

Bankruptcy and Diligence etc (Scotland) Bill – Floating Charges

In 2002, the Scottish Law Commission received a referral from the Department of Trade and Industry to;

“Examine the present scheme on the registration and priority of rights in security granted by companies and to make recommendations as it applies to

*(a) companies having their registered office in Scotland wherever the assets are located;
and*

(b) security granted under Scots law by overseas companies and companies having their registered office in England and Wales”

The referral was part of a UK-wide review of Company law by the DTI, culminating in the “Company Law Review Bill” currently making its way through the UK Parliament. The Bankruptcy and Diligence etc (Scotland) Bill addresses a small area of corporate law-making devolved to Scotland by virtue of the Scotland Act 1998.

There are four main categories of “charge” that require to be registered to become enforceable against a debtor and third parties. These are (1) securities over land, (2) securities over incorporeal moveable property (for example book debts), (3) securities over ships and aircraft, and (4) floating charges. For the sake of clarity, the last form of security is not a security over a particular class of asset, and this is where the peculiarity lies.

Securities taken over a tangible asset constitute “real” rights once registered. This is as opposed to “personal” rights simply constituted by a private contract between two or more parties. The difference between the two is that the former provides the grantee with a right to the thing secured in the event of default, while the latter is a right enforceable against the borrower only, to the value of the debt. An essential feature of a real right is that it can be enforced against third parties and accordingly involves an element of publicity. Registration of the charge in a public register satisfies the requirement of publicity. A Floating Charge is unusual by virtue of the fact that once signed by the grantor, it constitutes a real right in favour of the grantee and as such, is capable of affecting third parties...but it is not yet a public document. Therefore, the law states that the floating charge must be registered with the Registrar of Companies within 21 days of the final date of signature. The delay creates a blind period wherein the company file will not indicate the existence of the charge

Weaknesses in the Law

While one of the more obvious flaws in the existing law is this blind period, other weaknesses were identified during the Scottish Law Commission’s consultations with Industry, legal practitioners and academics;

- The text of charges registered with the Registrar of Companies is not retained on the public record. Instead, registration forms are completed and checked against a certified true copy of the deed by staff at Companies House.
- Late registration of a Floating Charge requires court permission. While this is normally granted, the charge will be subject to any rights acquired by others during the interim period
- Discharges are not required, and often are not sought or registered with the Registrar of Companies. Information therefore held by the Registrar may be out of date.
- Methods of persuasion to ensure registration within the 21 day period include; fines, rendering the debt immediately repayable, no effect against liquidators/administrators and creditors.

Harper Macleod acted for the pursuer in the case of AIB Finance Limited v Bank of Scotland (1993 SC 588; 1995 SLT 2) the facts of which perfectly illustrate the dilemma caused by the

law as it currently stands. The borrower company signed a floating charge in favour of A and a standard security in favour of B on the same day. Both deeds were registered with Companies House and the Register of Sasines, respectively, on the same day. The floating charge contained a provision seeking to prevent the creation of standard (fixed) securities subsequent to the date of creation of the floating charge that would rank prior to or *parri passu* with the floating charge. The Court, applying the law as drafted, held that the floating charge had been created at the date of signature, and the standard security was created when it was registered, some 11 days later. Therefore the clause within the floating charge had the effect of rendering the fixed security postponed to the floating charge. What was so disconcerting about this decision, was that the fixed security holder could not have been aware of the floating charge, or its terms, until it was registered with Companies House, some 21 days following creation. Having registered the standard security within this period, the lender would probably have not realised there was a problem until the borrower defaulted.

Recommendations for Reform

The Commission's recommendations spanned floating charges to other rights in security. While Westminster will legislate on other securities and company law in general, Holyrood retains power to legislate on floating charges.

The Commission recommended;

- Floating charges must be registered in a register of floating charges before becoming capable of constituting a real right
- Floating charges should rank along side other forms of security by date of registration
- Any variation, assignment or discharge of a floating charge must be registered before affecting any third party
- A system of advance notice is required to notify any Register of the existence of the floating charge, which when registered (within 21 days) will be backdated to the date of notification.
- In relation to the current statutory requirement on companies to maintain an internal register of securities and floating charges, the Commission recommended this requirement be removed and replaced with;
- A requirement to insert short details of securities granted in a company's annual return submitted to the Registrar of Companies
- For an administrative fee, security details should be provided to anyone making such a request.

With the exception of the recommendations as regards company administration and floating charges, the Bill embodies all recommendations of the Scottish Law Commission in full.

These proposals are contained in the Bankruptcy and Diligence etc (Scotland) Bill, which is currently placed before the Scottish Parliament.

For further information on the Civil Bankruptcy and Diligence etc (Scotland) Bill – Floating Charges, please contact
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