In early 2007 an Act of the Scottish Parliament entitled the Bankruptcy and Diligence etc (Scotland) Act 2007 ('BAD') was passed which largely introduced changes to personal insolvency and diligence. However, Pt 2 of BAD has created a little frisson of excitement for banking lawyers as it introduces an additional register of Floating Charges (the 'BAD Register').

The provisions of BAD in respect of the BAD Register slipped into the statute book in a relatively low-key manner. However, if those provisions come into force in their current form, there are some concerns that this new legislation might cause some cross-border headaches.

Following the briefest of Scottish history lessons on floating charges we shall consider the 'who, why, what, where and when' of the new BAD Register and identify potential headaches.

KEY POINTS

- From (est) 2011 it is proposed that a floating charge will need to be registered in a new Register of Floating Charges in Scotland to provide effective security over Scottish assets.

- A new register is to be maintained by the Keeper of the Registers of Scotland.

- There will be implications for, in particular, taking English-law governed debentures from Scottish companies.

- Scottish floating charges will benefit from an advance filing regime -- the date of creation of the security will be back-dated to the date of registration of the relevant advance notice (the charge needs to be registered within 21 days of registration of the notice to qualify).
RECENT HISTORICAL BACKGROUND

The notion of a floating charge was imported into the law of Scotland in 1961 to enable Scottish companies to have access to commercial funding on a similar basis to that access enjoyed by other GB companies. Before such introduction, generally rights in security could not be granted over Scottish assets (ie assets located in Scotland, rights governed by the law of Scotland and those rights/assets whose creation and/or enforcement is governed by the law of Scotland) which were corporeal moveable without delivery of those assets.

Like companies registered in England & Wales (‘E&W’), Scottish companies register charges granted by them with the Registrar of Companies but the office for submission is in Edinburgh (‘CH Edinburgh’), not Cardiff.

WHOM DOES IT AFFECT?

Potentially, any company granting a floating charge over Scottish assets wherever it is incorporated.

The legislation applies to any ‘company’ which grants a floating charge and ‘company’ is defined as an incorporated company (whether or not a company within the meaning of the Companies Act 1985).

WHY IS IT BEING ESTABLISHED?

The evolution of the BAD Register appears to have been fuelled principally by two concerns.

REMOVAL OF INVISIBILITY PERIOD FOR CHARGES

A general review of the security registration system in Scotland and E&W took place in 2004/5, which noted that the registration system was ‘widely regarded as unsatisfactory’, particularly in the context of the 21-day ‘invisibility period’:2 as a result, a search of the Register of Charges at Companies House cannot be relied upon as indicating the absence of a prior ranking floating charge (whether with or without a ‘negative pledge’ provision) or whether that charge had attached/crystallised. A particular focus of the review was whether the UK should mirror other jurisdictions and introduce advance filing of charges.

‘UNDOING’ SHARP V THOMSON

The Scottish case of Sharp v Thomson was decided by the House of Lords in 1997 which, if it had been widely construed, would have potentially imported the foreign concept of equity into Scotland.

It appears a little ironic that:

- the Law Commission of E&W considered the introduction of, among other things, the advance notice filing regime3 (which allows filing by advance notice -- in advance of execution and delivery of the charge -- followed by a 21-day period in which to register the charge) but it appears that, despite advance filing being recommended, the related consultation has been archived so we do not expect mirroring legislation in E&W soon, despite its proposed uptake in Scotland. There is a concern that if advance filing is not being contemporaneously introduced in E&W then there is an inconsistent, non-reciprocal approach in the UK to security registration. This might easily cause confusion, registration mistakes and potential for dispute between the respective private laws of those jurisdictions; and

- subsequent case law has clarified that Sharp v Thomson is to be very narrowly interpreted
and the decision only applies to Scottish floating charges rather than applying to the law of Scotland generally.

If the Scottish Law Commission recommendations\(^4\) were accepted and implemented, for notice of attachment to be registered in the BAD Register before a floating charge 'attaches' (in the event of appointment of a receiver, coming out of administration and going into liquidation) even greater transparency and fairness for third parties dealing with companies would be achieved.

WHERE DO FLOATING CHARGES OVER SCOTTISH ASSETS NEED TO BE REGISTERED?

