for registration on the RofFC where a floating charge was taken by a lender from an overseas company over assets which were or might be deemed to be located in Scotland, either at the time of creation of the charge or at a later date. The costs are likely to be substantial (see paragraph 26 above). It would be unfortunate, if having abolished the Slavenburg problem under Part 25 of the CA 2006, it were to be reintroduced in a different form but with similar impact under Part 2 of the B&D Act. The usefulness of these filings on the RofFC would be very limited where the companies did not have a UK registered name or number to enable access to the information. This problem could be reduced (but not avoided) if Part 2 was amended to provide that the duty of a foreign chargor to register would be treated as satisfied by making a filing on a public register in its home jurisdiction, as permitted by the US UCC (see paragraph 13 above).

49. **Implementation costs:** The costs of the development and operation of IT systems for information sharing between the Registrar of Companies and Registrars of Scotland will need to be carefully assessed. We note that Companies House estimate these to be in the order of £75,000 to £150,000 and could be greater.

Need for further amendments to Part 2

50. **Date of creation:** If Option 2 was adopted, the complication of different creation dates (see paragraph 27 above) would still need to be avoided. We suggest that the preferred solution would be the approach outlined in paragraph 5.2.2 on page 14 of the Report.

51. **Protection of special statutory regimes:** We agree with the suggestion made on pages 16 and 17 of the Report that consideration be given to exempting from registration under Part 2:

    (a) "market charges" within the meaning of Part VII of the Companies Act 1989;

    (b) "system-charges" within the meaning of the Financial Markets and Insolvency Regulations 1996;

    (c) "collateral security charges" within the meaning of the Financial Markets and Insolvency (Settlement Finality) Regulations 1999.

52. **Form and content of charging document:** We confirm that English solicitors and, in our experience, lenders would wish to have flexibility with regard to the content of a floating charge. We agree with the Report's recommendations that Scottish Ministers should therefore not prescribe under section 37(8) of the B&D Act that a floating charge must conform to any particular prescribed style.

53. We share the concern expressed in the Report about the requirement in section 48 of the B&D Act that a document registered in RofFC must be authenticated in conformity with sections 3 and/or 4 of the Requirements of Writing (Scotland) Act 1995. It should be made clear that this requirement applies only to deeds actually registered in the RofFC, and not to charges "carved out" by Option 2 which are treated "as if" created under Scots law. Again, as noted in the Report, foreign companies registering charges on the RofFC, and Scottish companies which are a party to English law multi-party debentures, could be disadvantaged by this rule.

54. **Advance notes:** We agree with the view expressed in the Report that the effect of registration of an advance notice should be the same in the case where the notice is followed by actual registration of the charge in RofFC as it would be under the proposal in part 5.2.1 of the Report. The date of creation of a charge should be deemed to be the date (or last date) that the charge deed is executed, provided that an advance notice has been registered on or before the date (or last date) of execution and that the charge itself is registered within 21 days of the registration of the advance notice. A notice should not operate to back date a floating charge to a date earlier than its date of execution.

Option 3: Abandonment of Part 2 of the B&D Act

Benefits

55. Option 3 would avoid the costs, complications and uncertainties outlined in paragraphs 24 to 46 above and continue to require floating charges to be registered only under Part 25 of the CA 2006. This registration regime has worked well in practice and is due to be improved further when the current BIS proposals are implemented. The system operates without any significant legal issues (following the abolition of the "Slavenburg problem") and, as far as we are aware, there is no call for further reform of it from lenders or borrowers.

Disadvantage

56. The potential benefits sought by Part 2 would not be obtained but, in our view, these potential benefits are outweighed by the above disadvantages of implementing Part 2.

Conclusion

57. In our view, the best solution is a unified UK registration regime of the kind proposed by BIS through restating and updating Part 25 of the CA 2006. This would obviate the need for a separate Scottish registrar of floating charges under Part 2 of the B&D Act. Admittedly, this would mean continuing to live with the "invisibility period" (which is not in itself a material problem) but would avoid all costs and potential issues associated with the implementation of Part 2.

58. We consider that, if Part 2 were to be implemented, Option 2 would be clearly preferable to Option 1 (unless the registration requirement under Part 2 was confined to Scottish companies only). However, Option 2 is merely a means of reducing (but not avoiding) the costs and inconvenience of double registration and the complications of having two dates of creation (all of which are avoidable if Option 3 is adopted). If either Option 1 or 2 is to

be taken further, we strongly suggest that a fresh impact assessment of implementing Part 2 should be carried out which takes into account the potential costs and complications referred to above.

The City of London Law Society
Financial Law Committee

20 June 2012

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