



THE UNIVERSITY *of* EDINBURGH

Edinburgh Research Explorer

The Case against the Floating Charge in Scotland

Citation for published version:

Cabrelli, D 2005, 'The Case against the Floating Charge in Scotland' *Edinburgh Law Review*, vol. 9, pp. 407-38. DOI: 10.3366/elr.2005.9.3.407

Digital Object Identifier (DOI):

[10.3366/elr.2005.9.3.407](https://doi.org/10.3366/elr.2005.9.3.407)

Link:

[Link to publication record in Edinburgh Research Explorer](#)

Document Version:

Publisher's PDF, also known as Version of record

Published In:

Edinburgh Law Review

Publisher Rights Statement:

©Cabrelli, D. (2005). The Case against the Floating Charge in Scotland. *Edinburgh Law Review*, 9, 407-38doi: 10.3366/elr.2005.9.3.407

General rights

Copyright for the publications made accessible via the Edinburgh Research Explorer is retained by the author(s) and / or other copyright owners and it is a condition of accessing these publications that users recognise and abide by the legal requirements associated with these rights.

Take down policy

The University of Edinburgh has made every reasonable effort to ensure that Edinburgh Research Explorer content complies with UK legislation. If you believe that the public display of this file breaches copyright please contact openaccess@ed.ac.uk providing details, and we will remove access to the work immediately and investigate your claim.



The Case against the Floating Charge in Scotland

David Cabrelli^{*}

- A. INTRODUCTION
- B. THE LAW COMMISSIONS' TERMS OF REFERENCE
- C. SUMMARY OF THE SLC'S AND LC'S VIEWS ON THE FLOATING CHARGE
 - (1) The SLC recommendations
 - (2) The LC recommendations
- D. THE PRACTICAL FUNCTION OF THE FLOATING CHARGE IN ENGLAND AND WALES AND SCOTLAND
 - (1) England and Wales
 - (2) Scotland
- E. THE IMPACT OF THE ENTERPRISE ACT 2002
- F. ARGUMENTS FOR AND AGAINST THE RETENTION OF THE FLOATING CHARGE IN SCOTLAND
 - (1) Reasons advanced for the retention of the floating charge
 - (a) *The ability to charge circulating corporeal moveables without delivery*
 - (b) *The ability to charge circulating incorporeal assets without intimation*
 - (c) *The desirability of uniformity between Scots law and English law*
 - (d) *The ability to "hive-down"*
 - (2) Response to the reasons advanced for the retention of the floating charge
 - (a) *The ability to charge circulating corporeal moveables without delivery*
 - (b) *The ability to charge circulating incorporeal assets without intimation*
 - (c) *The desirability of uniformity between Scots law and English law*
 - (d) *The ability to "hive-down"*
 - (3) Reasons against the retention of the floating charge
- G. IS REFORM OF THE LAW ON FLOATING CHARGES WITHIN THE LEGISLATIVE COMPETENCE OF THE SCOTTISH PARLIAMENT?
 - (1) Framework under the Scotland Act 1998

^{*} Lecturer in Law, University of Dundee. The writer is grateful to Stuart Cross and Professor Alice Belcher for their helpful comments on earlier drafts of this article. Thanks also go to Alison Bissett for assisting with the references.

(2) Does the Scottish Parliament have the power to legislate on the floating charge and a replacement model of security?

H. CONCLUSION

A. INTRODUCTION

In a series of articles published in the 1980s, George Gretton considered whether the floating charge should be abolished in so far as it applied to Scots law.¹ Gretton strongly advocated the bold step of abolition. A number of arguments have since been outlined² for the inability of the floating charge to fit with the principles of Scots law, not least of which is the inability of the floating charge, which is essentially a creature of English contract law and equity,³ to adapt to the Civilian model of Scots private law. Indeed, Gretton described the floating charge as “genetically incompatible” with Scots law.⁴

Despite such practical and conceptual difficulties, the floating charge has proved to be of great practical utility in Scotland. One of the main reasons advanced for the success of the floating charge is that it is one of the principal means by which the legal regime provides a structure favourable to the provision of credit by, and security to, lenders in the modern commercial world. The historic inability of Scottish companies to grant a security over their moveable assets, raw materials, stock-in-trade, manufactured goods, goods in the process of manufacture, etc, without relinquishing possession to the creditor,⁵ together with the

1 G L Gretton, “Floating charges: The Scottish experience” 1984 JBL 255; “What went wrong with floating charges?” 1984 SLT (News) 172; “Should floating charges and receivership be abolished?” 1986 SLT (News) 325.

2 G L Gretton, “Reception without integration? Floating charges and mixed systems” (2003) 78 *Tulane Law Rev* 307; R Rennie, “The tragedy of the floating charge in Scots law” (1998) 3 SLPQ 169; S C Styles, “The two types of floating charge: The English and the Scots” (1999) 4 SLPQ 235; R Rennie, “To *Sharp v Thomson*: An heir” 2000 SLT (News) 247.

3 Equity is a concept which is generally said to be unknown to Scots law. On this point see D M Walker, “Equity in Scots law” (1954) 66 JR 103; Rennie, “Tragedy of the floating charge in Scots law”, note 2 above; and Styles, “Two types of floating charge”, note 2 above. Equitable principles were used in England to create the floating charge, thus providing a financier with good security while permitting the debtor to deal with its assets in the ordinary course of business; see *Re Hamilton’s Windsor Iron Works Co* (1879) 12 Ch D 707; R M Goode, *Commercial Law*, 2nd edn (1995), ch 25; W J Gough, *Company Charges*, 2nd edn (1996), ch 5; G McCormack, “Present and future of real and personal security: England”, in J Bell (ed), *Studies in UK Law 2002* (2002), 142–143, 149–156; E Ferran, “Floating charges: The nature of the security” (1988) 47 CLJ 213; R R Pennington, “The genesis of the floating charge” (1960) 23 MLR 630.

4 See Gretton, “Floating charges”, note 1 above, at 256, and “What went wrong with floating charges?”, note 1 above, at 173.

5 Balfour, *Practicks*, 194, c 2; Stair, *Institutions*, 1.13.11; Bankton, *Institute*, 1.17.1; Erskine, *Institute*, 3.1.33; Bell, *Commentaries*, 2.19; Bell, *Principles*, § 1364; Hume, *Lectures*, IV, 1; *Pattison’s Trustees v Liston* (1893) 20 R 806 at 813 per Lord Trayner. For an historical analysis of the evolution of this rule of Scots law, see A J M Steven, “Rights in security over moveables”, in K Reid and R Zimmermann (eds), A

burdens⁶ associated with the granting of security over book debts, receivables and other incorporeal assets, were considerable sources of frustration for lawyers and their commercial clients prior to the 1960s.⁷ The introduction of the Companies (Floating Charges) (Scotland) Act 1961 altered matters, enabling a lender to obtain security over the fluctuating moveable assets of companies without having to take actual delivery. It is undoubtedly the generally accepted commercial benefit which the floating charge provides to Scottish registered companies which has made it so popular. As Robert Jack stated:

To put the clock back to the pre-1961 position might easily have harmful consequences for the fragile Scottish economy dependent as it must continue to be on the attraction of business from other legal jurisdictions.⁸

The purpose of this article is to consider the future of the floating charge in Scotland in light of (i) the reports⁹ of the Scottish and English Law Commissions on the reform of the law on the registration of charges (including floating charges), and (ii) the coming into force of the Enterprise Act 2002. The question of whether the floating charge should be abolished or reformed will then be considered afresh. Such an analysis will be made from both an academic and a practical perspective. Given the commercial significance of the floating charge, it is only natural that due regard will be paid to the practical and commercial implications of any such recommendations.

B. THE LAW COMMISSIONS' TERMS OF REFERENCE

The Scottish Law Commission (SLC) was handed terms of reference relative to the registration of floating charges and other rights in security granted by companies. In particular, its remit involved an analysis of the registration and fixing

History of Private Law in Scotland, Vol 1 (2000), 333; G Pienaar and A J M Steven, "Rights in security", in R Zimmermann, D Visser and K Reid (eds), *Mixed Legal Systems in Comparative Perspective* (2004), ch 25. Of course, this is subject to the limited exceptions to this rule, which are listed at note 36 below.

6 For example, intimation to the account debtor in the case of a book debt and an insurance company in the case of an insurance policy (*Strachan v McDougle* (1835) 13 S 954).

7 See A J P Menzies, "Is the creation of a floating charge competent to a limited company registered in Scotland?" (1909–1910) 21 JR 87 (Part I) and 159 (Part 2), 168–169; Eighth Report of the Law Reform Committee for Scotland (Cmnd 1017: 1960); R Jack, "The coming of the floating charge to Scotland: An account and an assessment", in D J Cusine (ed), *A Scots Conveyancing Miscellany: Essays in Honour of Professor J M Halliday* (1987), 133.

8 Jack, "Coming of the floating charge to Scotland", 145–146.

9 Company Security Interests: A Consultative Report (Law Com No 176, 2004), which follows on from the English Law Commission's work in Registration of Security Interests: Company Charges and Property other than Land (Law Com No 164, 2002); and Report on Registration of Rights in Security by Companies (Scot Law Com No 197, 2004).

of priorities of floating securities and other rights in security granted by companies (i) registered in Scotland, and (ii) registered in England and Wales or overseas in respect of assets located in Scotland with a view to reform. While the SLC was not specifically asked to consider the viability of the floating charge,¹⁰ the report presents an insight into the SLC's attitude to the floating charge. The English Law Commission's (LC) terms of reference were essentially the same as those for the SLC.¹¹ However, it was handed a further remit. First, the LC was asked to consider whether the company charges registration scheme should be extended to include "quasi-security" interests such as conditional sale transactions, retention of title clauses, hire-purchase agreements and finance leases. Secondly, it was also made responsible for investigating whether the company charges registration scheme should be expanded to comprise securities and "quasi-security" interests granted by unincorporated businesses and individuals over property other than land. Although the LC principally made recommendations relative to the company charges registration scheme, it also provided an exposition of its views on the future of the floating charge within England and Wales. For this reason, its views are of note for the purposes of this article.

C. SUMMARY OF THE SLC'S AND LC'S VIEWS ON THE FLOATING CHARGE

(1) The SLC recommendations

In its final report, the primary recommendations of the SLC were that (1) the Register of Charges¹² be converted into a Register of floating charges;¹³ and (2) the current transaction-filing system be retained, whereby a floating charge is created on its registration with the Registrar of Companies. It was recommended that (a) the existing triple sanctions of (i) invalidity/nullity, (ii) acceleration,¹⁴ and (iii) the liability of the company and its officers to a daily default fine¹⁵ and (b) the twenty-

10 This was also the case in relation to the previous review undertaken by the Scottish Law Commission in *Floating Charges and Receivers* (Scot Law Com Con Mem No 72, 1987), at paras 1.1 and 2.1, i.e. it was assumed that the floating charge and receivership should be retained.

