

Response to Discussion Paper on Heritable Securities: Pre-default (No. 168)

This response is provided by a working group of the Centre for Scots Law at the University of Aberdeen. The working group consists of Mr Malcolm Combe, Dr Alisdair MacPherson, Mrs Donna McKenzie Skene and Dr Euan West.

General Comments

We approve of the decision to review the law of heritable securities. It is an important area of law that is in need of reform and the Discussion Paper contains much useful material and many useful suggestions that would constitute improvements on the current law.

We welcome the opportunity to respond to the Discussion Paper. We agree that it is sensible to divide the project into two Discussion Papers, with one focused on general and conveyancing matters (“Pre-default”) and the other dealing with enforcement (“Post-default”) – the present Discussion Paper is already lengthy and contains a considerable number of questions. However, as is acknowledged in the Discussion Paper, pre-default matters and enforcement are inextricably linked in certain respects and, therefore, our answers to various questions also depend upon what the Enforcement Discussion Paper contains. Our response should be read with that caveat in mind.

References below to the Land Register are also references to the General Register of Sasines where appropriate.

1. What information or data do consultees have on:

(a) the economic impact of the current legislation on heritable securities in relation to pre-default issues, or

(b) the potential economic impact of any option for reform proposed in this Discussion Paper?

(Paragraph 1.34)

We do not have detailed evidence or examples on these points – we are not active practitioners. But, in principle, the possible reforms outlined in the Discussion Paper would modernise the law and bring greater clarity, which would be advantageous for parties using the law and, more broadly, would be positive economically.

2. The Conveyancing and Feudal Reform (Scotland) Act 1970 should be repealed and replaced with a new statute regulating heritable securities.

(Paragraph 3.2)

Agreed – the volume of significant changes required make it more sensible and straightforward to repeal the existing legislation and introduce new legislation regulating heritable securities. We suggest that careful consideration will need to be given to the matter of savings/transitional provisions and the extent to which any aspects of the new provisions could/should usefully be applied to existing securities.

3. The standard security should continue to be the only form of heritable security which can be granted.

(Paragraph 3.12)

Yes, so long as the standard security remains flexible enough to meet the requirements of parties wishing to engage in transactions involving heritable property for which security is to be granted. The points made in the Halliday Report (leading to the 1970 Act) regarding the simplicity and uniformity of the law where there is only one heritable security continue to apply. There are obvious disadvantages of having a fragmented system. It is also desirable for there to be consistency with the existing law.

Care should be taken to make sure that the continued operation of a floating charge in relation to heritable property is not affected. If necessary, floating charges could be mentioned expressly as continuing to have effect.

Section 9 of the Conveyancing and Feudal Reform (Scotland) Act 1970 (especially s 9(3) and (8)) is unclear in a number of respects and future wording should be more easily understandable, including with respect to what is meant by a standard security being the only heritable security which can be granted.

4. It should remain incompetent to transfer land in security.

(Paragraph 3.13)

Yes, as per answer to question 3.

5. Should any transactions other than transfers in security be prohibited to ensure that a standard security is used instead?

(Paragraph 3.15)

Yes. Given the advantages of a standard security being the only form of heritable security which can be granted (noted at question 3 above), it should not be possible to use functional securities to circumvent this. As such, the use of trust mechanisms for giving functional security in relation to land should be prohibited. A new provision should give clarity on the proscription on the use of functional securities in this context.

6. The term “standard security” should be retained.

(Paragraph 3.20)

Agreed. It provides consistency with the existing law. Parties involved in heritable security transactions have an awareness of the term and its meaning. There are considerable points of confusion and/or little advantage to be gained in using any of the other terms proposed.

7. Should there be a non-accessory form of standard security?

(Paragraph 3.27)

No. There is no obvious reason to change the current position, so long as the standard security is somewhat flexible in terms of accessoriness.

