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before the United Kingdom Parliament is longer than the whole draft code and, it may be suggested, not so well drafted. There will be pressure for new laws on corporate criminal liability and other matters. It is quite possible that enacting the code would not involve significantly more work over the years than enacting a lot of *ad hoc* legislation to achieve some, but only some, of the same results. The question is not whether there will be legislative intervention in the substantive criminal law of Scotland. There will be. The question is whether it will be coherent or incoherent. Will the Scottish Parliament in twenty years' time have left a legacy of legislative chaos in this area or something of which it and Scotland could be proud?

Eric M Clive
Visiting Professor
University of Edinburgh

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Transfer of Preferences on Payment: *Villaswan Ltd v Sheraton Caltrust (Blythswood) Ltd*

A. INTRODUCTION

Consider for a moment a very common situation. A and B are jointly and severally indebted to C. A pays C and seeks to recover, from B, B's share of the debt. The existence of A's right to recover a share from B is beyond dispute. What is less clear, perhaps surprisingly, is the precise nature of this right under Scots law. *Villaswan Ltd v Sheraton Caltrust (Blythswood) Ltd*¹ addresses the specific issue of whether a creditor's preference transmits to the paying co-debtor for the purposes of recovery against another co-debtor, but in doing so, this case raises difficult questions about the nature of the right of recovery.

The facts of *Villaswan* were simple. A number of companies were members of a VAT group, with the result that each company was jointly and severally liable for the VAT of the whole group.² One company, A, paid a large amount of VAT and, A having gone into liquidation, A's liquidator sought to recover a proportionate share from the other companies in the group. By this time, each member of the group was either in liquidation, receivership or had already been dissolved, and such was the financial situation of the other companies in the group that recovery would be possible only if A were entitled to the same statutory preference available to HM Customs and Excise on insolvency.³ For reasons which are not revealed, Customs and Excise refused to grant to A an express assignation of its rights against the other members of the group,⁴ and so A claimed a right of relief.⁵

1 1999 SCLR 199 OH.

2 Value Added Tax Act 1983, s 29(1), now Value Added Tax Act 1994, s 43(1).

3 Insolvency Act 1986, s 386, and Sch 6, category 2. The Crown's preference for unpaid taxes will be abolished by the Enterprise Act 2002, s 251.

4 At 206B.

5 See 204F.

The substance of the alleged right was that in paying the collective liability of the group, A's liquidator was entitled to exercise the Crown's preference in recovering a pro-rata share from the other members. Initially, it was argued for the liquidator that the right of relief gave the payer access to all securities and preferences held by the creditor without the need for assignation of the principal debt by the creditor to the co-obligant. Subsequently, the liquidator narrowed the scope of his argument and sought merely to claim that the statutory preference available to the Crown transmitted to A upon payment.⁶ It was argued, therefore, that the authorities dealing with rights in security were inapplicable.

Lord Penrose found for the liquidator, holding that he was entitled to exercise the Crown's statutory preference even in the absence of an assignation of the principal debt. His lengthy opinion is, however, of wider interest.

At the heart of Lord Penrose's decision lay a distinction between securities and preferences. He found that the authorities supported the view that payment by a co-obligant gives rise to a right to ask for assignation of the debt and any securities held by the creditor, although this request may be resisted by the creditor where an assignation would prejudice its right of recovery.⁷ Competing security rights, he observed, depend on voluntary contractual relationships⁸ and the rule which requires a demand for an assignation, which may or may not be resisted, is "an obvious way of focusing the issue"⁹ where there is competition between the paying co-obligant and the creditor for any security.

In contrast, a preference is a "characteristic of the principal obligation created for the benefit of or conferred on the principal creditor in circumstances prescribed by Parliament".¹⁰ While Gloag suggested that a preference only transmitted with an assignation of the debt,¹¹ Lord Penrose found that the authorities he cited did not support this and added wryly that the position as revealed by other commentators "is less than clear".¹² The basis of his decision, after long and careful analysis, appeared to be that, whilst there may be reasons for refusing an assignation of a security, none can possibly exist for refusing the transmission of a preference.

This brief case note considers two issues.¹³ First, is the difference between a preference and a security as clear as suggested by Lord Penrose? Second, even if it is, does this justify the different treatment afforded in this case?

B. THE DISTINCTION BETWEEN A PREFERENCE AND A SECURITY

Lord Penrose described a preference as an *incident* of the debt, and a security (real or personal) as an *ancillary* benefit to a debt.¹⁴ The distinction between incidental

6 At 204F.

7 *Sligo v Menzies* (1840) 2 D 1478; *Ewart v Latta* (1865) 3 M (HL) 36. As, for example, where there is an "all sums due" security in support of other debts which remain unpaid.