One of the main surprises in respect of the BAD Register is that floating charges are to be registered with the Keeper of the Registers of Scotland. The Keeper is the official responsible for maintaining registers of title to Scottish real estate and related interests. Unlike the E&W Land Registry, these Scottish Property Registers currently do not accept noting of floating charges or registration of debentures.

From a practitioner's perspective, it is disappointing that the BAD Register is not to be kept by CH Edinburgh. After all, that is the Register where everyone currently sends, and searches for,\(^5\) charges granted by Scottish companies and those overseas companies required to register particulars of charges to CH Edinburgh for inclusion in the Slavenburg Index.\(^6\) If CH Edinburgh maintained or, at least, populated the BAD Register, current floating charge registration practice could continue, almost seamlessly, for those companies with the added benefit of the advance filing regime.

It appears that the reason for the Keeper being allocated the BAD Register is Scottish Devolution: Scottish floating charges are, except in limited respects, a matter devolved to the Scottish government. The view taken is that, since the Registrar of Companies is a 'reserved' official (an official for whom Department of Business & Regulatory Entreprise ('BERR') and \textit{not} the Scottish government is responsible), it would be inappropriate for that official to maintain the BAD Register. There is no arguing with the political reasoning but the author's view is that spending time on a cross-border 'fix' might be worthwhile: it seems to make practical and financial sense for the Registrar of Companies in Edinburgh, who is well-experienced in all things 'floating charge', to take all necessary information for his own file and for the BAD Register (whoever maintains it) while checking the (successor to) Form 410 (Scottish Form 395 equivalent) and accompanying documentation. Such an approach would appear to be more efficient in the long term.

Assuming BAD maintains its current trajectory, practitioners are likely to be instructed that, from the appointed date, floating charges granted by E&W companies/overseas companies charging Scottish assets should be sent to the Keeper (which is clearly not a present requirement). One solution might be for details of each security document submitted to the Registrar of Companies in Cardiff which contains a floating charge to be automatically populated into the BAD Register by Companies House Cardiff and for a full electronic copy of that document to be linked to the BAD Register by the Cardiff team.\(^7\)

Of course, there are political and technological hurdles to achieving a joined-up registration solution and getting 'conversation' between the Registrar of Companies in Edinburgh/Cardiff and the Keeper could prove a challenge despite the common aims of increasing transparency and avoiding a 'double-registration requirement' (ie registration with the Registrar of Companies and with the Keeper).\(^8\)

... 

\begin{itemize}
  \item Floating charges granted by Scottish companies and by overseas companies with Scottish assets or a place of business in Scotland still need to be registered with CH Edinburgh although BERR are working on proposals which, if brought into force, would remove the burden of double registration;
  \item Ranking arrangements (deeds of priority in Scottish form) would need to be registered in
the BAD Register in respect of the Scottish floating charges affected in order to be valid (replacing the requirement to file Forms 466 with CH Edinburgh in respect of such arrangements);

· Documents altering a floating charge, affecting the property subject to the charge or the obligations secured by the charge would need to be registered in the BAD Register in order to be valid; and

· A notice of attachment needs to be registered in the BAD Register by the chargeholder to make the floating charge attach to the company's undertaking -- this notice only applies where insolvency proceedings are opened in another member state (publicising the attachment) -- otherwise it attaches when a company goes into liquidation.

A new facility is being introduced to enable an assignation (assignment) of a Scottish floating charge to be published on the BAD Register but failure to register does not appear to invalidate the assignation provided the assignation is assigned in accordance with any other applicable rule of law or any other enactment.

WHEN WILL PT 2 COME INTO FORCE?

Good news: Pt 2 is currently not expected to come into force until 2011.

HEADACHES

HEADACHE 1: WHAT FORM DOES THE FLOATING CHARGE TAKE?

Part 2 of BAD indicates that the document which creates the floating charge needs to be registered in the BAD Register. This is not as easy as sending in a certified copy to the Registrar of Companies in Edinburgh (current Scottish filing requirement) with particulars but is not unduly onerous in practice as many practitioners regularly submit original documents to the Registrar of Companies in Cardiff and to the Scottish Property Registers.