11 But with reference to companies registered in, and assets located in, England and Wales.

12 Operated by the Registrar of Companies.

13 This is the combined effect of the recommendations made by the SLC in Scot Law Com No 197, 2004, note 9 above, at paras 1.20(a) and 2.2–2.11, and David Guild, consultant to the SLC, in "The registration of rights in security by companies" 2002 SLT (News) 289 at 292. See also Lord Eassie, "Reforming registration of company charges" (2002) 47 JLSS 26 and the criticisms of the existing registration system made by G L Gretton, "Registration of company charges" (2002) 6 EdinLR 146.

14 Currently contained in the Companies Act 1985, s 410(2) and (3).

15 Section 415(3) of the Companies Act 1985.

one-day time limit for registration both be removed.¹⁶ Therefore, it is evident from the SLC's Report that it is of the belief that the floating charge should continue to form part of the law of Scotland.

(2) The LC recommendations

The LC's Consultation Paper in relation to the registration of charges by companies recommended wholesale alterations of the existing charges registration regime. As in the case of the SLC, its recommendations are interesting for the purposes of this article to the extent that they reveal its attitude towards the floating charge.

The LC has advocated the replacement of the floating charge¹⁷ with a new category of charge, namely the fixed charge coupled with a licence to deal.¹⁸ In essence, the floating charge would be substituted by a fixed security over all of the property, assets and undertaking of a company, including goodwill, uncalled capital and called capital, not yet paid, with a licence to deal with the collateral by virtue of new rules on attachment of such security. Such a bold recommendation is attributable to (1) the difficulty with which the floating charge adapts to notice-filing systems of charge registration (which the LC proposed in its report), (2) the limited commercial function served by the floating charge as a result of the introduction of the Enterprise Act 2002, and (3) the views of Goode.¹⁹

D. THE PRACTICAL FUNCTION OF THE FLOATING CHARGE IN ENGLAND AND WALES AND SCOTLAND

(1) England and Wales

In England and Wales, prior to the 1860s, bondholders (i.e. lenders) providing debt capital to companies could rely only on the mortgages of land and goods or pledged goods in order to securitise their advances. This lack of security was insufficient to satisfy the requirements of lenders and companies in the dynamic era of the Industrial Revolution.²⁰ This was due to the fact that the bulk of most companies' assets was comprised of fixed plant, equipment, tangible assets, etc,

16 See Scot Law Com No 197, 2004, note 9 above, paras 2.2–2.5.

17 The LC's initial consultation report (Registration of Security Interests: Company Charges and Property other than Land (Law Com No 164, 2002)) did not make this clear.

18 Law Com No 176, 2004, note 9 above, paras 1.12 and 2.56–2.60.

19 R M Goode, *Commercial Law in the Next Millennium, The Hamlyn Lectures 49th Series* (1998), 68.

20 For excellent introductions to the history of the evolution of the floating charge in England, see Gough, *Company Charges*, note 3 above, 102–108, and Pennington, "Genesis of the floating charge", note 3 above.

which could not easily be securitised without the use of the pledge security device, with all of the practical problems which this entailed. To be competently effected, a pledge involved the borrower surrendering possession of the property to the lender. Moreover, and more importantly, a borrower had no power to deal with the pledged goods, being subject to a fixed charge. Every time an item of stock was sold, a partial discharge would be required from the chargee.²¹

The property of the borrower and the pledged goods over which possession had been relinquished by the borrower, formed a minimal proportion of the value of the entire assets of the company. The Roman Law concept of the *hypotheca*,²² which was similar to the floating charge, had already been rejected in England.²³ The question was how the circle could be squared by enabling lenders to obtain some form of security encompassing the circulating body of a company's assets, in order to satisfy commercial demand. It was to this problem that the English courts turned their attention in the seminal cases of *Holroyd v Marshall*,²⁴ *Re Panama, New Zealand, and Australian Royal Mail Co*²⁵ and others²⁶ in the 1860s and 1870s. The result of these cases was the emergence of the floating charge in England via the intercession of equitable principles. Thus, from the 1870s onwards, it was possible for a company to grant a security over its entire assets, including future assets. However, the nature of such a charge was not so much a fixed charge coupled with a licence to deal, but a charge which hovered above the whole of the circulating stock, assets and undertaking of a company, from time to time, which could be disposed of or added to by the company in the ordinary course of its business as it saw fit.²⁷

The traditional approach adopted by lenders and their advisers in England was to obtain floating charges *in gremio* of a debenture deed, as a means of taking

21 Otherwise, the seller would have been in breach of the Sale of Goods Act 1893, s 12, which provided that goods were sold subject to an implied warranty that they were free from any charges or encumbrances in favour of any third party, not declared or known to the buyer before or at the time when the contract was made.

22 J Inst 4.6.7 and D 20.1.34. pr. It is a moot point whether the *hypotheca*, which enabled a debtor to pledge corporeal moveables without delivery of the same to the creditor, was ever available in terms of Scots law. See Steven, "Rights in security over moveables", note 5 above, at 336.

23 *Ryall v Rolle* (1749) 1 Atk 165 at 166.

24 (1862) 10 HLC 191.

25 (1870) 5 Ch App 318.

26 *Re Florence Land and Public Works Co, ex parte Moor* (1878) 10 Ch D 530; *Re Colonial Trusts Corporation, ex parte Bradshaw* (1879) 15 Ch D 465; *Moor v Anglo-Italian Bank* (1878) 10 Ch D 681; and *Re Hamilton's Windsor Ironworks Co, ex parte Pitman and Edwards* (1879) 12 Ch D 707.

27 *Evans v Rival Granite Quarries Ltd* [1910] 2 KB 979 at 999 per Buckley LJ. For a review of the theoretical bases of the nature of the floating charge, see Ferran, "Floating charges", note 3 above, and S Worthington, "Floating charges: An alternative theory" (1994) 53 CLJ 81, which reviews the "defeasible charge", "licence" and "mortgage of future assets" theories of the floating charge.

floating security over the entire assets and undertaking of a company. Moreover, lenders, fearing that the shield of fixed charges which they had obtained may have missed something (e.g. book debts), used the floating charge to cover any potential gaps. The commercial benefits associated with the floating charge, whereby the borrower could continue to deal with their assets, entrenched its position within English lending practice.

However, two modern developments subsequently altered the practical function of the floating charge in England. First, as the ability to obtain fixed charges over an ever greater class of assets increased,²⁸ so the floating charge was used purely to perform a “sweeping up” exercise, enabling a lender to take security over those assets of the debtor which it had failed to cover by the taking of such fixed charges. In essence, territory normally falling within the domain of the floating charge began to be invaded by the fixed charge with all of the concomitant benefits which this produced for lenders.²⁹ Moreover, a practice emerged whereby quasi-security devices began to be used by lenders to obtain a form of charge over tangible assets, e.g. retention of title, commercial trusts, sale and leasebacks and conditional sale devices. The greater the law evolved to expand the portfolio of security which could be made available to the creditor, the more likely that the value of the securitised assets was sufficient to cover the value of the indebtedness owed by the charger to the lender. These developments with regard to fixed securities led Gretton to comment recently that “the floating charge itself is increasingly of marginal importance south of the border”.³⁰

Secondly, and much more importantly, following the introduction of the Insolvency Act 1986, the practical purpose of the floating charge to the secured lender had been its ability to thwart the appointment of an administrator.³¹ Essentially,

28 See the cases of *In re Brighlife Ltd* [1987] Ch 200; *In re Cosslett (Contractors) Ltd* [1998] Ch 495; *Re New Bullas Trading Ltd* [1994] BCLC 485 (CA); *Agnew v Commissioner of Inland Revenue* [2001] 2 AC 710 (also known as *Re Brumark Investments Ltd*); and *Re Spectrum Plus Ltd* [2005] 3 WLR 58, which dealt with the thorny issue of whether certain charges over book debts were fixed or floating in nature. See also A Berg, “Recharacterisation after Enron” 2003 JBL 205, which charts the history of the classification of charges as fixed or floating and the circumstances in which the English courts will treat an alleged “sale” or other quasi-security contract as a sham, and in reality a “charge” transaction and vice versa.

29 Principally in relation to the enhanced control exerted by the lender over the asset subject to fixed security, but more importantly, the ability of the fixed chargee to rank and be paid out in priority to preferential creditors on the insolvency of the borrower company, on which see *Re Portbase Clothing Ltd* [1993] Ch 388 and the Companies Act 1985, s 464(6) and Insolvency Act 1986, s 175 and Sch 6.

30 G L Gretton, “The reform of moveable security law” 1999 SLT (News) 301 at 302. At the time of writing this article, this view perhaps overstated the position, bearing in mind the importance in England of using the floating charge as a means of thwarting the appointment of an administrator.

31 See F Oditah, “Lightweight floating charges” 1991 JBL 49; *Re Croftbell Ltd* [1990] BCLC 844; M G Bridge, “The English law of real security” (2002) 10(4) *European Review of Private Law* 483 at 496; and M G Bridge, Book review of *Proprietary Interests in Commercial Transactions* (1997) 17 *Legal Studies* 507 at 511.

the effect of the Insolvency Act 1986, sections 9(2), (3) and 10(2)(b) was to enable the floating charge holder to veto the appointment of an administrator.³² This was achieved by the floating charge holder appointing a receiver out of court in accordance with the provisions of the instrument creating the floating charge (normally a debenture deed) before the petition for the administration order was heard by the court.³³ As a result, it made sense in practice for a lender to continue to take “light-weight” floating charges, even where they were “already secured up to the hilt by fixed charges over a company’s most valuable assets”.³⁴ In addition, the Insolvency Act, section 43 empowered (and empowers) a receiver appointed under a floating charge to apply to the court to dispose of property which was subject to a prior ranking fixed charge in favour of a secured creditor. This ability to impede the appointment of an administrator became the principal practical function of the floating charge in England and the main reason why it continued to be used.

(2) Scotland

The practical function performed by the floating charge in England can be contrasted with that which contemporary wisdom holds as its primary commercial function in Scotland.³⁵ The floating charge offers the solution to three major commercial problems; first, the limited ability³⁶ of a company registered in Scotland, or any debtor for that matter, to grant a security over corporeal moveables without

32 It has now been made clear that the obligations of the administrator are owed to the general body of creditors as a whole, see e.g. Insolvency Act 1986, Sch B1, subparas 3(1) and (2). This can be contrasted with the receiver, who was, and is, technically, an agent of the company in terms of the Insolvency Act 1986, s 44 (and s 57 in Scotland), but has the power to exert management control over the company’s affairs and sell assets of the company in order to satisfy the indebtedness due by the company to the floating charge holder.

