

# **BANKRUPTCY AND DILIGENCE ETC. (SCOTLAND) ACT 2007**

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## **EXPLANATORY NOTES**

### **THE ACT**

#### *Commentary*

#### **Part 2 – Floating Charges**

#### **Registration and creation etc.**

#### ***Section 37 – Register of Floating Charges***

115. This section provides for the setting up of the new Register of Floating Charges under the management of the Keeper of the Registers of Scotland. The form and manner in which the Register is to be organised and maintained, and the form of documents and notices, the particulars they are to contain and the manner in which they are to be delivered to the Keeper, will be the subject of regulations made by statutory instrument. Those regulations are subject to the negative resolution procedure.
116. The date of registration of the relevant document or notice is to be the date of receipt of it by the Keeper. The intention is that (as with the Sasine Register) the Register should record the text of the document rather than, as at present, only particulars. Subject to the stipulation of appropriate regulations by the Scottish Ministers, it is intended that registration can in due course be effected electronically

#### ***Section 38 – Creation of floating charges***

117. Subsections (1) and (2) of section 38 derive from section 462(1) of the Companies Act 1985 and restate the statutory rule that, in Scotland, a company may grant a floating charge. In view of the generality of the phrases “debt or other obligation” and “all or any part of the property” the reference in parentheses in the existing provision to the former including a “cautionary obligation” and the latter “uncalled capital” is unnecessary. The term “company” is defined in section 47.
118. Subsection (3) lays down the new rule that, after the new legislation enters into force, the creation of a floating charge occurs only when the document granting the floating charge is registered in the Register of Floating Charges (which is instituted in terms of section 37).
119. Subsection (4) clarifies the meaning of “document granting a floating charge” to reflect the fact that it is a company which grants a floating charge albeit by means of a document.
120. Section 462(5) of the Companies Act 1985 provides that a floating charge has effect in relation to heritable property without the need for the document granting the charge to be registered in the Land Register or recorded in the Register of Sasines. It is evident from section 28 of the Land Registration (Scotland) Act 1979 that a floating charge

constitutes an “overriding interest” and is not a registrable interest. The provision that floating charges are created by registration in the Register of Floating Charges implies no further act of registration is required and the terms of section 462(5) are not re-enacted.

### ***Section 39 – Advance notice of floating charges***

121. This section makes provision for the registering of an advance notice of a floating charge. The purpose of an advance notice is to assist the mechanics of settling secured transactions by allowing parties to obtain priority of ranking from the date of the advance notice provided that settlement is completed to the extent that the floating charge is registered within 21 days of the advance notice. An advance notice cannot be registered unilaterally. The form of an advance notice, the particulars it is to contain and the manner in which it is to be delivered to the Keeper may be prescribed by statutory instrument in terms of section 37(8)(b) above. It is envisaged that the regulations will provide that the advance notice may be subscribed either by the parties or by their solicitors.

### ***Section 40 – Ranking of floating charges***

122. This section is concerned with the ranking of a floating charge both with other floating charges and with fixed securities affecting all or part of the same property as that covered by the floating charge. Subsections (1), (2) and (3) set out the leading principle that ranking proceeds on the basis of date of creation which, in the case of fixed securities is the date upon which the security was constituted as a real right. Where the floating charge is created on the same day as another floating charge or fixed security, the rule is that the respective securities rank equally.
123. Subsection (4) is concerned with a competition between a floating charge and a fixed security arising by operation of law – such as lien or a landlord's hypothec. It continues the existing rule that such fixed securities arising by operation of law have priority over any floating charge.
124. Subsections (5) and (6) continue an existing provision whereby the holder of the second, later floating charge may protect the value of the security by giving notice to the holder of the earlier floating charge. In that event, the priority of ranking of the earlier floating charge is restricted to the amount of the debt then outstanding plus any further advances which the holder of that earlier floating charge is contractually obliged to make. In view of the change in the ranking rule, the same facility is extended to the holder of a subsequent fixed security. The priority of debts is preserved by subsection (7).