However, the legislation indicates that the charge, in order to be created, needs to be 'subscribed' by the company granting the floating charge. Subscription is Scottish terminology for execution. Scotland has its own legislation, the Requirements of Writing (Scotland) Act 1995, which governs formal validity of Scottish documents.

The suggestion that every company must 'subscribe' might suggest that:

· if the floating charge is signed by a director, company secretary or authorised signatory of the company concerned (the minimum requirement to make it binding[9]) that it can be registered in the BAD Register; or

· the floating charge needs to be in the form of a Scottish law floating charge and comply with all Scottish law execution and formalities requirements.

The former would be good news; the latter (which is, from commentary reviewed, the more likely intention) could result in more acute repercussions for practitioners (see Headache 2 below).

The Keeper's Office conducts admirable due diligence on documentation it receives. If the Keeper's Office is
satisfied the document submitted for registration is not in the correct format, has incorrect particulars or is not signed in accordance with Scottish requirements it is returned to sender, unregistered. A decision will need to be made as to whether this level of due diligence will apply to the BAD Register.

A Scottish law floating charge is different from floating charges in other jurisdictions in a number of legal respects (for example, a Scottish floating charge cannot 'attach' or crystallise simply by the serving of notice on the company). Oddly, it is Scottish formalities for the execution of documents which are, from a practitioner's perspective, sometimes problematic on transactions and, if not properly managed, leave open opportunities for completion blunders on execution, particularly on transactions where documents are being signed in jurisdictions other than Scotland.

By way of example:

- Scottish documents cannot be executed in counterpart -- additional time will be needed to complete the transaction if the floating charge is a bilateral document (still the fashion) rather than a unilateral document.

- Some text needs to be included on the signing page (ie a separate execution page is not acceptable).

**HEADACHE 2: WILL IT BECOME A MATTER OF PRACTICE FOR A SCOTTISH FLOATING CHARGE TO BE TAKEN FROM EVERY UK/OVERSEAS CORPORATE BORROWER/CHARGOR?**

Due to the nature of assets, how can a banker or a lawyer tell that valuable/key assets of a borrower company (i) are currently located in Scotland; or (ii) are going to be located in Scotland in the future? Scottish real estate held at the time of completion is usually relatively obvious. However, assets can be moveable (such as construction vehicles) and can find themselves moving from one jurisdiction to another to fulfil different projects. In the future, a borrower might buy Scottish assets (including Scottish real estate). The answer is one cannot tell. To cover off the eventuality lawyers might:

- review their 'Further Assurance' clauses in their facility/security documents to ensure that the borrower company is under a covenant/obligation to advise the lender if Scottish assets are acquired and to grant promptly (at least) a floating charge over those assets to the lender; and

- adopt the practice of including a short-form Scottish floating charge as a schedule to their English law debenture and that Scottish floating charge (the 'Schedule Charge') would be required to be 'advance filed', executed and delivered as a condition precedent to drawdown.

An alternative to the Schedule Charge would be taking a 'hybrid' debenture covering execution requirements of both jurisdictions but the author thinks the Schedule Charge approach is likely to be less cumbersome.

It appears to remain current practice for a number of E&W law firms to include Scottish chargors in an omnibus debenture without considering taking separate Scottish security. That is a practice which might be revisited in the wake of BAD: Absent a BAD-registered floating charge, if there is a dispute over Scottish assets which ends up in the Scottish courts those courts (on current interpretation of the enabling legislation) would appear to be entitled to find that Scottish mandatory provisions for the creation of a floating charge have not been satisfied. If that were the case, effective floating charge security over Scottish assets would not have been created by such an omnibus debenture. 'Practical' solutions might be employed such as moving assets across the Scottish/English border -- unfortunately that would not work for Scottish incorporeal rights such as Scottish shares and Scottish contractual rights.
From experience of cross-border transactions, most London City practitioners are aware that a debenture is not going to give fixed charges over Scottish assets. The awareness is highest in respect of Scottish real estate -- a standard security being mandatory to give a fixed security over Scottish real estate.