33 This is to be contrasted with the position in Scotland where the power of the floating charge holder to appoint a receiver is technically embodied in statute in terms of the Insolvency Act 1986, ss 51, 52, not the floating charge instrument itself.

34 McCormack, “Present and future of real and personal security”, note 3 above, at 165.

35 For an analysis of the Scottish position prior to the introduction of the floating charge, see Menzies, “Is the creation of a floating charge competent to a limited company registered in Scotland?”, note 7 above; Jack, “Coming of the floating charge to Scotland”, note 7 above, at 133–134; and Gretton, “Reception without integration?”, note 2 above, at 311–313.

36 It was, and is, possible to grant some non-possessory security over corporeal moveables, e.g. in relation to bonds of *bottomry* and *respondentia*, i.e. over ships and the cargo of ships respectively; some non-consensual types of security, e.g. hypothecs, the depositing of alcohol (usually whisky) in bonded warehouses (Bell, *Commentaries*, 1.185); and the pledge of bills of lading and other documents of title by symbolical delivery (see e.g. the opinion of the House of Lords in *North Western Bank v Poynter, Sons and Macdonald* (1897) 24 R 758, which implicitly limits the requirement of actual delivery and the rule in *Hamilton v Western Bank of Scotland* (1856) 19 D 152). It is noteworthy that there are now certain statutory securities available over registered ships and registered aircraft in terms of the Merchant Shipping Act 1995, s 16, the Civil Aviation Act 1982, s 86 and the Mortgaging of Aircraft Order 1972, SI 1972/1268. Moreover, agricultural credits are available in terms of the Agricultural Credits (Scotland) Act 1929.

actual or constructive delivery of the secured property to the creditor;³⁷ second, the practical problems associated with intimation to the account debtor where a party wishes to securitise incorporeal moveables such as book debts (especially in a commercial context where the denomination, amount and nature of the debts are continually shifting); and, finally, the absence of judicial recognition of any form of “floating” security³⁸ over corporate property in Scotland meant that the floating charge was unavailable as a form of security in Scotland.³⁹ In relation to these problems, the introduction of the floating charge by the Companies (Floating Charges) (Scotland) Act 1961 was of practical and commercial utility. It enabled a company to grant a form of security over present and future corporeal moveables, such as stock-in-trade, manufactured goods, raw materials *and* incorporeal moveables or incorporeal heritables, such as book debts, receivables, insurance policies, pensions, goodwill, etc, while retaining possession and control of the same and without requiring to intimate to any party.⁴⁰

The introduction of the floating charge also enabled a company to grant a form of security over its heritage without requiring a document or deed to be registered with the Register of Sasines.⁴¹ In addition, there was, and continues to be, no obligation on the company or the lender to register a notice or document with the Register of Sasines or the Land Register when the floating charge attaches and thus becomes a fixed security.⁴²

37 *Pattison's Trustees*, at 813 per Lord Trayner: “Now it is quite certain that an effectual security over moveables can only be effected by delivery of the subject of the security”; *Ballachulish Slate Quarries Co v Bruce* 1908 16 SLT 48 at 51 per Lord President Dunedin; *Carse v Coppen* 1951 SLT 145 at 148 per Lord President Cooper.

38 *Carse*, at 148 per Lord President Cooper. When the phrase “floating security” is used in this article, it is deployed in the sense that the company can dispose of, and expand, its assets in the ordinary course of business without prejudicing the validity of the security.

39 Despite some ingenious technical arguments to the contrary, see Menzies, “Is the creation of a floating charge competent to a limited company registered in Scotland?”, note 7 above, 162–168.

40 In the case of incorporeal moveable assets, see W A Wilson, “Floating charges” 1962 SLT (News) 53 and J H Greene and I M Fletcher, *The Law and Practice of Receivership in Scotland*, 2nd edn (1992), paras 2.06–2.07.

41 Therefore, the floating charge does violence to the publicity principle, i.e. the rule of Scots law that real rights in security can only be validly constituted by the happening of an overt act which, in the context of land and buildings in Scotland, is the recording or registration of a deed with the Register of Sasines or the Land Register, i.e. the standard security. Of course, the damage done to the publicity principle is diluted to the extent that a floating charge, when created (on signing of the floating charge, as held by *AIB Finance v Bank of Scotland* 1995 SLT 2), must be registered in the Register of Charges within twenty-one days after the date of its creation.

42 On the appointment of a receiver, the appointment of a liquidator or on an administrator filing a notice to the effect that he thinks that the chargor company has insufficient property to enable a distribution to be made to unsecured creditors (ignoring the “prescribed part”), see e.g. Insolvency Act 1986, s 53(7); Companies Act 1985, s 463(1); and Insolvency Act 1986 Sch B1, subparas 115(2) and (3). The case of *National Commercial Bank of Scotland v Liquidator of Telford, Grier Mackay & Co Limited* 1969 SLT 306, 313 per Lord President Clyde states that a floating charge becomes a fixed security on attachment.

Therefore, the availability of the floating charge meant that Scots registered companies could grant securities over their fluctuating body of assets, dealing with them in the ordinary course of business. Of course, while it is possible to provide effective assignments in security constituting real rights over incorporeal moveables, it continues to be extremely difficult in practice.⁴³ Moreover, the floating charge provided the lender with a claim preferential to that of unsecured creditors on the insolvency of the debtor in relation to such corporeal and incorporeal moveables, by enabling the receiver to exert direct management control over the company and realise sufficient assets of the company in order to repay the indebtedness due to the floating charge holder. Therefore, the practical function of the floating charge in Scotland was not only concerned with its evident value in being able to block the appointment of an administrator (as was the case in England), but the fact that it covered assets over which the company would otherwise be unable to create security. The latter practical function, unlike England, it is claimed, constituted the cornerstone of the advantages provided by the floating charge in Scotland.

E. THE IMPACT OF THE ENTERPRISE ACT 2002

In 2001, the government signalled its intention to take a close look at the interaction between administrative receivership and administration in the insolvency process. In a White Paper,⁴⁴ the government expressed the view that “administrative receivership should cease to be a major insolvency procedure”. The opinion was that the receivership route was incompatible with a rescue culture, which the government wished to engender within corporate Britain. Therefore, since the introduction of the Enterprise Act 2002,⁴⁵ the rights of the floating charge holder to obstruct the appointment of an administrator and appoint an out-of-court

43 Consisting of a requirement to assign each incorporeal moveable and intimate to the relevant party, e.g. the account debtor in the case of book debts or insurance company in the case of an insurance policy. See *Gallemos Limited (In Receivership) v Barratt Falkirk Limited* 1990 SLT 98 and *Bank of Scotland Cashflow Finance v Heritage International Transport Limited* 2003 SLT (Sh Ct) 107, which demonstrate the difficulties.

44 The Insolvency Service, *Insolvency: A Second Chance* (Cmnd 5234: 2001), para 2.5.

45 The provisions dealing with the abolition of receivership contained in Enterprise Act 2002, s 250 (introducing Insolvency Act 1986, ss 72A–72H) came into force on 15 Sept 2003. The provisions in Enterprise Act 2002, s 252 (introducing Insolvency Act 1986, s 176A, and in particular s 176A(2)(a)) re the earmarking of the “prescribed part” for unsecured creditors also came into force on 15 Sept 2003 by virtue of Insolvency Act 1986 (Prescribed Part) Order 2003, SI 2003/2097 and Enterprise Act 2002 (Consequential Amendments) (Prescribed Part) (Scotland) Order 2003, SI 2003/2108. On the Enterprise Act generally, see V Finch, “Re-invigorating corporate rescue” 2004 JBL 527.

administrative receiver have been severely curtailed.⁴⁶ Subject to certain limitations,⁴⁷ lenders holding floating charges which were granted after 15 September 2003, will have no option but to appoint an administrator where a company is experiencing financial difficulties.⁴⁸ In addition, possibly, up to 20–50% of floating charge realisations made by an administrator are to be set aside for unsecured creditors.⁴⁹ Therefore, it is a widely held belief among commentators that there will be increased reliance on fixed charges and other quasi-securities in England (rather than floating charges) by lenders such as banks and traditional users of floating charges, despite the impact of *Agnew v Commissioner of Inland Revenue*.⁵⁰ It is inevitable that banks and other lenders will look at ways of restructuring security transactions to the effect that they are treated as effective non-possessory security-holders. This will also involve the use of factoring, discounting, sale and leasebacks, conditional sale, retention of title and other non-possessory quasi-security devices which can be deployed to constitute a form of charge over tangible property.

Therefore, the effect of the introduction of the Enterprise Act 2002 is that the principal practical function which the floating charge performs in England has been removed. It was the ability of the floating charge holder in England to obstruct the appointment of an administrator which was so important.⁵¹ The LC has since moved on to the next logical stage by somewhat unsurprisingly proposing that the floating charge be abandoned.

46 It is now only possible for a receiver to be appointed in relation to (1) floating charges granted before 15 Sept 2003 in terms of the Insolvency Act 1986, s 72A(4); (2) those floating charges which fall within the exceptions highlighted in the Enterprise Act 2002, s 250 (introducing Insolvency Act 1986, ss 72A–72H), namely (a) capital market charges; (b) public-private partnership charges; (c) utilities charges; (d) project finance charges; (e) financial market charges; and (f) registered social landlord charges. See K G C Reid and G L Gretton, *Conveyancing 2002* (2003), 89–91.

47 See note 46 above.

48 This is the effect of the Insolvency Act 1986, s 72A, Sch B1, para 14.

49 See Insolvency Act 1986 (Prescribed Part) Order 2003, para 3, and Insolvency Act 1986, s 176A (inserted by Enterprise Act 2002, s 252), which provides that where the amount available for satisfaction of the claims of debenture or floating charge holders is (1) £10,000 or less, 50% of the relevant value, or (2) £10,000 or more, (a) 50% of the first £10,000 in value, and (b) 20% of the excess over such £10,000, will be available for distribution to unsecured creditors. On no account is the prescribed part to exceed £600,000.