### ***Section 41 – Ranking clauses***

125. The ranking of securities may be the subject of agreement among the secured creditors. Section 41(1) allows for secured creditors to enter into ranking agreements regulating the order in which floating charges are to rank in the event of insolvency.
126. Subsections (2) and (3) clarify that the rule contained in sections 40(1) and (2), that floating charges rank by date of creation, can be displaced by a ranking agreement. These subsections also clarify that the capping provisions contained in sections 40(5) and (6) can be altered by a ranking agreement. Subsection (2)(b) makes it clear that a ranking agreement cannot displace the rule contained in section 40(4) that a fixed security arising by operation of law (such as a lien or landlord's hypothec) has priority over a floating charge.
127. Subsection (4) makes provision for requiring the consent of a floating charge (or fixed security) holder, where the holder's position would be adversely affected by the provisions of a ranking agreement. It does not require such a holder to subscribe the document granting the floating charge. In practice, it may often be impractical to require the lender to grant consent by becoming a party to the floating charge document

itself. Subsection (5) therefore provides that the lender may give consent in a separate document which may be (but need not be) registered in the Register of Floating Charges. As the registration of consent will be in the interests of the borrower (it makes clear to third parties that consent was duly obtained), there is no need to impose a requirement to register.

### **Section 42 – Assignment of floating charges**

128. The existing legislation contains no provision on assignment of floating charges but in one first instance judicial decision (*Libertas–Kommerz v Johnson*, 1977 SC 191) it was held that a floating charge was assignable on general principles of law. Section 42(1) gives statutory affirmation of the assignability of a floating charge and further provides for vesting in the assignee on registration in the Register of Floating Charges. Subsection (2) makes clear that partial assignment is possible. Subsection (3) is necessary since a floating charge may transfer not only by voluntary assignment but also by operation of law (e.g. on sequestration of the holder, the floating charge transfers to the trustee).

### **Section 43 – Alteration of floating charges**

129. This section deals with alterations to the terms of a floating charge.
130. **Section 43(2)** sets out the alterations to the terms of a floating charge which must be registered, namely alterations concerning the ranking of the charge with any other floating charge or any fixed security and alterations concerning the specification of the property that is subject to the charge or the obligations that are secured by the charge.
131. An unregistered agreement to alter the terms of a floating charge would remain as a contractual agreement between the parties to it but could not affect any third party.
132. A ranking agreement is essentially an agreement between secured creditors and may be of no interest to the debtor. Accordingly, subsection (4) enables an agreement between the secured creditors, in which the debtor is not a participant, to be registered, provided that the debtor is not thereby adversely affected.
133. Subsection (5) addresses the case – exemplified in *Scottish & Newcastle plc v Ascot Inns Ltd*, 1994 SLT 1140 - in which the holder of a floating charge gives consent to specific assets, or a specific class of assets of the company, being released from the scope of the floating charge while yet remaining in the ownership of the company. If, as is currently the case, the fact of such a release is not published, an acquirer from a liquidator, an administrator or a receiver appointed by the holder of the floating charge cannot be confident of their title.
134. The subsection is not directed towards the escape of individual assets from the scope of the charge on the onerous or gratuitous transfer of the asset by the company to a third party prior to attachment of the floating charge. Unless or until the company goes into liquidation or a receiver is appointed, the company should be able to deal with its secured assets as normal by (say) selling them. It is not intended that normal business events of this kind should be registered as alterations. Accordingly, subsection (6) clarifies that, for the purposes of subsection (5), property is not to be regarded as released from the scope of a floating charge by reason only of its ceasing to be the property of the company which granted the charge.

### **Section 44 – Discharge of floating charges**

135. This section is essentially permissive. Payment of the debt, or performance of the obligation, secured by the floating charge will normally discharge or extinguish the security and this is recognised in subsection (3). But it is useful to have a means whereby the Register of Floating Charges may be cleared of floating charges which have been so discharged or extinguished. There may also be instances in which, as part of a re-

financing arrangement, it is desired to discharge an existing floating charge in favour of some other form of security and this section provides a ready, public means of achieving that.