As well as further points below, there are certain issues regarding the accessoriness of standard securities that should be considered in the Enforcement Discussion Paper. These should include, for example, whether there is a continued ability for a standard security holder to enforce if a corporate debtor has been dissolved and the encumbered property was earlier transferred to another party (i.e. the question of whether the dissolution extinguishes the debt and therefore also extinguishes the right of enforcement of the standard security).

8. (a) The grantor of a standard security (and any successor) should not require to be the same person as the debtor in the secured obligation.

Agreed.

(b) The grantee of a standard security (and any successor) should not require to be the same person as the creditor in the secured obligation.

(Paragraph 3.40)

Agreed.

We consider that a flexible and commercially-focused approach is appropriate here (despite the possible intrusion upon the accessoriness principle, on a strict analysis of that doctrine). Any new legislation should probably make it clear that the above-noted arrangements are possible and, if necessary, have specific provisions facilitating such arrangements.

Some attention should also be given to whether there ought to be publicity requirements with respect to the party to whom the obligation is owed, where that party differs from the standard security holder (e.g. the identification of the creditor in the Land Register). It may be useful to third parties seeking to deal with the company, the encumbered property or the creditors to have such information readily available. It may be justified to adopt different approaches here dependent upon whether a relevant creditor is or is not a trustee but this would require further consideration.

9. Do consultees have any comments on the use of security trustee or nominee arrangements in relation to standard securities?

(Paragraph 3.41)

We have no relevant practical experience on this point and so are not in a position to comment in detail. One contributor to this report does however recall encountering “security trustee” arrangements in various corporate finance situations whilst in legal practice, most notably “restricted asset” situations where a special purpose vehicle was incorporated in relation to a specific enterprise, and that vehicle then furnished collateral (perhaps including heritable assets in Scotland) to funders by way of granting security to a security trustee acting for those funders. That was approximately ten years ago, and as such we are reticent to make too many inferences from that, but from that experience it seems fair to say that making use of a security trustee is far from idiosyncratic.

10. (a) Do consultees agree that the parties to a standard security should continue to be referred to as the “debtor” and “creditor”?

(b) Do consultees agree that “grantor” and “grantee”, and “proprietor” should continue to be used where appropriate?

(Paragraph 3.42)

We note that the current terminology is not strictly accurate in all cases, e.g. if the standard security is held by a party that is not the party to whom the secured debt is owed then that holder should not strictly speaking be referred to as the creditor. However, parties involved in relevant transactions are familiar with the terminology and it makes sense in most cases. It is also difficult to come up with alternative terminology that is accurate in all instances. Perhaps it is best to take into account the terminological issues arising from questions 8 and 9, and in other contexts, and build this in to the interpretation of the terms (whether in an interpretation section or elsewhere). This is done to some degree in the 1970 Act but perhaps not sufficiently. Consistency of terminology should be used as much as possible in any new legislation.

11. Section 47 of the Conveyancing (Scotland) Act 1874 and section 15 of the Conveyancing (Scotland) Act 1924 should be repealed and not replaced.

(Paragraph 3.49)

Yes, this would be a worthwhile clearing up exercise. The provisions are complicated, unclear and serve little useful purpose.

12. (a) It should be competent for a standard security to secure monetary obligations which are owed or which may become owed in the future.

Yes, this is recommended as part of a flexible and commercial-oriented approach.

(b) A standard security should also secure ancillary obligations, in particular obligations to pay interest, damages and expenses (subject to rules governing what expenses are allowable).

(Paragraph 4.33)

Yes.

13. Which of the following approaches do consultees prefer?

(a) Standard securities should not be able to secure non-monetary obligations (but they may secure a damages claim in respect of such an obligation).

(b) Standard securities should be able to secure non-monetary obligations, but in such case it would be the damages claim for breach of the obligation which would actually be secured.

(Paragraph 4.85)

We consider approach (b) to be preferable. It is clearer and neater. A provision in the legislation can outline appropriate legal rules (which may be more difficult for (a)). In certain respects such an obligation would be comparable to a contingent debt, which could be secured by a standard security (see question 12 above).