50 The impact of *Agnew*, note 28 above, is encapsulated in the views expressed by Baroness Miller of Hendon in the debate on the reading of the Enterprise Bill in the House of Lords, HL Deb 2 July 2002, col 147: “There is a danger that banks, for example, will be reluctant to lend on the security of debentures and will insist on charges over fixed assets to the detriment of borrowers whose assets are mostly intangible.” The same view is expressed by G McCormack in “The priority of secured credit: An Anglo-American perspective” 2003 JBL 389 at 416–419, and Finch, “Re-invigorating corporate rescue”, note 45 above, at 536–537 and 540–541.

51 It will only be on those occasions where the floating charge falls within those types of charges listed in the Insolvency Act 1986, ss 72B–72H, that the floating charge holder will be able to impede the engagement of an administrator; see note 46 above.

F. ARGUMENTS FOR AND AGAINST THE RETENTION OF THE FLOATING CHARGE IN SCOTLAND

Although what follows owes an amount to the arguments presented by George Gretton in the 1980s,⁵² there are now more compelling arguments which point towards the abolition of the floating charge. The points made by Gretton are still relevant to a large degree, but the context within which those arguments were made has changed.

(1) Reasons advanced for the retention of the floating charge

There are four principal reasons why it is said that the floating charge should be retained.

(a) The ability to charge circulating corporeal moveables without delivery

The first reason cited in favour of the floating charge is that it circumvents the inability of a debtor in Scotland to grant security over its most valuable assets, namely its corporeal moveable assets, stock-in-trade, raw materials, etc, without delivering such assets to the creditor.⁵³ As a result, the argument runs that the floating charge makes it easier for a company to obtain borrowing, while preserving corporate freedom over its fluctuating body of assets. This is based on the premise that lenders will decline to lend in the absence of adequate security. To the extent that the floating charge achieves this by extending the pool of assets over which a company can grant security, it is reasonable to assume that more lenders will be willing to lend.⁵⁴ This is in harmony with the principal practical function served by the floating charge in Scotland as outlined above.⁵⁵

(b) The ability to charge circulating incorporeal assets without intimation

Secondly, the abolition of the floating charge would necessarily involve a reconsideration of the vexed issue of the competency of creating a fixed charge over book debts and other incorporeal moveables or incorporeal heritables in Scotland.

⁵² See note 1 above.

⁵³ In other words, the pledge.

⁵⁴ See the Department of Trade and Industry, *Security over Moveable Property in Scotland: A Consultation Paper* (Nov 1994), which advocated the introduction of a further form of security into Scots law (i.e. in addition to the floating charge) which would enable any legal person to grant a non-possessory real right in security over corporeal moveables (or incorporeal moveables). However, no final report was ever produced or legislation ever introduced.

⁵⁵ See D.(2) above.

In reality, this is not a major issue at present.⁵⁶ The practical difficulties inherent in obtaining fixed securities over book debts and receivables are eschewed by the fact that book debts are captured by the use of the floating charge. The existence of the floating charge evades the difficulties associated with the creation of securities over valuable incorporeal assets.⁵⁷ Any abolition of the floating charge in Scotland will mean that Scots law will require to grapple with the difficulties inherent in creating non-possessory securities over incorporeal moveables and incorporeal heritables. This is most important as it is the ability of the floating charge to securitise (1) incorporeal moveables and (2) incorporeal heritables, which is its main attraction in Scotland.

Moreover, the Scots law rules on the ability to constitute fixed charges over incorporeal moveables constituting *acquirenda* would need to be revisited. For example, it is generally impossible, impracticable or difficult to effect a real right in security over incorporeal moveable property constituting *acquirenda* or a *spes successionis* in Scotland, i.e. future or contingent rights to property which are not yet in existence or owned by the cedent at the point of execution of the assignment in security from debtor to lender, or rights to payment under contracts with prospective account debtors which have not yet been entered into.⁵⁸ The principal issue is that if a cedent attempts to vest a real right in security over future or contingent incorporeal moveable rights/property in favour of a creditor, it is often

56 Due to the availability of the floating charge. However, this is a live issue in England. Fixed charges over book debts can easily be created in England, but this itself leads to conceptual problems. The difficulty is in whether the charge can be characterised as fixed or floating; see e.g. *Brightlife, Cosslett, New Bullas, Agnew and Spectrum Plus* (all at note 28 above). This may involve an examination of the legitimacy of establishing a dichotomy for legal fiction purposes between “uncollected debts” and the “proceeds of realisation of the debt” which English law has considered in *New Bullas, Agnew and Spectrum Plus*.

57 See Scot Law Com Con Mem No 72, 1987, note 10 above, para 2.62.

58 Such debts do not constitute collected sums and therefore are not yet in existence or acquired by the debtor—on which see W M Gloag and J M Irvine, *Law of Rights in Security Heritable and Moveable including Cautionary Obligations*, 7th edn (1897), 443; K G C Reid, *The Law of Property in Scotland* (1996), paras 527–528, 652; G L Gretton, “The assignment of contingent rights” 1993 JR 23; and *Bank of Scotland Cashflow Finance v Heritage International Transport Limited* 2003 SLT (Sh Ct) 107. However, in the recent judgment of Lord Hoffmann in the House of Lords case of *Buchanan v Alba Diagnostics Ltd* 2004 SLT 255, it was reported that senior counsel for the appellant had conceded that the doctrine of accretion enabled the assignation of future incorporeal property to vest that property in the assignee immediately upon its coming into existence, without any need on the part of the assignor to perform some further act. Reid, *Law of Property*, paras 677, 549–550 and Bell, *Principles*, § 881 were cited in favour of such a proposition. If this is correct and extends to incorporeal moveable property (a view expressed by Reid at para 678, based on the law of warrandice), then it represents a major exception to the *acquirenda* and *spes successionis* rule in the case of incorporeal moveable property. The House of Lords in *Buchanan* held that the transfer/assignation of “improvements” of certain intellectual property rights (being a form of incorporeal moveable) from assignor to assignee was competent, despite the fact that such “improvements” did not exist at the time of such assignation. The writer wonders whether Lord Hoffmann perhaps misconstrued the law on this point. See further commentary on this case by R G Anderson at xxx–xxx infra.

the case that this is impossible or impracticable given the absence of any account debtor to whom intimation can be made. It is understood that the SLC will analyse the competency of fixed charges over book debts and the best manner in which the *acquirenda* and *spes successionis* issues could be tackled in its Seventh Programme of Law Reform. This is a most welcome development.

(c) The desirability of uniformity between Scots law and English law

The third reason advanced for the adoption of the floating charge is the sentiment that there should be a large degree of uniformity between English law and Scots law on the subject of the ability of companies to grant security, and that this, in particular, warranted the introduction of the floating charge. As Gretton stated:

Not very much was said [within the Eighth Report of the Law Reform Committee for Scotland⁵⁹] about [harmonisation with English law] ... but it was undoubtedly an important factor, and has equally certainly been an important factor (perhaps the most important) in keeping floating charges in existence.⁶⁰

Such a sentiment was echoed by Lord Clyde in the House of Lords case of *Sharp v Thomson*,⁶¹ where it was suggested that it would be unfortunate if the law relating to floating charges was at variance in England and Scotland. It is submitted that this was one of the most compelling reasons for the introduction of the floating charge.⁶²

(d) The ability to “hive-down”

Finally, there is an argument that the existence of the floating charge facilitates the separation of the assets of a company from its debts, obligations and liabilities through the process of “hiving-down”. Hiving-down occurs where a company, through a receiver appointed under the Insolvency Act 1986, section 51 or 52, sells the business, assets and goodwill and transfers the employees of the company in receivership to a subsidiary company. The subsidiary company obtains the assets, goodwill, employees, etc, of the company in receivership with effect from the transfer date, and the debts, obligations and liabilities of the company, constituting pre-transfer liabilities, remain with the company in receivership.⁶³ The perception is that the process of hiving-down performs a useful economic function by

59 Cmnd 1017: 1960.

60 Gretton, “Should floating charges and receivership be abolished?”, note 1 above, at 326.

61 1997 SLT 636 at 646 per Lord Clyde.

62 Similar statements were made in Cmnd 1017: 1960.

63 See e.g. the powers of a receiver which include those listed in the Insolvency Act 1986, Sch 1, paras 14–18. For a more complete explanation of the concept of hiving-down, see S Beswick, *Buying and Selling Private Companies and Businesses*, 6th edn (2001), 37–39.

preserving businesses, rescuing companies, saving jobs, conserving intellectual capital and property. The floating charge therefore forms an integral part of the “rescue culture”.⁶⁴

(2) Response to the reasons advanced for the retention of the floating charge

This article conceives of the reasons in favour of the retention of the floating charges as being essentially misplaced. Each of the four reasons will now be considered.

(a) The ability to charge circulating corporeal moveables without delivery

First, the argument is probably more apparent than real that the inability of a company registered in Scotland to grant security over its moveable assets, without delivery of those assets to the creditor, creates a demand for the floating charge. It fails to explain why the best cure for the malaise in Scots law on the constitution of rights in security over moveables is the floating charge. Other models of security may have been, and may be, available, which are more consistent with Scots law, e.g. other forms of non-possessory security common to other Civilian legal systems or “mixed” legal systems (such as the “notarial bond” in South African law).

Moreover, the strength of the related argument that lenders may decline to lend in the absence of the floating charge,⁶⁵ is limited in three principal areas.

(i) Lenders may decline to lend in the absence of the floating charge: Effect of this argument on non-corporate organisations

First, it fails to account for the fact that it is generally only companies incorporated under the Companies Acts⁶⁶ which can grant the floating charge, the relevant provisions having no application to other entities or individual persons. The latter require easy access to borrowing as much as companies. Therefore, this argument

64 See the British Bankers’ Association, Response of the BBA to the Insolvency White Paper: “Insolvency—A Second Chance” (Oct 2001), 3 and Finch, “Re-invigorating corporate rescue”, note 45 above, at 534–535 and 542.

65 To the extent that the floating charge achieves the goal of enabling a legal person to provide adequate security to a lender (by extending the pool of assets that can be granted to the lender), the argument runs that it is reasonable to assume that more lenders will be willing to lend.