Post-Pt 2 implementation, practitioners will be thinking about whether a Scottish floating charge ought to be taken. There might be a hidden benefit: as advance filing effectively backdates the date of the floating charge your Scottish floating charge might pre-date your English law debenture. An earlier date of creation might prove beneficial in, admittedly, limited situations where the debenture is potentially subject to challenge under ss 238 et seq. of the Insolvency Act 1986 (or similar legislation in other jurisdictions). The date of creation of your Scottish floating charge could be outside the 'clawback' timeframe. Whether Scottish or non-domestic insolvency law would recognise the statutory 'date of creation' of the charge\(^{10}\) as the effective date for those purposes or the later date of execution of the charge would remain to be seen.

Once Pt 2 is in force, practitioners are likely to be more alive to mention of Scottish chargors/Scottish assets by customers. Currently it is not unheard of that the existence of Scottish borrowers/chargors is identified late in the day, on the odd occasion on the eve of completion. It is not difficult to spot a Scottish company -- 'SC' before the company number is a giveaway and, if the 'SC' has been inadvertently omitted, checking the name/company number supplied for the company at Companies House will indicate whether the company is incorporated in Scotland.\(^{11}\)

Scottish lawyers tend to get instructed when a Scottish borrower/chargor/guarantor is identified or where there are conspicuous Scottish assets (ie Scottish real estate). Scottish lawyers describe to the bankers that the usual, comprehensive Scottish security package would include:

- a Scottish law floating charge from the company;
- standard securities over heritable (ie freehold equivalent) and long leases (a long lease is a lease with a term of 20 years or more);
- an English law debenture if there are likely to be substantial assets in E&W (you might catch some assets with a fixed charge);
- Scottish shares pledge (rough equivalent of a full legal mortgage over shares); and
- disclosed assignations of contractual rights (in security).

**Headache 3: Advance Filing Regime**

Advance filing is a regime which is very appealing to lawyers (the date of the creation of the charge is 'backdated' to the date of registration of the advance notice). Given **Headache 2**, advance filing is likely to be **Headache 3** when it is one of those completions which slips, and slips, and slips ... then slips again. Rather annoyingly from a practitioner's perspective, the notice needs to be signed by both borrower and lender.

There does not appear to be any facility to re-new an advance notice filing but (to address that concern) there does not appear to be any restriction on submitting more than one advance notice.\(^{12}\) Lawyers will be switching their 21-day post-completion registration paranoia for checking (on the run up to completion) their advance notice has enough 'life' left to enable registration within the 21-day time limit. The paranoia will not be quite as acute as, absent an advance notice (and given the advance notice appears not to be compulsory),\(^{13}\) the floating charge would still appear to be valid if filed outside the notice time-limit provided it is registered within the 21-day period prescribed by the Companies Acts.
However, if a charge misses its priority window (which is conceivable where transactions are 'tools down' then reactivate a day or so before the intended 'hard' completion date) there might be a potential issue where an advance notice of a charge is filed before, or at the same time as your charge and, as a result, that new charge ranks ahead of/equally with your charge if it is filed within the priority period afforded by its advance notice.

**HEADACHE 4: TREATMENT OF INSOLVENCY**

All rights in security become most interesting in the event of insolvency. There are a number of insolvency considerations in the wake of Pt 2 implementation.14

· Absent a BAD-registered floating charge, the onus would be on potential and actual GB administrators and liquidators to decide, following due diligence, whether an English law Debenture post-dating such implementation gives the creditor effective security over those Scottish assets within the undertaking of the company concerned.

· Administrators might take additional care in acceptance of their appointment as administrator if such appointment is on the basis of a 'qualifying floating charge', the company concerned has significant Scottish assets, a BAD-registered floating charge is not in place and such Scottish assets are not subject to effective Scottish fixed security -- does that 'qualifying floating charge' remain qualifying?

· Difficulties are most likely to arise if there is a dispute in respect of Scottish assets as the Scottish courts' position is likely to be that a floating charge by an English registered company which has not been BAD-registered is ineffective as floating security over Scottish assets. The English courts in an English liquidation might say that the charge is a perfectly valid and effective charge under the laws of England. Competing secured creditors 'in the know' might take action in the courts of either jurisdiction to challenge the 'lack of security' by the prior ranking creditor with a view to improving their own position. Legislative clarity on the cross-border implications would be beneficial rather than leaving the matter to be solved by a future series of expensive litigation.

