1. Introduction

Tods Murray LLP is a leading Scottish law firm based in Edinburgh and Glasgow. Its Banking Department is one of the largest banking law practices in Scotland and is highly regarded in both the local Scottish market and for its work on cross-border transactions in relation to businesses operating throughout the United Kingdom and in other countries. This practice involves sophisticated use of floating charges.

Our comments relate to the following matters:

- amendments required to deal with problems from recent legislation
- registration of floating charges granted by non-Scottish companies
- registration practicalities
- points of detail

2. Problems from recent legislation

a. Attachment of charge by receivership

Council Regulation (EC) No.1346/2000 on insolvency proceedings introduced a new general regime for cross-border insolvency throughout the EU and as part of this new regime altered the basis on which insolvency proceedings might be commenced in the Scottish courts.

Since May 2002 it has not been possible to commence winding up or certain other insolvency proceedings in Scotland in relation to an insolvent company with its “centre of main interests” in the EU unless that “centre of main interests” is in the UK or it has an “establishment” in the UK, even if the company in question is incorporated in Scotland. It was formerly possible to commence winding up proceedings in Scotland in relation to a company without significant links to Scotland other than the presence of assets in Scotland owned by that company.

Section 51 of the Insolvency Act 1986 permits a receiver to be appointed to enforce a floating charge granted by a company which the Court of Session in Scotland has jurisdiction to wind up and this section was not amended to take account of this EU Regulation.
It thereupon ceased to be possible to appoint a receiver in Scotland to enforce a floating charge covering assets located in Scotland if the granter of the charge had its “centre of main interests” in the EU but that “centre of main interests” was not in the UK and it had no “establishment” in the UK.

This is not uncommon as, for example, an Irish property investment company holding significant investments in Scottish property may readily have its “centre of main interests” in the Republic of Ireland and no “establishment” in the UK (as an “establishment” requires “non-transitory economic activity with human means and goods” – which the courts have confirmed does not include passive holding of assets). As at May 2002 it therefore ceased to be possible to enforce a floating charge granted by such a company over its Scottish assets by appointing a receiver.

We believe this was an inadvertent change in law caused by the EU Regulation and consider that Section 51 of the Insolvency Act should be amended by deleting the requirement in that section that the Scottish courts have winding up jurisdiction over a company in order that a receiver may be appointed to enforce a floating charge in respect of its Scottish assets.

b. **Attachment of charge by liquidation (winding up)**

Liquidation is the main alternative to receivership by which to cause a floating charge to attach to charged assets under Scots law. Clause 38 of the Bill reflects the current Section 463 of the Companies Act 1985 in this regard.

Given the restrictions of Scottish liquidation jurisdiction under the EU Insolvency Regulation mentioned above, it is more likely than formerly that a relevant company will be subject to a liquidation in another EU country rather than in the UK. It would consequently be helpful to clarify that liquidation for the purposes of Clause 38 is not intended to be restricted to liquidation in England or Scotland as the cross-reference in Clause 38 to Section 247(2) of the Insolvency Act 1986 is not completely clear on the point. This would clarify, for example, that the liquidation in the Republic of Ireland of the company mentioned in the example above would cause the floating charge over the Scottish assets to attach to them – as it would on a liquidation in Scotland of that company, were such a liquidation possible.

It is suggested that Clause 38 be amended to cross-refer to “winding up proceedings” as defined in the EU Insolvency Regulation as this would ensure that all EU proceedings considered analogous to liquidation in the UK would trigger attachment of a floating charge over Scottish assets. Further generic reference to non-EU winding up proceedings may then also be beneficial.
c. **Attachment of charge following administration**

The only other basis on which a floating charge will attach to charged assets under Scots law is when an administrator appointed to the company has lodged a notice to such effect with the registrar of companies under paragraph 115(3) of Schedule B1 to the Insolvency Act 1986 following his conclusion under paragraph 115(2) that the company has insufficient property to enable a distribution to be made to unsecured creditors in general. This provision was introduced from September 2003 by the Enterprise Act 2002.

It would be worth clarifying that an administrator appointed to an English, Northern Irish or foreign company is entitled to lodge such a notice and whether such notice should be lodged with the registrar of companies in Edinburgh, Cardiff or Belfast. It should be noted in this regard that paragraph 2(4) of the Insolvency Act (Amendment) Regulations 2005 (SI 2005/879) clarified the potential availability of administration proceedings in Scotland and England in respect of foreign companies.

Given the increased significance of attachment indicated below, it is arguable that a floating charge should, instead, simply crystallise automatically on any appointment of an administrator, though it may then be necessary to consider “decrystallisation” of the charge on success of the administration.

d. **Attachment of charge to parts of assets charged**

Section 51 of the Insolvency Act 1986 permits appointment of a receiver “of such part of the property of the company as is subject to the charge”. Conventional opinion indicates that this does not permit appointment of a receiver to only some of that part of the company’s property which is charged. Thus when all of a company’s property is charged by a floating charge it is thought that a receiver may not be appointed only to some of that property, for example only debts payable to the company or a given branch operation. Banks and borrowers have lived with this inflexible situation and the fact that such appointments to parts of a company’s charged assets is competent in England but not Scotland. Though we have no specific evidence, it is indeed possible that businesses have been lost through a full receivership of all of their assets where they might have survived had receivership of part only been possible.