66 Of course, housing associations and organisations registered under the Industrial and Provident Societies Acts 1965–2002, s 1; limited liability partnerships registered under the Limited Liability Partnerships Act 2000 (LLPs have the power to grant floating charges by virtue of the Limited Liability Partnerships Act 2000, s 15 and, in Scotland, the Limited Liability Partnerships (Scotland) Regulations 2000, SSI 2001/128, reg 3 and Sch 1, and in England, the Limited Liability Partnerships Regulations 2001, SI 2001/1090, reg 4, Sch 2, Part 1); European Economic Interest Groupings (established under Council Regulation (EEC) 2137/85/EC of 25 July 1985 on the European Economic Interest Grouping (EEIG) OJ 1985 L199/1) and overseas companies (as defined in the Companies Act 1985, s 744) are all able to grant floating charges.

presupposes that either lenders would decline to lend to such non-corporate organisations or, less radically, the cost of borrowing to such non-corporate organisations and individuals is much more expensive than that to companies. The former proposition is doubtful as it does not recognise the importance of personal guarantees procured by lenders from the managers of such non-incorporated organisations,⁶⁷ and the importance attached by lenders to cash-flow projections and business plans. In addition, if it were true, it would mean that organisational structure (or more accurately, a lack of it) dictates the ability to obtain credit. Indeed, in a recent empirical research report, the Scottish Executive Central Research Unit concluded that the inability of unincorporated businesses to grant floating charges does not significantly impede their access to external finance.⁶⁸ Meanwhile, the second proposition does seem unsustainable.⁶⁹ The empirical work conducted by Franks and Sussman⁷⁰ demonstrates that there is little scope for a debtor to negotiate a lower interest rate with its lender by offering more security since lenders will generally not fix interest rates with reference to the availability and amount of security which the debtor can offer. The findings of Franks and Sussman have been corroborated by the empirical research of the Scottish Executive Central Research Unit, the latter concluding that the ability of a borrower to offer extra security only had a marginal effect on the interest rate charged by the lender.⁷¹

(ii) Lenders may decline to lend in the absence of the floating charge: Effect of this argument on listed companies

This argument fails to explain the all too common phenomenon whereby large public limited companies or companies listed on the London Stock Exchange or the Alternative Investment Market refuse to grant floating charges or securities for their corporate borrowings,⁷² without any prejudice to their credit position. If the

67 See R J Mokal, "The search for someone to save: A defensive case for the priority of secured credit" (2002) 22 OJLS 687 at 713–714.

68 Scottish Executive, Business Finance and Security over Moveable Property, <http://www.scotland.gov.uk/cru/kd01/purple/bfas.pdf> at para 4.10.

69 See Mokal, "Search for someone to save", note 67 above, at 713–714. See also the general discussion in McCormack, "Priority of secured credit", note 50 above, at 402–404.

70 J Franks and O Sussman, *The Cycle of Corporate Distress, Rescue and Dissolution: A Study of Small and Medium Size UK Companies*, Institute of Finance and Accounting (London Business School) Working Paper 306-2000, 2000, which is discussed in Mokal, "Search for someone to save", note 67 above, at 712–717. The Working Group was set up by the Treasury and the Department of Trade and Industry. For a summary of the paper, see <http://www.ifk-cfs.de/papers/franks.pdf> and for the whole paper see <http://facultyresearch.london.edu/docs/306.pdf>.

71 Scottish Executive, Business Finance and Security over Moveable Property, <http://www.scotland.gov.uk/cru/kd01/purple/bfas.pdf> at para 4.6.

72 See Mokal, "Search for someone to save", note 67 above, at 694–695 and McCormack, "Priority of secured credit", note 50 above, at 402–404.

argument that lenders may decline to lend in the absence of the floating charge were correct, it would mean that plcs, having failed to grant security, would be unable to obtain borrowing. This is patently not the case. Moreover, plcs have the financial strength to negotiate with their lenders to use financing arrangements which are generally more sophisticated than the floating charge. For example, lenders may agree to take convertible bond issues or convertible preference shareholdings from plcs instead of floating charges on the basis that the risk of non-payment is insignificant.⁷³

(iii) Lenders may decline to lend in the absence of the floating charge: Effect of the introduction of the floating charge in 1961

The argument that lenders may decline to lend in the absence of the floating charge is counterbalanced to the extent that it is difficult to accept that the introduction of the floating charge, and hence the increase in the security available to lenders after 1961, led to an increase in lending to companies. The more valid analysis is to hold that there was no increase in borrowing or lending, but that, if there was any effect at all,⁷⁴ it was that the increase in the pool of corporate assets resulted in a cheaper cost of corporate borrowing. If it were otherwise, then it should be more difficult for non-companies to obtain borrowing. Moreover, there is no evidence that credit lines from third parties⁷⁵ were withdrawn or limited. Any argument in favour of the floating charge must demonstrate that its introduction resulted in greater access to corporate borrowing and that this was not accompanied by any countervailing saturation of alternative credit lines.

(b) The ability to charge circulating incorporeal assets without intimation

It is a fair point that the abolition of the floating charge would necessarily involve a reconsideration of the vexed issue of the competency of creating a fixed charge over book debts in Scotland. However, in itself, this is not a reason to reject the idea of replacing the floating charge with an alternative model in Scotland. The SLC's Seventh Programme of Law Reform includes an analysis of the difficulties involved in the taking of effective securities over incorporeal moveables, including

73 In such a case, the "lender" has the ability to convert the bonds into shares of the corporate "debtor" in order that the "lender" can exert control over the company, e.g. the debt for equity swap agreed between Marconi Corporation plc and its principal bondholders, <http://www.marconi.com/media/MarconiplcInvestorsArchive/RNS/413100.pdf>, <http://www.marconi.com/media/MarconiplcInvestorsArchive/RNS/413112.pdf> and <http://www.marconi.com/media/MarconiplcInvestorsArchive/RNS/413118.pdf>.

74 According to the empirical evidence of Franks and Sussman, *Cycle of Corporate Distress, Rescue and Dissolution*, note 70 above, there would have been no effect.

75 In other words, other lenders, suppliers, etc, on a secured or unsecured basis.

book debts due to a business by its customers.⁷⁶ This would be an appropriate juncture to consider afresh the abolition of the floating charge and any replacement model.

(c) The desirability of uniformity between Scots law and English law

The argument that there should be no discrepancies between the laws of England and Scotland in this area would be redundant if English law adopted the thinking of the LC and replaced the floating charge with the fixed charge with a licence to deal.

(d) The ability to “hive-down”

Finally, there is no particular reason why the economic benefits associated with “hiving-down” could not be achieved through the administration or liquidation processes.⁷⁷ For example, the terms of paragraph 60 of Schedule B1 to the Insolvency Act 1986 empower the administrator to do anything which a receiver can do, including the hiving-down of assets and goodwill, etc.

(3) Reasons against the retention of the floating charge

The main line of attack on the floating charge centres around its fundamental inability to adapt and fit into Scots law in a great number of areas, for example, in relation to Scots conveyancing practice⁷⁸ and general Scots commercial law.⁷⁹ Likewise, the existence of the floating charge leads to problems for Scots registration laws, by virtue of the fact that it requires no recording in the Register of Sasines or registration in the Land Register even where it affects land.⁸⁰ This then results in issues for the law of property, and in particular the effect which the floating charge has on the fundamental publicity principle of Scots property law that a real right in security can only be effected by the happening of an overt act.⁸¹

76 See Seventh Programme of Law Reform at http://www.scotlaw.com.gov.uk/html/law_reform.html.

77 Furthermore, in the case of administration, the company benefits from a moratorium on the enforcement of creditor's claims and winding-up in terms of the Insolvency Act 1986, Sch B1, paras 40, 42.

78 Wilson, “Floating charges”, note 40 above.

79 In the Inner House judgment of Lord President Hope in *Sharp v Thomson* 1995 SC 455 at 481, the floating charge was described as “a concept which is alien to Scots law”.

80 See Rennie, “To *Sharp v Thomson*”, note 2 above, and Gretton in “What went wrong with floating charges?”, note 1 above, at 174.

81 For example, the problem associated with the decision of the House of Lords in *Sharp v Thomson* and the damage which this case does to the publicity principle (see Gloag and Irvine, *Law of Rights in Security Heritable and Moveable*, at 8), which in the case of heritage in Scotland is effected by registration in a public register. See also Rennie, “Tragedy of the floating charge in Scots law”, note 2 above, at 175–178; Styles “Two types of floating charge”, note 2 above, at 242–243; G L Gretton, “The integrity of property law and of the property registers” 2001 SLT (News) 135; D L Carey Miller, “Present

Floating charges also affect the traditional rules of the Scots law of diligence,⁸² bankruptcy,⁸³ set-off⁸⁴ and insolvency.⁸⁵ Finally, and perhaps most remarkably, the rules relative to the constitution and enforcement of the floating charge, which is itself a form of security right, are far from in accordance with the rules of Scots law on rights in security⁸⁶ generally. Indeed, the introduction of Schedule B1 to the Insolvency Act 1986 (by the Enterprise Act) opens up the possibility of a floating charge never actually attaching and thus never becoming a real right in security since the appointment of an administrator (which is now the predominant insolvency procedure on the enforcement of a floating charge) does not lead to the attachment of the floating charge. Thus, to the extent that it is now possible for a floating charge never to attach and thus confer a subordinate real right, it is conceptually difficult to conceive of the floating charge as a right in security in any meaningful sense at all. All of this adds to a potent argument for the reform or abolition of the floating charge.

However, the conceptual and practical difficulties which the floating charge impose upon Scots law, while considerable in themselves, have never been viewed as sufficient to warrant any reform of the position.⁸⁷ One suspects that the desirability of jurisdictional uniformity between Scotland and England was one of the principal reasons why calls for the abolition of the floating charge fell on deaf ears

and future of real and personal security: Scotland”, in J Bell (ed), *Studies in UK Law 2002* (2002), 123; and the various articles cited by the Scottish Law Commission in their Discussion Paper on *Sharp v Thomson* (Scot Law Com Disc Paper No 114, 2001).

82 *Lord Advocate v Royal Bank of Scotland* 1977 SC 155; *Armour and Mycroft, Petitioners* 1983 SLT 453; *Forth & Clyde Construction Co Ltd v Trinity Timber & Plywood Co Ltd* 1984 SC 1; *Ross v Taylor* 1985 SLT 387; *Iona Hotels Ltd (in receivership) v Craig* 1990 SC 330; *Hawking v Hafton House Ltd* 1990 SLT 496; *Taymech Ltd v Rush and Tompkins Ltd* 1990 SCLR 789; and *Murray v Long* 1992 SLT 292. See also Rennie, “Tragedy of the floating charge in Scots law”, note 2 above, 171–175; Styles, “Two types of floating charge”, note 2 above, 241–242; G L Gretton, “Receivers and arresters” 1984 SLT (News) 177; *The Laws of Scotland: Stair Memorial Encyclopaedia* (henceforth *SME*), vol 4 (1991), para 663; and S Wortley, “Squaring the circle: Revisiting the receiver and ‘effectually executed diligence’” 2000 JR 325.