8 Any competition will be regulated by the date of the creation of the real right in security. This is effected only on registration, intimation or possession.

9 At 210C.

10 At 210F.

11 W M Gloag, *The Law of Contract in Scotland*, 2nd edn (1929) 213.

13 There are many others which could be considered: for example why, on policy grounds, should a Crown preference be available to other creditors?

14 At 205B–C.

preferences and ancillary benefits is rather novel, as is the characterisation of a security right as an “ancillary” benefit. The classic formulation of the relationship between security and debt is that the security or cautionary obligation is *accessory* to the debt.¹⁵ This is well-rooted in Scots law. From this fundamental principle it follows that rights in security and cautionary obligations cannot exist in the abstract¹⁶ and there must be an obligation to which they are accessory.¹⁷ Moreover, where the principal debt goes the accessory follows. Generally speaking no mention need be made of the accessory in the transfer of the principal: it is necessarily assigned with the underlying right under the *accessorium sequitur principale*,¹⁸ a position adopted by many other legal systems.¹⁹ Although, in contrast to a preference, security rights are exercisable against someone or something other than the debtor, it is not entirely clear that this creates a relevant distinction.

So, on what basis can a distinction be drawn between a security and a preference? Lord Penrose proceeded on the basis that a “preference has no substance divorced from the debt”, in contrast to a security. The difference appears to be this: there can never be a reason for a preference to be detached from the debt, for “the principal creditor has the benefit of such a preference exclusively in relation to the specific debt”.²⁰ Different considerations apply to securities: a security can cover more than one debt but a creditor can only be required to assign a security if such assignation is not prejudicial to him.²¹

It is sometimes suggested that it is only on full payment that the cautioner is entitled to an assignation of both the debt and the security.²² However, all the cases in which this principle has been asserted have involved a demand by the cautioner for the creditor’s *entire* security: this would obviously be prejudicial where there are other debts outstanding.²³ But what if the co-obligant had demanded a *partial* assignation of both the debt and the security to the extent of the payment? In practice this would be unusual but both in principle and by

15 Stair, *Institutions*, 3.1.17; Erskine, *Institute*, 3.5.8; Bankton, *Institute*, 3.1.7; W M Gloag and J M Irvine, *The Law of Rights in Security* (1897) (henceforth Gloag and Irvine) 2. See also *Morison’s Dictionary* 23–42, sv “*Accessorium sequitur principale*”.

16 *Jackson v Nicoll* (1870) 8 M 408; *Cameron v Williamson* (1895) 22 R 293.

17 *Trotter v Trotter* 2001 SLT (Sh Ct) 42 at 47H per Sheriff Principal Nicholson. The obligation may be contingent, as in the “all sums due and to become due” formulation.

18 *Wilson v Burrel* (1751) Kilkerran 1; *Edinburgh Entertainments Ltd v Stevenson* 1926 SC 363 at 386. Further difficulties may arise when formalities of transfer are involved, for example as with a standard security.

19 See e.g. *Code civil* art 1250 (subrogation), art 1692 (cession); Louisiana Civil Code art 1826 (subrogation), art 2645 (cession); *Code civil du Québec* art 1638 (cession); *Schweizerisches Obligationenrecht* art 170 (cession); J G Lotz (rev’d J J Henning) in W A Joubert (ed), *The Law of South Africa* vol 26 (reissue 1997) sv “Suretyship” para 205. But cf BGB § 1153(2).

20 At 210E.

21 It would generally only be prejudicial where a security covers further sums due to the creditor: for example it is in “all sums” terms.

22 Erskine, *Institute*, 3.5.11; *Ewart v Latta* (1863) 1 M 905 at 908 per Lord Barcaple (Ordinary), at 909 per Lord Deas.

23 *Ewart v Latta* (1865) 3 M (HL) 36 at 42 per Lord Chancellor Westbury.

the authority of the House of Lords, it would appear to be a request which the creditor would not be permitted to refuse.²⁴

If it is the case that the co-obligant has no right to refuse a partial assignment of the debt and securities, then the basis of the distinction between securities and preferences is not as clear as perhaps suggested in *Villaswan*. This leads on to a consideration of the whole basis of the right of recovery by a co-obligant.

C. A DIFFERENT APPROACH—RIGHTS BASED ON RELIEF AND RIGHTS BASED ON TRANSFER

Even if the distinction between an incident of a debt and ancillary benefit of a debt is valid, does it necessarily follow that a preference should be available to a co-obligant without the assignment of the principal? An alternative analysis based on the possibility of two very different rights of recovery may suggest not.