· Hopefully *Re Anchor Line*15 might act as a cross-border sticking plaster for English companies with Scottish assets. If it does, it might be arguable by lenders in the English courts, absent complicating factors such as competing chargeholders/third party interests, that they have rights to the proceeds of sale of the Scottish assets via their (valid) English law Debenture which purports to take security over those proceeds, even where the lender has not taken effective security over Scottish assets. However, that decision is of some considerable vintage and its application might be very limited in post-Enterprise Act culture. In the case of competing parties, the courts are unlikely to be as conciliatory today, where it is normal practice for lenders to protect themselves by taking legal advice about which security and registrations are required or desirable. From a Scottish law perspective, competing parties would seem to have a much stronger position than any lender finding themselves without a BAD-registered floating charge over Scottish assets. The lender might end up with the sale proceeds (if any) left after the competition and the various insolvency practitioners have been paid in full.

· There is the added complication for companies subject to the EC Regulation on Insolvency Proceedings: if the 'centre of main interests'16 of a UK company shifts from its jurisdiction of incorporation to another EU member state -- how that jurisdiction will view the lack of a Scottish law compliant floating charge over Scottish assets in main insolvency proceedings is an
unknown quantity.

**HEADACHE 5: COST**

Implementing a new register does take time, effort and money and there is a relative cost. It is understood that the likely registration fee might be in the region of £30 per BAD floating charge. That fee would be in addition to the Registrar of Companies filing fee for a charge (currently £13). These costs would be passed onto the borrowers by lenders. On deals involving numerous property special-purpose vehicles it is easy to see that the registration/filing costs could become chunky when compared with present-day registration costs.

**CONCLUSION**

The Scottish registration system seems to be moving fast in the right direction (by, perhaps, a more circuitous route than is ideal due to political, technological and practical hurdles) to give third parties dealing with a company a much more fair and transparent way to know if prior ranking or competing floating charges have been granted or have attached which, of course, would prejudice their rights. As a result, the 'invisibility period' should be minimised significantly.

Implications for overseas companies are probably less exciting as Scottish lawyers tend to be engaged early in overseas transactions and overseas counsel tend to positively expect, and be forgiving of, local security requirements.

There are a number of cross-border issues to iron out and a number of stakeholders are actively engaged with lenders, businesses, practitioners and other interested parties with the aim of bringing in this legislation in a joined-up manner. Those implementing the legislation are very open to discussing proposals with interested parties. There is awareness that the introduction of a new system in Scotland ahead of E&W will have cross-border impact, including, potentially, those mentioned above. Mirroring reciprocal arrangements have been enjoyed by the jurisdictions of Scotland and E&W for a few decades but, in this case -- no pain, no gain?

---

1 The process whereby a creditor who holds an unsatisfied Scottish judgment (or equivalent decree in registration) for payment can enforce that judgement/decree against the assets of his debtor.


5 Searches are also carried out at the Scottish Property Registers in connection with Scottish real estate transactions as standard securities which are historic (but remain on the Register) or which have not been filed at CH Edinburgh may still show up.

6 Such companies would continue to need to file particulars with the Registrar once Pt 6 of The Overseas Companies Regulations 2008 comes into force.

7 It would be undesirable for floating charges registered in Cardiff not to disclose the same details as those charges being directly registered in the BAD Register.
Pursuant to the fourth principle of Reducing Administration Burdens, Effective Inspection and Enforcement, 2005 Philip Hampton, that 'businesses should not have to give the same piece of information twice'.

There are additional requirements to give the signature 'self-proving' status -- providing a rebuttable presumption in Scottish court proceedings that the document was executed in the manner and at the date and place described.

Section 39(3) of BAD.

Companies House Online in the UK provides details of, among other companies, those incorporated in Scotland -- this might appear obvious but my experience on cross-border transactions generally suggests it does merit mention.

Concerns were raised during consultation that the BAD Register would be 'cluttered' with advances notices but it was thought the bilateral nature of notice would mitigate this potential problem.

Section 39 of the Act provides that the company and the potential chargeholder 'may' (not must) apply to have a joint notice of the proposed charge registered in the BAD Register.

Comments assume that centre of main interests ('COMI') remains in the UK.

Re Anchor Line (Henderson Bros) Ltd [1937] 2 All ER 823.

COMI is ascertained pursuant to the EC Regulation on Insolvency Proceedings.