This is, however, a matter that will need to be revisited in the Enforcement Discussion Paper. There may need to be specific rules on how a non-monetary obligation is to be enforced. This is where a lot of the current uncertainty lies.

14. There should be a separate reform project in relation to making options and similar agreements enforceable against third parties by means of registration. That review should consider other models, such as a special form of standard security which could secure non-monetary obligations and which would have special ranking and enforcement rules.

(Paragraph 4.86)

Yes, agreed.

15. A standard security may only be granted over immoveable property.

(Paragraph 5.4)

Yes, subject to an appropriate definition. If considered desirable, the definition could include reference to certain types of property for which there may be some doubts. What seems to be crucial is that a standard security can be granted over property that is registered (or registrable) in the Land Register (this obviously excludes some types of heritable property).

16. (a) The new legislation should use consistent terminology to refer to the property affected by a standard security.

Yes.

(b) What term should be used?

(Paragraph 5.9)

Encumbered property or security subjects would be fine (albeit that we note the points of difficulty raised in the Discussion Paper regarding terminology here).

17. A standard security may not be granted over a real burden.

(Paragraph 5.15)

Agreed. We note the apparent impossibility of enforcing by sale separate from the benefited property. The same point applies in relation to servitudes. As suggested in the Discussion Paper, it may be possible to enforce in relation to personal real burdens; however, we note the restrictions on doing this and consider that it is probably simpler just to expressly prohibit this in legislation.

18. A standard security may not be granted over a proper liferent.

(Paragraph 5.17)

Yes. To avoid potential uncertainty in relation to the current law, and because of the limited value of a standard security over proper liferents and their rarity, it would be sensible to prohibit standard securities being granted over such interests.

19. (a) A standard security may be granted over a lease, where that lease has been recorded in the Register of Sasines or registered in the Land Register as appropriate.

Yes.

(b) A standard security may not be granted over any other lease.

(Paragraph 5.24)

Yes, on the basis of the law as it currently stands. A standard security is the only voluntary (fixed) security in relation to heritable property that is registrable in the Land Register. This includes only some real rights in land. The real right of lease in relation to shorter leases is excluded, and there would be practical and doctrinal problems if a standard security was to be registered for a type of lease for which there is no registration or recording in the same register. It is a wider question whether shorter leases (or at least some of them) should be registered. This could sensibly be considered as part of the SLC's project on leases.

The inclusion of long leases (as property over which a standard security can be granted) may also be considered in the context of the definitional points noted under questions 3 and 15 above. Perhaps an express statement in new legislation could be included to this effect; however, a provision akin to the current law would obviously have the same effect (given the availability of standard securities over long leases).

The issue of securing a rural lease that falls within a recognised statutory scheme is touched on in the Discussion Paper, as are the reasons why plans to facilitate the use of rural leases as collateral have not been taken forward. That being said, the position in relation to crofting might be worth some particular consideration, especially as there is now a Crofting Register maintained by Registers of Scotland. Admittedly, the likely reluctance of lenders to advance money whilst using a croft tenancy as collateral is a factor that might mitigate any drive for reform, and the (at the very least) tangential impact of a crofter's individual right to buy will also be a consideration before undertaking what might be a relatively complex reform. That being said, the increased access to credit that could flow to the crofting counties on the basis of a reform might be worth revisiting at some point, and as such this issue could be discussed with the Scottish Land Commission and the Crofting Commission, or at least brought to their attention.

20. (a) Should it continue to be possible to create a standard security over a standard security or would it be preferable to allow a standard security to be assigned in security?

We think the current position should be retained. It allows for there to be multiple security rights over the same property. It also adheres with the principle that the standard security should be the only voluntary security over registered (or registrable) heritable property and this type of property clearly includes standard securities.

(b) In either case what should be the rules on enforcement?