### ***Section 45 – Effect of floating charges on winding up***

136. The essence of a floating charge is that until some event, such as the company going into liquidation or the appointment of a receiver, the security right is inchoate and the company may dispose (even gratuitously) of assets within the scope of the charge and the acquirer will obtain ownership unencumbered by any security right.
137. This section does a number of things. It repeats the existing law dealing with attachment, or crystallisation, of the floating charge on a winding up, when the floating charge is converted into a fixed security over the assets then within its scope.
138. It also provides in subsection (2) that if there is an insolvency in another EU state which is the company's centre of main interests that will trigger the crystallisation of a Scottish floating charge only if a notice is registered in the Register of Floating Charges.
139. It also clarifies that liquidation for the purposes of section 45 covers both the meaning within the Insolvency Act 1986 and, in the situation outlined in subsection (7)(a), the opening of "insolvency proceedings" within the meaning of Article 2(a) of the EC Regulation on insolvency proceedings (EC No 1346/2000).
140. A floating charge similarly attaches or crystallises on the appointment of a receiver or the delivery of a notice by an administrator. The relevant statutory provisions on receivership and administration are in the Insolvency Act 1986. They are not affected by these reforms. The priority of debts as provided for in section 176A of the Insolvency Act 1986 is also preserved. Going into liquidation within the meaning of section 247(2) of the Insolvency Act 1986 encompasses the insolvent liquidation of assets of an overseas company – see sections 220 and 221 of that Act.

### ***Section 46 – Repeals, savings and transitional arrangements***

141. **Section 46(1)** repeals Part XVIII of the Companies Act 1985 which is replaced by the new provisions on floating charges as set out in this Part. However, so that the new rules do not have retrospective effect, it is necessary to regard Part XVIII as still having effect in respect of all floating charges subsisting before the coming into force of these new rules (see subsections (2) and (3)). This will enable all matters relating to pre-commencement floating charges, such as the alteration of them, to be dealt with under the relevant pre-commencement provisions.
142. The new rules on creation of floating charges and ranking by date of creation will not disturb the priority of ranking of existing securities, whether fixed or floating, since they have all been created prior to the coming into force of the new rules. Holders of such securities will not be adversely affected by the creation of any new floating charge. In the interest of clarity, subsection (4) is intended to make plain that, for existing security rights, the pre-commencement rules of ranking continue in force.
143. Subsection (5) is consequential on the repeal of Part XVIII. Although it repeals section 140 of the Companies Act 1989, that section is to be treated as having effect for the purposes of subsections (3) and (4).
144. It should be noted that section 893 of the Companies Act 2006 provides the Secretary of State with a power to make provision for the effect of registration in the Register of Floating Charges and other similar registers.

**Section 47 – Interpretation**

145. This section defines “company” in a way which includes an overseas company. It also defines “fixed security” in terms based on and to the same effect as the definition in section 486 of the Companies Act 1985.

**Related further provision**

**Section 48 – Formalities as to documents**

146. The Requirements of Writing (Scotland) Act 1995 provides for a form of subscription of documents whereby the document has an evidential presumption of having been validly subscribed by the signatory. The 1995 Act provides that only documents having such “presumed authenticity” may be registered in *inter alia* the Register of Sasines. In practice, the same requirement is asked of documents presented to the Land Register. Section 48(1) applies the equivalent rule in the case of the Register of Floating Charges, which will facilitate a uniform treatment of applications to the Registers of Scotland when electronic conveyancing is introduced. Although not dealt with in this Act, section 222 (registration and execution of electronic standard securities) represents part of that electronic conveyancing system (see paragraph 842842 below.)
147. Subsections (2) and (3) are necessary to deal with the following situations: (a) where a document registered in the Register of Floating Charges has been annulled as a result of an application to the court for a decree of reduction; and (b) where something has been inaccurately expressed in a document registered in the Register of Floating Charges and, on application, the court has granted an order rectifying the defect. Although both may happen rarely, it is important that, as is already the law in relation to standard securities, a third party such as a person to whom a floating charge is being assigned should be able to rely on the Register. Accordingly, the effect of these provisions is that the decree of reduction or order of rectification will not affect the rights of the third party unless it has been duly registered in the Register of Floating Charges.

**Section 49– Industrial and provident societies**

148. The purpose of this section is to apply the recommended registration regime for floating charges by companies to floating charges in Scottish form granted by industrial and provident societies registered in Great Britain. Such charges are currently registered with the Financial Services Authority by virtue of section 4 of the Industrial and Provident Societies Act 1967, which is repealed.