83 See e.g. *Burnett’s Trustees v Grainger* 2004 SLT 513.

84 The rule in *Forth & Clyde Construction* that no right of set-off obtained after the appointment of a receiver in respect of a debt due to the company at the time of the receiver’s engagement will be valid against the receiver, on the basis that matters are treated as if the debt had been assigned in security to the floating charge holder and intimated to the debtor at the time of the receiver’s appointment. See *SME*, vol 4, para 661; Scot Law Com Con Mem No 72, 1987, note 10 above, paras 2.67–2.83; and Gretton, “Receivers and arresters”, note 82 above.

85 See e.g. *Sharp v Thomson*.

86 See e.g. *Forth & Clyde Construction*, which stated that the general law of rights in security has no application in the context of the floating charge; W A Wilson, “The receiver and book debts” 1982 SLT (News) 129; A J Sim, “The receiver and effectually executed diligence” 1984 SLT (News) 25; Gretton, “Receivers and arresters”, note 82 above, 179; S C Styles, “Floating charges and subsequent securities” (2001) 6 SLPQ 73; D Cabrelli, “Negative pledges and ranking reconsidered” (2002) 7 SLPQ 18; and D Cabrelli, “The curious case of the ‘unreal’ floating charge” 2005 SLT (News) 127.

87 See Scot Law Com Con Mem No 72, 1987, note 10 above, paras 1.1 and 2.11.

or were ignored. If this was the case, then the combination of recent and future events may deprive this argument of any force which it may have ever had. The combination of the terms of the Enterprise Act 2002, which introduces the “prescribed part”⁸⁸ for the benefit of unsecured creditors and the removal of the principal practical function associated with the floating charge in England, i.e. the ability to block the appointment of an administrator, will result in the increased use of fixed charges in England and a decrease in the visibility of floating charges.⁸⁹ Any reservations regarding this argument⁹⁰ will be superseded if the government implements the LC’s proposals by enacting legislation which abolishes the floating charge.⁹¹

In light of these developments and the fact that the whole concept of the floating charge does not fit in easily with the principles of Scots law, one must question why the abolition of the floating charge is not on the agenda in Scotland. It is surprising that the jurisdiction which developed the floating charge is contemplating its elimination while the jurisdiction which has always had fundamental problems with the floating charge is impliedly advocating its retention and, *a fortiori*, elevating the register of charges maintained by the Registrar of Companies into a register of floating charges. One suspects that the importance of jurisdictional uniformity in relation to this subject was accompanied by a feeling that the principal practical function relative to the floating charge in Scotland must be retained at all costs.

As mentioned at the beginning of this article, Jack submitted that any abolition of the floating charge would have harmful consequences for the “fragile” Scottish economy.⁹² This sentiment is predicated on the difficulties which Scottish registered companies would experience in obtaining inexpensive finance were the floating charge not available. It reflects the deep-seated view that the floating charge is the only means available for the company registered in Scotland to securitise their fluctuating body of corporeal and incorporeal moveables without delivery of the same to the creditor or intimation to the account debtor. This is the principal practical function associated with the floating charge in Scotland which was identified earlier in this article. It is submitted that the importance given to the requirement for uniformity across the UK on the topic of floating charges was matched by the importance attached to the principal practical function of the

88 See note 49 above.

89 See McCormack, “Priority of secured credit”, note 50 above, and N Grier, “The Enterprise Act 2002” 2004 SLT (News) 27 at 31.

90 For example, that lobbying by the banks has resulted in a form of administration procedure (in the Enterprise Act 2002) which is very similar to receivership in respect of the benefits and advantages which it produces for banks as floating charge holders; see e.g. Finch, “Re-invigorating corporate rescue”, note 45 above, 548.

91 Law Com No 176, 2004, note 9 above, 2.56–2.60.

92 Jack, “Coming of the floating charge to Scotland”, note 8 above, 45–46.

floating charge in Scotland. The reasoning is that to remove the floating charge would consign Scottish registered companies to economic turmoil overnight.

Jack's view may be true, reflecting a relatively long-standing perception which may or may not be justified. However, the principal practical function performed by the floating charge in Scotland should not per se be seen as an impediment towards its abolition. It is submitted that the SLC should be asked to review the English replacement model, and any alternative replacement models, with a view to assessing the suitability of the identified model for application (with or without amendments) to the Scottish system. To cover the situation where the SLC views the English replacement model as inappropriate for Scotland, the SLC's remit should also involve the production of a model⁹³ that would enable a company registered in Scotland to grant security over its circulating moveable assets, stock, raw materials, etc, *retenta possessione*.⁹⁴ The present impetus for reform of the law of both the registration of company charges and the law on the assignation of incorporeal moveables in security represents an ideal opportunity to consider the reform or abolition of the floating charge. Indeed, the LC originally called for a particular rule of Scots international private law to recognise the "new" charge which it is proposing to replace the floating charge where a financing statement has been filed by an English registered company in Cardiff (in terms of the notice-filing system which the LC has proposed should be introduced in England and Wales).⁹⁵

One should also consider the problems which may be encountered if the floating charge is retained in Scotland, yet abolished for the purposes of English law and replaced with a fixed charge coupled with a licence to deal, as recommended by the LC. It is a subject for concern that there is the potential for cross-jurisdictional mismatch within the insolvency context. If Scotland continues with the present transaction-filing system⁹⁶ and England introduces a notice-filing system,⁹⁷ differences in the position of preferential creditors in Scotland and England may

93 The suitability of any replacement can be considered in a separate article. Such an undertaking would require to take into account the proposals of the Department of Trade and Industry in the paper referred to at note 54 above and the criticisms thereof in H Patrick, "Security over moveable property: Some general comments" 1995 SLT (News) 42; A J M Steven, "Reform of security over moveable property: Some further thoughts" 1995 SLT (News) 120; and Scottish Law Commission, Comments on Consultation Paper by Department of Trade and Industry on Security over Moveable Property in Scotland (March 1995).

94 Based on other Civilian or "mixed" jurisdictions.

95 See Law Com draft Conflict of Law Issues (Seminar Version) 22 Oct 2003, para 1.137 (this call never found its way into Law Com No 176, 2004, note 9 above). However, the initial call of the LC appears to have been rejected by the SLC; see Scot Law Com No 197, 2004, note 9 above at paras 5.8–5.17 (para 5.11 in particular).

96 Which the SLC recommended; see Scot Law Com No 197, 2004, note 9 above, paras 1.6, 1.20 and 2.2–2.5.

97 Which the LC recommended; see Law Com No 176, 2004, note 9 above, para 2.69 and Recommendation 6.2.

be generated. The proposed abolition of the floating charge in England will mean that lenders who would otherwise have obtained a floating charge will take the new form of fixed charge (with a licence to deal with their circulating stock, assets, etc) from debtor companies. The current law in both Scotland and England dictates that preferential creditors are paid out after fixed charge holders, but before floating charge holders.⁹⁸ Therefore, if it is likely that there will be an increase in fixed charge holders in England, then it stands to reason that this may result in preferential creditors being placed in an inferior position. One can contrast this with the position in Scotland where the continued existence of the floating charge may result in the situation whereby preferential creditors continue to be paid out before floating charge holders.

The differences between the jurisdictions may also have a knock-on effect on the amounts paid to unsecured creditors as a result of the provisions on the “prescribed part” in section 176A of the Insolvency Act 1986.⁹⁹ The “prescribed part” is payable out of the realisations of a floating charge.¹⁰⁰ Therefore, if the floating charge is replaced by the fixed charge with a licence to deal in England, this could render the provisions relative to the “prescribed part” redundant.¹⁰¹ Contrast this with Scotland, where the floating charge would continue to exist.

There is also the possibility that the effectiveness of the rules¹⁰² which have been recently introduced on the satisfaction of the administrator’s expenses in an administration¹⁰³ could be removed in England. The current law in England and Scotland dictates that the expenses of an administrator are payable out of the proceeds of sale of the charged assets which are realised to repay the indebtedness secured by a floating charge.¹⁰⁴ If the floating charge was abolished in England, this might mean that the administrator’s expenses would require to be met from another fund, whereas in Scotland the expenses of the administrator would continue to be satisfied out of the realisations of the floating charge.

98 Companies Act 1985, s 464(6); Insolvency Act 1986, s 175 and Sch 6.

99 Inserted by Enterprise Act 2002, s 252. For further information, see note 49 above.

100 Insolvency Act 1986, s 176A(6) (inserted by Enterprise Act 2002, s 252).

101 See McCormack, “Priority of secured credit”, note 50 above, 418, where McCormack made the point that lenders may take more fixed charges or quasi-security devices in order to avoid the rules on the “prescribed part” which make funds available to unsecured creditors. There would be the same effect if lenders take the new fixed charge with a licence to deal.

102 Insolvency (Amendment) Rules 2003, SI 2003/1730, r 2.67 (in relation to England) and Insolvency Act 1986, s 8, Sch B1, para 116, and Insolvency (Scotland) Amendment Rules 2003, SI 2003/2111, r 2.39 (in relation to Scotland), as introduced by the Enterprise Act 2002, s 248.

103 The administration position can be contrasted with liquidation; see e.g. *Buchler v Talbot* [2004] 2 WLR 582, where the House of Lords held that a liquidator’s expenses in the winding-up of an insolvent company are not payable out of the assets comprised in a crystallised floating charge in priority to the claims of the holder of that charge.

104 See note 102 above.

Of course, the straightforward means of avoiding the possible difficulties outlined above¹⁰⁵ would be by the enactment of a provision that the “substitute” fixed charge with a licence to deal be made subject to the existing rules (on the payment of preferential debts, the “prescribed part” fund and the satisfaction of the expenses of administration, etc) which currently apply to the floating charge. However, the existence of such potential difficulties only goes to demonstrate the point that there has been a failure by the Law Commissions to adopt a co-ordinated approach across the UK in relation to the subject of charges, rights in security, the treatment of preferential creditors and priorities on insolvency.

A related argument based on the Enterprise Act 2002 concerns the ability of an English registered company to grant a larger pool of fixed non-possessory security than its sister company registered in Scotland. After the Enterprise Act 2002, the view in England is that lenders will insist on obtaining more fixed charges than at present (to compensate for the removal of the right to appoint an administrative receiver under the floating charge). As we have seen, the English law of fixed charges, based as it is on equitable principles, is more willing to empower its companies to provide valid fixed non-possessory security over a greater class of assets than is the case in Scotland. Meanwhile, in Scotland, the difficulties associated with the creation of fixed non-possessory securities will result in the floating charge continuing to be taken by lenders, constituting the predominant security in the lender’s security package. On the basis that an English registered company is more likely to have granted a larger portfolio of fixed non-possessory security to a lender, a lender may elect to call up the fixed securities only to repay the outstanding debts. This would avoid the need for the lender to have recourse to the fixed charge with a licence to deal, which the writer suspects will be made subject to the same rules on administration as the floating charge. Therefore, where difficulties ensue in the English corporate borrower’s capacity to meet its debt repayment commitments, there is more scope for it to remain outside the formal insolvency procedures. However, given the difficulties in creating fixed non-possessory securities in Scotland, in the same set of circumstances, it is more likely that a lender will appoint an administrator in terms of a floating charge. Therefore, Scottish registered companies may become more prone to premature administration or liquidation than English companies. This situation must be avoided at all costs, should Scotland wish to sustain an economic level playing field with England.