(Paragraph 5.30)

“Stepping into the shoes” of the debtor as far as that party’s standard security is concerned may not be too problematic. The standard security is the encumbered “property” and other parties should not lose out, as the “enforcing” party is simply taking control of existing security and rules regarding priority of ranking and distribution remain and can be used in the normal way. For example, A grants a standard security over Whitemains to B, securing debt of £100k (Security 1); B grants a standard security over Security 1 to C, securing debt of £50k (Security 2), and A and B default. C steps into B’s shoes and sells A’s land for £100k. C gets £50k and B gets £50k – any entitlement that C has in relation to Whitemains is limited to the amount of B’s claim against A that is secured by Security 1. Security 2 operates within the confines of Security 1 as Security 1 is the encumbered property.

A variation of the example may also be useful. A grants a standard security over Whitemains to B, securing debt of £50k (Security 1); B grants a standard security over Security 1 to C, securing debt of £60k (Security 2). A grants a standard security over Whitemains to D, securing debt of £50k (Security 3). A and B default. C steps into B’s shoes and sells A’s land for £100k. C gets £50k and D gets £50k – any entitlement that C has in relation to Whitemains is limited to the amount of B’s claim against A that is secured by Security 1. C has a contractual claim against B for the remaining amount due.

Enforcement mechanisms for a standard security over a standard security will need some express provision and tweaking of “normal” enforcement rules but this can be revisited in the Enforcement Discussion Paper. Another means of enforcement could be to allow the holder to assign the debtor’s standard security, for value, which would be closer to realisation of land by way of sale.

21. Are there other types of immoveable property over which it should be possible to grant a standard security?

(Paragraph 5.31)

No. If other registrable immoveable property is identified or introduced in future it may be necessary to revisit this.

22. (a) The secured obligation should be a matter for the parties to a standard security and no longer be the subject of default provisions.

Yes. This seems reasonable.

(b) Form A should be abolished.

(Paragraph 6.30)

Yes. Moving away from the use of forms is consistent with other areas of law.

23. There should no longer be a statutory form of standard security. Form B, like form A should be abolished. Instead, the constitutive document of a standard security should require to:

- (a) be signed by the debtor;**
- (b) identify the property which is to be the encumbered property;**
- (c) identify the secured obligation; and**
- (d) use the words “standard security”.**

(Paragraph 6.37)

Yes, see the answer to question 22 as well. The standard security document should just comply with key requirements, as noted.

24. Should a non-obligatory model form of a standard security document be provided?

(Paragraph 6.38)

Maybe it would be preferable for the Keeper to just produce a “model”, rather than for one to be contained in statute. If a model is included in the statute then there is the potential for this to be treated like the required form of standard security document (at least in some respects).

25. What comments do consultees have in relation to identification of the encumbered property?

(Paragraph 6.42)

We are happy with the suggestions in the Discussion Paper on this point. The current approach seems sufficient.

26. What comments do consultees have in relation to identification of the secured obligation?

(Paragraph 6.43)

A flexible approach should be adopted, including allowing for reference to made to a separate document.

27. Should it continue to be possible for unregistered holders to grant standard securities?

(Paragraph 6.47)

Yes. The position is admittedly somewhat complicated but it allows for unforeseen circumstances to be dealt with. There may be scenarios when, for example, a trustee in sequestration wishes to grant a standard security without having to first register to complete title to land.

28. A standard security should continue to be made real by registration.

(Paragraph 6.49)

Yes! Compliance with the publicity principle is key here. Registration is an effective method for giving notice to third parties who may be affected by the creation of a real right (the standard security).

29. The power under section 893 of the Companies Act 2006 should be used so that standard securities granted by companies do not require to be registered twice.

(Paragraph 6.53)

Yes. This would be a very helpful and desirable development.

30. What comments do consultees have on whether it should be permissible to create a servitude in a standard security deed?

(Paragraph 6.56)

We can see the argument in favour of this, but there is also a case for having to use separate deeds to keep the creation of different real rights distinct.

31. Rules on enforcement (including the recovery of expenses by the creditor) and redemption in relation to a standard security should not be dealt with in standard conditions but in the substantive provisions of the new legislation.