Section 72A of the Insolvency Act 1986 was introduced by the Enterprise Act 2002 with effect from September 2003 and for most purposes prevents the appointment of a receiver to the entire assets of a company – in line with the UK Government’s objectives in the Enterprise Act of encouraging the use of administration rather than “administrative” receivership as a route to rescue businesses. As most floating charges are granted over all of a company’s assets, Section
72A has, however, rendered most floating charges unenforceable in Scotland by receivership as Section 51 does not permit appointment of a receiver of part only of the assets charged. We believe this was again an inadvertent consequential effect of legislation with a different general purpose and it should be noted that it applies to floating charges granted by both UK and foreign companies.

It is suggested that Section 51 of the Insolvency Act 1986 be amended to make it clear that it is competent to appoint a receiver of a part or parts of the assets charged by a given floating charge as this will enable a floating charge to be enforced and to attach to relevant assets in situations in which it is not necessary for the company in question to go into liquidation or administration. Some consequential amendment to relevant secondary legislation may also be required.

e. Old view of receivership as insolvency process

We believe that many of these problems have arisen from the view which seems to have been taken when receivership was introduced to Scots law in 1972 that it was an insolvency process rather than a method of enforcing a security. The reforms to receivership brought in by the Enterprise Act 2002 and the exclusion of receivership from the “insolvency proceedings” subject to the EU Insolvency Regulation make it clearer than ever that receivership is indeed a method of enforcing a security and not an insolvency process and that it should not, therefore, be treated as if it were an insolvency process in the manner indicated above.

f. Increased significance of attachment

These issues will be of even greater significance under the new Bill than at present as Clause 34(1)(b) relates the ranking of a floating charge to its attachment. The corresponding Section 464(3) of the Companies Act 1985 does not relate ranking to attachment to the same extent.

g. Westminster legislation

It is possible that some of the comments made in this paragraph will require UK primary legislation by the Westminster Parliament and it is suggested, given the urgency of some of these issues and the increased difficulties possibly created by the Bill itself, that the possibility is explored as a matter of urgency of adding relevant provisions to the Company Law Reform Bill currently before the Westminster Parliament.
3. **Registration by non-Scottish companies**

Under Part XII of the Companies Act 1985, floating charges require to be registered in Scotland if granted by Scottish companies or by companies incorporated outside Great Britain and having a place of business in Scotland. Floating charges granted by English companies (including those relating to Scottish assets) currently require to be registered in England under Part XII of the Companies Act. This registration system, with reference to the person granting the charge rather than the assets charged is well known both to those granting charges and those dealing with companies in the UK, whether such companies are based otherwise in the UK or coming from abroad. Those granting charges therefore know where to register their charges and those dealing with companies who may have granted charges know where to look for them.

Although Clause 32 of the Bill is not explicit on the subject, it would appear that registration in Scotland of a floating charge will be necessary in order to create a floating charge over assets located in Scotland or otherwise governed by Scots law wherever the granter of the charge is incorporated and wherever it is otherwise based. It would also appear that a Scottish company would not require to register in the new register in Scotland a floating charge granted over English or other non-Scottish assets.

Registration of charges with reference to the assets charged, as in Clause 32 of the Bill, is commonplace regarding assets which are themselves registered, such as land. It is also likely to be foreseen by those granting and searching for charges where the charge deals with specific identified assets, such as fixed equipment in a factory. It is more problematic when the assets charged are intended to fluctuate from time to time, as is one of the principal purposes of a floating charge, and the more so when such fluctuating assets may or may not include Scottish assets from time to time.

Clause 32 is therefore likely to cause problems for English and other non-Scottish companies which routinely grant floating charges which do not at the time they are granted include Scottish assets but which subsequently do so when Scottish assets are acquired by the granter of the charge. It would appear that such a floating charge would no longer be valid in relation to such Scottish assets until registered in relation to such assets. In very many cases the holder of the floating charge will be unaware that this has happened and unable to protect its position by registering the charge. The granter of the charge may also be unaware of the need to register a charge in Scotland in situations where the assets charged fluctuate frequently or where the law governing the asset in question is not clear (as is not uncommon in certain types of business). This is likely to lead to precautionary registration in Scotland of all floating charges granted by any company based anywhere which is thought may at any time in the future have Scottish assets – where the holder of the charge happens to become aware that this type of charge registration regime exists in Scotland.
Registration of floating charges under Part XII of the Companies Act (as that regime is also scheduled to be substantially amended) appears likely to continue in parallel for Scottish Companies to the new regime under the Bill, increasing the administrative burden on those granting and holding floating charges. It should, however, be noted that those dealing with a company are far more likely to search a register organised with reference to the company when looking for charges granted over fluctuating assets of various types than they are to assume a register will exist which is organised with reference to assets having such characteristics and which may not themselves be registered.