Classical Roman law recognised two separate types of right of recovery by a guarantor from the principal debtor and other co-guarantors: those which arose out of the relationship between the co-obligants themselves and those which arose on transfer from the creditor.²⁵ A paying guarantor had an action against a debtor based either on express or on tacit mandate (the *actio mandati*) or, where there was no mandate, under the *negotiorum gestio*. Both these rights derive from the relationship of the co-obligants and do not rely on the transfer of any rights from the creditor. However, there was also an entirely separate right of recovery deriving from the *beneficium cedendarum actionum*, the right of the paying guarantor to demand transfer of the debt by the creditor. Rights deriving from the relationship of the parties are here referred to as rights based on relief and those which follow from the *beneficium* as rights based on transfer. The important difference between these rights is that, after transfer, the co-obligant was operating the rights of the creditor. Although these rights were developed in the context of guarantees, there is no reason to suspect that the principles would not also operate in relation in similar fashion to other co-obligants.

There is abundant authority in Scots law for the existence of two sets of rights based respectively on relief and transfer²⁶ although there are passages in Lord Penrose's judgement which may suggest that the clear historical and theoretical distinctions between them were not uppermost in his mind. For example, in criticism of Gloag's view that an assignment of a debt is required to carry a preference, he stated:²⁷ "And there is no explanation of why the debt should transmit to the paying co-obligant for purposes of relief shorn of the preference conferred on it by Parliament."²⁸ A response might be that the debt does *not* transmit to the payer without assignment. The payer

24 *Campbell of Clochombie v Campbell of Duntroon* (1775) Mor 2132; Hailes 641 at 642 per Lord Kames and Lord Coalston (Lord President Dundas, at 643, adopted the reasoning of Lord Coalston); *Lowe v Greig* (1825) 3 S 543, approved in *Ewart v Latta* by Lord Chancellor Westbury at 42; *McMillan v Smith* (1879) 6 R 601 at 604 per Lord President Inglis.

25 See R Zimmermann, *The Law of Obligations* (1990) ch 5 at 132–137 for an account of the development of Roman law.

26 Bankton, *Institute*, 1.23.XX–XX; Erskine, *Institute*, 3.3.74; Bell, *Principles*, §§ 255, 268; Bell, *Lectures on Conveyancing*, 287–288; Gloag and Irvine, 797, 803–804 and 818–819.

27 Gloag, *Contract*, 213.

28 At 211C–D.

in this case can seek recovery in the absence of any transmission of the debt because it has a right based on relief; it does not need to rely on the transmission of the Crown's debt. Similarly, his Lordship later says, "the issue is what is transferred to enable [A] to work out its right of relief. In my opinion, it can only be the Crown's claim against Villaswan". Again, the point is that A does not require anything to be transferred from the Crown for a right of relief to arise. In fact, in the absence of an assignation, it is suggested that *nothing* transfers from the Crown.

This is not to pretend that the distinction between the two types of right has always been clearly recognised in case-law, partly at least because it does not matter which right is being operated except where there are securities or preferences involved. It is also the case that rights acquired following an assignation are not necessarily identical with those of the creditor-cedent. For example, assume A and B are bound jointly and severally to C. A pays C, obtains an assignation and seeks to exercise C's rights against B. Although A is now in possession of C's rights (and C would have been entitled to full payment from B), A will only be able to seek to exercise the creditor's rights to the full extent if the relationship between A and B is that of principal and cautioner. If A and B are simply co-obligants, A's right of recovery is restricted to a pro-rata share.²⁹

The precise nature of each right cannot be regarded as absolutely settled: for example, the right of relief has been ascribed variously to "equity",³⁰ as a right arising *de jure*,³¹ as deriving from the *actio mandati* or *negotiorum gestio*,³² and most recently as deriving from principles of unjustified enrichment.³³ More relevant for present purposes is the nature of the right under the *beneficium cedendarum actionum* and, in particular, the extent to which it differs from the right of relief.