105 In other words, the potential for jurisdictional mismatch between Scotland and England in respect of the rules on preferential creditors, the “prescribed part” fund for unsecured creditors and the satisfaction of the expenses of an administration out of floating charge realisations.

Moreover, under the LC's proposals, attachment¹⁰⁶ of the security or charge generally will take effect immediately on execution of the security agreement/debenture. This contrasts with the current position in England and Scotland, where automatic attachment occurs converting the floating charge into a fixed security (a) by operation of law immediately upon the liquidation of the company or on the appointment of a receiver (in respect of the assets included in the charge); or (b) on the filing of a notice in terms of subparagraphs 115(2) and (3) of Schedule B1 to the Insolvency Act 1986. Any failure on the part of Scots law to abolish the floating charge will result in a mismatch between the position in England and Scotland. The attachment/crystallisation of the floating charge will continue to occur only in the specified events highlighted above in Scotland, but in England, immediately on execution (albeit, in the case of the replacement model of the fixed charge with a licence to deal). Therefore, there could be confusion, uncertainty and litigation (particularly in the private international law field), for example, where an English company grants a fixed charge with a licence to deal over property which is wholly or partly situated in Scotland. In this situation, assuming the LC's proposals are rejected by the Scottish Executive,¹⁰⁷ Scots law will apply as regards the question of the validity of the charge, where the collateral is located in Scotland, and therefore attachment will only occur in the usual circumstances.¹⁰⁸ This may confuse English lawyers who might assume that attachment will be effected according to the ordinary rules of English law.¹⁰⁹ Of course, the issues are similar where a Scots company grants a floating charge over collateral principally or wholly situated in England and English law applies to the security agreement.

A subsidiary argument against the retention of the floating charge is that it is inherently inequitable and causes economic harm.¹¹⁰ The argument runs that the floating charge is unfair in the sense that losses on insolvency are shifted away from

106 Defined in No 176, 2004, note 9 above, para 2.14 as follows: "(1) [where] there is a security agreement for a [security interest] and the collateral is sufficiently identified either in the agreement or by subsequent appropriation; (2) value is given; and (3) the debtor has rights in the collateral."

107 In other words, the suggestion that Scots law should recognise non-possessory security interests over incorporeal moveable assets located in Scotland as valid if the debtor company is registered in England and Wales and the charge is properly constituted in England and Wales by the filing in Cardiff of a financing statement (the notice filed with the Registrar of Companies to confer priority on attachment of the charge duly backdated to the date of registration of such filing). The notice filing system has been rejected by the SLC; see note 95 above.

108 On the appointment of a receiver (Insolvency Act 1986, s 53(7)), the appointment of a liquidator (Companies Act 1985, s 463(1)) or the filing of a notice by an administrator (Insolvency Act 1986 Sch B1, subparas 115(2) and (3)).

109 Perhaps a duty should be imposed on the party lodging the financing statement to expressly state that the security agreement creating the charge is subject to Scots law.

110 V Finch, "Security, insolvency and risk: Who pays the price?" (1999) 62 MLR 633, 651-660 and J Hudson, "The case against secured lending" (1995) 15 *Int Rev of Law and Economics* 47 at 57-61.

the sophisticated secured creditor holding a floating charge (and possessing know-how and commercial acumen) onto the preferential creditor, unsecured trade creditors and other involuntary creditors, e.g. victims of delictual or tortious acts.¹¹¹ This enhances the possibility of losses to those less able to shoulder the burden and hence enhances the possibility of a chain of bankruptcies among unsecured creditors in the habit of dealing with the company. While there may be some force in this argument, it is limited by a number of factors. First, this point can be argued in relation to all kinds of secured credit, not just the floating charge. Secondly, it fails to explain studies which demonstrate that the larger the company, the less likely it is that a floating charge has been granted to obtain credit.¹¹² For these reasons, although there may be some merit in this point, it is a narrow argument.

One other issue to be tackled is whether it is legitimate to assume that the answer to the issue of the floating charge in Scotland is to abolish it and harmonise Scots and English law. Of course, this view possesses some merit. For this reason, the SLC might consider the English replacement model and whether it should be adopted in Scotland. However, the fundamental point is that whatever replaces the floating charge should be a model of security which is sufficient to permit a company, or any legal person, to grant a form of security over present and future corporeal and incorporeal moveables, without relinquishing possession or control of the same and without any onerous burdens to complete the perfection of any real right in security. This is the principal practical function associated with the floating charge in Scotland which will also require to be secured by any replacement model. If the English replacement model cannot be introduced into Scotland (with or without amendments) because it fails to achieve this or does not fit well with the principles of Scots law, then it may be that an appropriate model which is more consistent with the Civilian tradition of Scots law could be fashioned or identified. Such a model should also be considered. However, the benefits to be obtained by the adoption of such a Civilian model (in fulfilling the principal practical function and providing conceptual fit with the rules of Scots private law) would require to be considerable. The merits in such a model would have to be so significant that they outweighed the sizeable disadvantages inherent in any disunity between the laws of Scotland and England and Wales which have been mentioned earlier.¹¹³ Moreover, the issue of priorities on insolvency between the (replacement) security holder and preferential and unsecured creditors would

111 This argument is mitigated by the “prescribed part” fund which is reserved for unsecured creditors; see note 49 above.

112 Mokal, “Search for someone to save”, note 67 above, 694–695.

113 In other words, any discrepancies in the laws of both countries on the making of payments, and amounts paid, to preferential and unsecured creditors and the laws of attachment and priority of charges.

require to be settled and harmonised across the whole of the UK, as would the structure and shape of the procedure adopted to secure the enforcement of the replacement model of security. However, these are all issues to be considered in relation to the adequacy of any replacement model, not in respect of the question as to whether the floating charge itself should be abolished, which is altogether compelling.¹¹⁴

G. IS REFORM OF THE LAW ON FLOATING CHARGES WITHIN THE LEGISLATIVE COMPETENCE OF THE SCOTTISH PARLIAMENT?

(1) Framework under the Scotland Act 1998

The Scotland Act 1998 (henceforth the Act) afforded wide powers to the Scottish Parliament and Scottish Executive to legislate for Scotland. The Act empowers the Scottish Parliament to make laws for Scotland within specific areas falling within its legislative competence. The Act also gives the Scottish Parliament the power to deal with those matters which are not expressly reserved to the UK Parliament at Westminster. This is what some commentators have referred to as the “retaining model”¹¹⁵ of devolution.

In the context of the reform or abolition of the floating charge in Scotland, the reserved matters listed in Schedule 5 to the Act are the most important.¹¹⁶ In terms of the Act, section C1 of Schedule 5, the enactment of laws on the creation, regulation, operation and dissolution of business associations and companies are preserves of the UK Parliament. Likewise, the power to legislate on business and corporate insolvency is reserved to the Westminster Parliament under the Act, section C2 of Schedule 5. What is also interesting is that it is outwith the legislative competence of the Scottish Parliament to make laws on the fixing of priorities in insolvency, i.e. the preferential payment of debts over other debts in insolvency,¹¹⁷ whereas matters relating to floating charges and receivers are within the Scottish Parliament’s legislative capability.¹¹⁸ If the Scottish Parliament is entitled to pass

114 If the floating charge is ultimately abolished in England.

115 See A C Page, C Reid and A Ross, *A Guide to the Scotland Act 1998* (1999), ch 5, para 5.5.

116 The other areas outwith the legislative competence of the Scottish Parliament are those outlined in the Scotland Act, ss 29(2)(a), (b), (c), (d), (e), 126(1) and (9) and Sch 4. See Page, Reid and Ross, *Guide to the Scotland Act 1998*, ch 5, paras 5.1–5.27; C M G Himsworth and C R Munro, *The Scotland Act 1998*, 2nd edn (2000), 37–42; C M G Himsworth and C M O’Neill, *Scotland’s Constitution: Law & Practice* (2003), 164–208; and C T Reid, “The limits of devolved legislative power: Subordinate legislation in Scotland” (2003) 24 SLR 187 at 188–191.

117 Scotland Act, Sch 5, Section C2.

118 Scotland Act, Sch 5, Section C2, Exceptions.

laws in relation to the floating charge, then it is assumed that the SLC is empowered to make recommendations about the law on this same issue.

However, the fundamental question is whether the Scottish Parliament has the power (1) to legislate the floating charge out of existence; (2) to modify Scots private law on the constitution, variation and assignation of securities/charges by recommending a new form of non-possessory security over moveables; and (3) to modify insolvency law by recommending the removal of the floating charge from Scots law, with the resultant effect this will have on the enforcement, satisfaction and ranking of securities/charges and thus the payment and ranking of preferential debts in insolvency. Sections C1 and C2 of Schedule 5 of the Act create an assumption that the Scottish Parliament can pass laws in respect of the floating charge in so far as they do not affect the fixing of priorities on insolvency. The problem with this analysis, however, is that it is difficult to conceive of circumstances where the removal of the floating charge from Scots law will not have at least some bearing on the priorities attached to the payment of preferential debts. Therefore, the three issues above are not mutually exclusive and demand to be assessed individually *and* cumulatively. The enactment of laws in relation to one of the categories, while *prima facie* affecting a devolved matter, may incidentally also relate to a reserved matter. To these questions, this article now turns.

(2) Does the Scottish Parliament have the power to legislate on the floating charge and a replacement model of security?

First, it is perhaps trite to state that the Scottish Parliament, having the power to make laws in relation to the floating charge, also has the power to pass laws for its removal. The power to reform, by implication, should include the power to abolish. Secondly, although it is not expressly stated in unequivocal terms,¹¹⁹ by implication the Scottish Parliament does have the power to legislate on “Scots private law”. This phrase is defined in the Act, section 126(4), to include the general principles of Scots private law,¹²⁰ the law of obligations,¹²¹ the law of property¹²² and the law of actions.¹²³ The formulation and implementation of a model

119 It is to a major extent implied from the language of the Act; see e.g. Scotland Act, ss 29(4) and 126(4) and Sch 5, Section C1, Exceptions, and Himswoth and Munro, *Scotland Act 1998*, 37–42. See also the following excerpt from the speech of Lord Clyde, HL Deb 21 July 1998, vol 592, col 821:

We recognise, of course, that it is important to ensure that the Scottish Parliament can legislate on the general rules of Scots private law and criminal law across the board and without fragmenting the general principles which distinguish Scots law as a separate system of law.