4. Registration practicalities

a. Registering the charging document

The charge registration regime under Part XII of the Companies Act is rightly criticised for difficulties it raises in summarising charging documents for the purposes of submitting particulars for registration and submission of charging documents is sometimes proposed as the solution to this. Clause 32 of the Bill adopts this solution.

This should work quite well for the large numbers of short stand-alone standard form floating charges which are used in smaller and more standardised transactions. In larger and more complex transactions and in many cross-border transactions this may raise more problems than it solves as the documentation of floating charges in such transactions is often set out by cross-reference among a number of documents. Each of these documents may be more than a hundred pages long and contain floating and other charges granted by entities operating in various countries and contain various other unrelated provisions and commercially sensitive information, the publication of which by registration could not readily be justified. As currently drafted, Clause 32 may lead to the need to restructure the current convenient manner in which floating charges over Scottish assets can be included in these types of transactions or may lead to the register becoming largely incomprehensible to a third party considering a floating charge of this type on the register.

It is suggested that instead of registering the charging document, only particulars relating to any specific assets or the types of assets charged should be registered. Summarising this information does not normally cause significant problems when registering charges under Part XII of the Companies Act as it is normally relatively clear and concise in charging documents. It is also the information which a third party really needs to know when acting relative to the assets of a company.
Problems arise under Part XII of the Companies Act in summarising information regarding secured obligations and ranking provisions. Secured obligations normally fluctuate over time and are often expressed in a such a way as to make it difficult even from their full initial terms to assess their amount at any given time without further information from the granter or holder of the charge. It is also now highly unusual for a floating charge not to contain the maximum statutory ranking protection against later third party interests and such third parties now assume this is the case. This leaves ranking provisions as summarised in Part XII particulars now relevant largely only to the parties to those ranking provisions, who should know what they are anyway. It is suggested that if the new register is intended to provide third parties with information on secured obligations or ranking provisions in floating charges or as regards other terms of floating charges, it would be preferable to require the granter of the charge to provide copies to third parties for an appropriate fee and subject to appropriate safeguards regarding commercial sensitivity of information which may be disclosed.

If only particulars are to be registered under Clause 32, it would then be possible if advance notice of a charge has been lodged under Clause 33 of the Bill for particulars under Clause 32 merely to confirm those previously lodged under Clause 33.

b. Advance notice filing

Clause 33 of the Bill is to be welcomed, as without its backdating effect of actual registration of a charge timing problems would arise similar to those relating to transactions in Scottish land, where events between cash settlement of a transaction and registration are effectively covered by the guarantee solicitors conventionally give in “letters of obligation” to other parties’ solicitors backed by their insurance cover. This regime in Scottish land transactions is, of course, itself overdue for reform.

Similar gaps could occur on the assignation, alteration and discharge of floating charges by registration under Clauses 35, 36 and 37 of the Bill, where it will be routinely necessary to make payments before the relevant changes on which the payments rely become effective by registration. It is suggested that the advance notice filing regime is extended appropriately to cover these situations.

5. Points of detail

a. Security Trusts

Clause 32(1) should be amended to clarify the current concern that a security trustee holding a floating charge for a syndicate of lenders may not be “the creditor in the [secured] obligation”.


b. **Notice of subsequent security**

Clause 34(7) does not prevail over Clause 34(5) whereas the predecessor Section 464(1) of the Companies Act 1985 prevailed over the corresponding Section 464(5). We are not aware of any fully-discussed policy change restricting the preference of a floating charge in relation to later securities notified to the holder of the floating charge and this would have serious commercial consequences which should be carefully considered.

c. **Consents to postponed ranking**

It will often be inconvenient to require an existing secured creditor who agrees to be postponed to a new floating charge to sign the floating charge itself to become postponed as required under Clause 34(8) of the Bill. It would be preferable also to permit this agreement to be set out in a separate document which could, if it were thought necessary, itself be registered.

d. **Assignment of Charges**

As clause 35(3) of the Bill provides for alternative modes of assignment of floating charges to registration under Clause 35(1) a mechanism would seem to be required to determine conflicts between these sub-clauses.

e. **Release of assets from charge**

Clause 36(3) of the Bill should be amended to make it completely clear that disposals of charged assets in the ordinary course of business or as otherwise anticipated in a charging document do not require to be registered as alterations to the floating charge.

f. **The Financial Collateral Arrangements (No.2) Regulations 2003 (S.I. 2003/3226)**

Amendment may be required to these regulations or the Bill to take account of their potential interaction and in particular the disapplication by the regulations of certain registration requirements concerning certain floating charges.

**Tods Murray LLP**

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