The initial argument on behalf of A was that upon payment, A became entitled to all rights available to the creditor without assignation.³⁴ Although the argument does not appear to have been expressed in such terms, the same result would be achieved if the *beneficium* operated as an implied assignation of the debt, or *cessio legis*. There is some limited authority in Scots Law for the *beneficium* operating in this way. Bell says that a cautioner has the right of recovery from other co-cautioners on the principle of the *beneficium* without assignation.³⁵ Lord McLaren in an *obiter dictum* in *Clark*

29 Gloag and Irvine, 819. In *Anderson v Dayton* (1884) 21 SLR 787 one of three co-cautioners paid the debt in full and received assignation of it. He sought recovery of two-thirds of the debt from another co-cautioner. It was decided, in order to avoid Pothier's circularity of actions (*Traité des Obligations*, vol 1, para 523), that only one third was recoverable. One way of explaining this disjunction between the rights of the creditor and the assignee would be to regard the *beneficium* as permitting the payer to acquire the creditor's securities in support of the payer's right of recovery against the other co-obligants. It is suggested that this is not a satisfactory explanation as it would be entirely contrary to our understanding of the accessory nature of securities.

30 E.g. Gloag, *Contract*, 26.

31 Gloag and Irvine, 797.

32 *Mirrie v Sir Robert Pollock* (1745) Mor 2125; *Campbell of Clochombie v Campbell of Duntroon* (1775) Mor 2132.

33 *Caledonia North Sea Ltd v London Bridge Engineering Ltd* 2000 SLT 1123, 1141F per Lord President Rodger (aff'd 2002 SC (HL) 117). In relation to co-obligants generally (not specifically cautioners) see *Moss v Penman* 1993 SC 300; *Christie's Exx v Armstrong* 1996 SC 295. Stair also speaks of the "natural obligation of recompence" between those who are liable *in solidum*: *Institutions*, 1.8.9.

34 At 201C.

35 Bell, *Commentaries*, 1.369.

v Bowring & Co suggested that no written assignation is required for the payer to gain advantage of the *beneficium*.³⁶ Furthermore, two judicial statements to the effect that a co-obligant cannot enlarge its rights by virtue of an assignation provide indirect support for the implied assignation theory, although neither statement was addressing this particular issue.³⁷ However, this view is contrary to the generally understood content of the *beneficium* as a right of the payer to call for an assignation of the debt and any securities attached thereto, rather than as an implied assignation in itself.³⁸ Indeed the view of Lord Penrose in *Villaswan* was that a demand for an assignation is necessary, in relation to security rights at least,³⁹ which suggests that he was not relying on the implied assignation theory of the *beneficium* to provide an explanation for the transfer of the preference. The desirability of certainty might also suggest that actual assignation should actually take place: for example, if it is implied, is intimation also implied? If so, how does the original debtor know that performance has taken place? If not, what does the payer intimate to the debtor? Implied assignation also causes difficulties for the transfer of securities which, as accessory to the debt, cannot become detached from it.⁴⁰

D. CONCLUSION

Villaswan raises deeply difficult questions about the nature of the right of recovery of a co-obligant which this brief note cannot fully address. The decision was ultimately based on the distinction between a security and a preference but does not fully explain how, without actual or implied assignation, the rights attached to a debt transmit to a third party. Had the analysis started with the distinction between rights arising out the relationship between co-obligants and rights based on transfer, it is entirely possible that a different result would have been obtained.

Ross Gilbert Anderson and Sandra Eden
Postgraduate student, University of Edinburgh
Senior Lecturer in Law, University of Edinburgh

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36 1908 SC 1168 at 1176. See also *Osborne v Walker* (1903) 20 Sh Ct Rep 208 at 214.

37 One case was *Anderson v Dayton*, note 29 above, at 788, a case which did not involve securities at all. The other was *Thows Trs v Young* 1910 SC 588 where the view was expressed by Lord President Dunedin that “while an assignation is a useful piece of machinery, it does not alter the substantial rights of the parties” (at 595). In context, both statements probably refer to the point made above (text to note 29) that even after assignation the extent of the right of recovery is regulated by the relationship between the parties.

38 J M Irvine, “*Beneficium cedendarum actionum*”, in *Green’s Encyclopaedia of Scots Law* vol 2 (1909) 50 at 52; Erskine, *Institute*, 3.5.11; *Sligo v Menzies*, note 7 above, at 1485; *Bruce v Scottish Amicable* 1907 SC 637 at 643–644; *Fraser v Carruthers* (1875) 2 R 595 at 597; Gloag and Irvine, 804, cited with apparent approval by Lord President Rodger in *Caledonia North Sea Ltd*, note 33 above, at 1139J.

39 At 208B–C, 210C. This is on the basis that it needs to be established that there are no “countervailing equities” in favour of the creditor which would prevent the transfer of “ancillary” rights.

40 It is noted above (text to note 18) that an assignation of an obligation carries with it securities without express transfer of the securities. Perhaps an implied assignation would similarly carry securities.