120 Scotland Act, s 126(4)(a).

121 Scotland Act, s 126(4)(c).

122 Scotland Act, s 126(4)(d).

123 Scotland Act, s 126(4)(e).

into Scots law which replaces the floating charge with a new type of real, fixed right in security would undoubtedly involve the variation of the Scots law of property. For this reason, it is submitted that the constitution of an alternative model of security would *prima facie* fall within the jurisdictional competence of the Scottish Parliament.

However, any modification of insolvency law resulting from the abolition of floating charges raises a substantive issue. As stated above, by definition, any Act of the Scottish Parliament which discards the floating charge and introduces a new form of right in security will alter the rules on the payment of preferential debts, thus impinging upon matters which are reserved.¹²⁴ The question is whether this would result in any such legislation falling outwith the competence of the Scottish Parliament and thus being liable to challenge in the courts on the basis of legislative incompatibility.¹²⁵ In this regard, it is important to bear in mind the terms of the Act. Section 29(3) of the Act provides as follows:

... the question whether a provision of an Act of the Scottish Parliament relates to a reserved matter is to be determined, subject to subsection (4), by reference to the *purpose of the provision*, having regard (among other things) *to its effect in all the circumstances*.¹²⁶

Moreover, paragraph 3 of Schedule 4, Part I, is in the following terms:

Paragraph 2 [which prohibits an Act of the Scottish Parliament from modifying the law on reserved matters] does not apply to modifications which:

- (a) are incidental to, or consequential on, provision made (whether by virtue of the Act in question or another enactment) which does not relate to reserved matters, and
- (b) do not have a greater effect on reserved matters than is necessary to give effect to the purpose of the provision.

Furthermore, the Act (section 101(2)) provides the Scottish Parliament with a measure of flexibility, stating: “Such a provision [which may relate to a reserved matter] is to be read as narrowly as is required for it to be within competence, if such a reading is possible, and is to have effect accordingly.”

Himsworth and Munro, referring to the ministerial debates on the Scotland Bill, commented that the combination of these statutory provisions is such that the

¹²⁴ See note 117 above.

¹²⁵ There have been two unsuccessful attempts to challenge legislation of the Scottish Parliament in the cases of *Adams v Scottish Ministers* 2002 SCLR 881 and *Whaley v Lord Advocate*, OH, 20 June 2003 (testing whether the provisions of the Protection of Wild Mammals (Scotland) Act 2002 contradicted Articles 8 and 14 and Article 1 of Protocol 1 of the ECHR), and *Anderson v Scottish Ministers* 2002 SC (PC) 63 (which reviewed whether the terms of the Mental Health (Public Safety and Appeals) (Scotland) Act 1999 were inconsistent with Article 5 of the ECHR).

¹²⁶ Emphasis added.

primary purpose or “pith and substance”¹²⁷ of a piece of legislation should be placed under the microscope in order to determine whether a legislative provision “relates to” a reserved matter.¹²⁸ As Lord Sewel stated at committee stage in the House of Lords:

In other words, it is intended that any question as to whether a provision in an Act of the Scottish parliament “relates to” a reserved matter should be determined by reference to its “pith and substance” or its purpose and if its purpose is a devolved one then it is not outside legislative competence merely because “incidentally it affects” a reserved matter. A degree of trespass into reserved areas is inevitable because reserved and other areas are not divided into neat watertight compartments.¹²⁹

On the basis of such a broad-brush approach, it is submitted that if the purpose of an Act of the Scottish Parliament is to abolish the floating charge, replacing it with a new form of fixed security, this would satisfy the test in the Act, section 29(3) and fall within the Scottish Parliament’s legislative competence. This would be the case regardless of the fact that it made consequential amendments or “trespassed” to a degree, into the law of preferential debts.¹³⁰ Moreover, Schedule 4, paragraph 3 provides that any amendment to the law on preferential debts can be treated as merely “incidental” and “necessary” to achieve the purpose of reforming the Scots law on the creation and extinction of real rights in security (by the abolition of the floating charge and its replacement with a new form of non-possessory security) and is thus within the legislative competence of the Scottish Parliament.¹³¹

Matters are somewhat complicated by the fact that a special category exists where an Act of the Scottish Parliament purports to amend “Scots private law”.¹³² In this connection, it is relevant to refer to section 29(4), which is framed in the following terms:

A provision which—

- (a) would otherwise not relate to reserved matters, but
- (b) makes modifications of Scots private law, or Scots criminal law, as it applies to reserved matters,

127 This wording is based on the judgment of Lord Atkin in *Gallagher v Lynn* [1937] AC 863, which was cited by Lord Sewel at the committee stage of the reading of the Scotland Bill in the House of Lords, HL Deb 21 July 1998, vol 592, cols 818–819.

128 Himsworth and Munro, *Scotland Act 1998*, 40.

129 Hansard, HL Deb 21 July 1998, vol 592, col 819.

130 This is also in line with the views of Himsworth and O’Neill, *Scotland’s Constitution*, 185:

... [s 29(3)] should operate to save not only provisions which have a merely trivial impact on a reserved matter: even if the impact of a provision on a reserved matter is quite substantial it will be saved provided that its “purpose” can be held to be within the devolved area.

131 This ties in with Himsworth and O’Neill’s analysis based on the devolved matter of the prevention of pollution which impinges on the reserved matter of coal mining and the coal industry; Himsworth and O’Neill, *Scotland’s Constitution*, 190–192.

132 Which is defined with reference to the Scotland Act, s 126(4).

is to be treated as relating to reserved matters unless the purpose of the provision is to make the law in question apply consistently to reserved matters and otherwise.

On this basis, Lord Sewel expressed the view that the type of provision described above would only affect those rules of Scots private law which are special to reserved matters: those rules of Scots private law which result in a distinct and separate treatment of a reserved matter.¹³³ Applied to the particular context of this article, the question is whether the Scots law rules on the floating charge and rights in security result in a distinct and separate treatment of the law on preferential debts on insolvency, the latter being a reserved matter. In other words, whether the Scots law rules on the floating charge and rights in security are special to reserved matters. It is submitted that the rules on the floating charge are not special to the reserved matter of preferential debts. Moreover, it is submitted that any incidental amendments to the rules on the payment of preferential debts by an Act of the Scottish Parliament which replaced the floating charge with a new form of fixed right in security would not be “special to reserved matters”. The writer’s view is that the replacement exercise would alter Scots private law, in particular the law of property. However, it would not change Scots law in so far as it applied to a reserved matter; it would only change Scots private law in so far as it applied to Scots private law, albeit having an incidental bearing on the reserved matter of the ranking and priority of payments of preferential debts. On this basis, it is submitted that the Scottish Parliament would have the power to legislate on these issues, and that the SLC should be asked to report on the same.

H. CONCLUSION

One of the main reasons why the floating charge has been immune from the calls for its abolition over the years has been the desirability of maintaining coherence of approach across the UK. A second reason was its commercial utility, whereby it allowed Scottish registered companies to grant security over their circulating corporeal and incorporeal moveable assets without relinquishing possession to the lender (in the case of corporeal moveables) or intimating the creation of security to the account debtor (in the case of incorporeal moveables). The third reason advanced for the retention of the floating charge is that lenders may refuse to grant credit, or increase interest rates, in the absence of the floating charge. Finally, it is argued that the floating charge performs a useful commercial function by enabling

¹³³ Hansard, HL Deb 21 July 1998, vol 592, col 821. Of course, all the references in this article to ministerial debates and speeches explaining the terms of the Act are to be treated with caution and tempered with reference to the contemporary judicial attitude towards the use of Hansard as an aid to statutory interpretation, on which see Himsworth and O’Neill, *Scotland’s Constitution*, 184–189.

the assets of a company to be separated from its debts, obligations and liabilities through the process of “living-down”.

The intention of this article is to demonstrate that the reasons for the retention of the floating charge could be challenged in light of current developments. The line of attack is now more formidable than ever and the floating charge should be abolished. This approach is adopted for five particular reasons. First, Scots law has experienced particular difficulties in incorporating the floating charge within the general principles of private law. Since the time of Gretton’s writings in the 1980s, those difficulties have progressively become acute. Second, the principal practical function associated with the floating charge has been removed in England, resulting in the LC recommending that it be substituted for a fixed charge which permits trading of the chargor’s circulating assets and stock. Any abolition of the floating charge in England would remove the argument that discrepancies between Scots law and English law on the recognition of the floating charge must be avoided. Third, this article has shown that there is no reason why the floating charge is the answer to the difficulties inherent in Scots law on the constitution of rights in security over moveables. Other more appropriate models could be investigated. Fourth, recent empirical research has discredited the argument that the absence of the floating charge might prejudice the position of a prospective borrower. There is nothing to suggest that lenders may (1) decline to lend or (2) increase the cost of borrowing (by raising interest rates) if the legal environment failed to include the floating charge. Fifth, if English law does replace the floating charge and Scotland does not follow suit, there is the possibility of a divergence of approach between English law and Scots law on the subject of priority of payments to preferential creditors, the “prescribed part”, the ranking of the payment of an administrator’s expenses and the rules on the attachment of charges.

The removal of the reasons for the retention of the floating charge in light of recent developments at least merits an examination by the Scottish Ministers as to whether legislation should be introduced to replace the floating charge with a form of security which captures the main commercial purpose of the floating charge in Scotland while adapting easily with the principles of Scots private law. Such a task would be best performed by the SLC within its Seventh Programme of Law Reform, which already contains an intention to review the law on the constitution of rights in security over incorporeal moveables. The review of the floating charge in Scotland could be undertaken at this time, given how closely related these topics are. This article’s conclusion that the floating charge should be replaced should be analysed in light of the SLC’s research findings.

The future replacement model proposed by the LC should also be examined by the SLC with a view to assessing its suitability for application to Scots law. In

addition, a model of effecting security over incorporeal and corporeal moveables which is consistent with the principles of the “mixed” system of Scots law should be considered. As part of this process, the securities prevalent in other “mixed” systems should be studied. However, if any system other than the English replacement model is adopted, the benefits associated with such a system must outweigh any disadvantages generated as a result of any discrepancies between the laws of England and Scotland on the constitution of non-possessory security. It is submitted that these are the guiding principles which should underpin any future review of a replacement model.