(Paragraph 7.39)

Yes, these should just be formulated as clear rules (especially when certain relevant standard conditions cannot be modified anyway).

32. Statute should provide for a freely variable default set of standard conditions in relation to preservation of the value of the encumbered property and expenses (other than in relation to enforcement). If consultees agree:

(a) should these conditions be set out in primary or secondary legislation?

(b) what default conditions should be included?

(Paragraph 7.49)

33. The standard conditions should be abolished, but statute should set out:

(a) a broad rule requiring the debtor to preserve the value of the encumbered property;

(b) a default rule that the debtor should be liable for the creditor's reasonable expenses (with enforcement expenses being dealt with separately in terms of the rules on enforcement); and

(c) a default rule allowing the creditor either to (i) require the debtor to insure the property for reinstatement value or to (ii) insure the property directly.

Should there be any additional rules?

(Paragraph 7.49)

We prefer the approach set out in question 32 i.e. a (largely) freely variable set of default conditions equivalent to the Model Articles for companies. Any variations ought to be accessible to parties with a legitimate interest. We consider that such conditions should be set out in secondary legislation.

Default conditions should include a requirement for a debtor to take reasonable care of encumbered property (and take reasonable steps to make sure others exercise such care), for expenses other than

enforcement expenses, for the property to be insured adequately, for there to be no demolition without permission etc.

34. Where property which is encumbered by a standard security has a lease granted over it without the creditor's consent, the secured creditor should be entitled to remove the tenant if the security is enforced.

(Paragraph 8.37)

The general position should be that a prior real right has priority over a personal right or a later real right (such as lease). As such, the standard security holder should be entitled to remove the tenant under a later lease if the security is enforced, where the lease is granted without the creditor's consent. Legislation could provide clarity regarding the legal position here. In principle, the lease interest should be a voidable real right but the case law is somewhat ambiguous on the point.

However, there is something to be said for requiring details of the prohibition to be included in the Land Register to allow for removal of a tenant even in the context of enforcement of the standard security (see the answer to question 35 below for more details).

35. Should the secured creditor be entitled to remove a tenant under a lease granted after a standard security prior to enforcement if express provision is made in the security documentation prohibiting the grant of a lease? Should that provision require to be on the face of the Land Register?

(Paragraph 8.40)

The secured creditor should be able to remove a tenant in this situation too. For this to happen, the tenant should need to have actual or constructive knowledge of the existence of the standard security and the prohibition of the grant of a lease. Details on the Land Register would certainly be helpful on this front and would provide necessary real or constructive knowledge for the tenant. Whether it would be sufficient for removal of the tenant for there only to be knowledge of the standard security (e.g. if the standard security is registered but there are no details on the Land Register regarding the prohibition on leasing) is a more difficult question. The tenant may be put on notice regarding the possibility of a prohibition on leasing by knowledge of the standard security and could be expected to enquire further. However, we would tend to the view that, because standard securities and leases are not necessarily incompatible in technical and practical terms (sometimes leases of property can be of considerable value), having details of the prohibition of leasing on the Land Register should be necessary to allow for the removal of a tenant under a lease. It would promote the role of the Land Register as the source of information binding third parties. By contrast, the effect of putting a tenant on notice by registration of the standard security alone would be rather unclear (see the absence of clarity regarding the "offside goals rule" on this point). Even if a lease could not be reduced, there would still be a breach of an obligation by an owner who leased out property without the creditor's permission and the creditor could seek damages for this. However, the lease itself would not be reducible.

36. What comments do consultees have on the rights of the secured creditor where the debtor carries out a juridical act in relation to an existing lease without the secured creditor's consent?

(Paragraph 8.44)

We accept that this is a difficult issue. We would note only that if third parties are to be affected, it is probably advisable for relevant prohibitions to be disclosed on the Land Register, as per the comments in response to question 35 above.

37. Should the Private Housing (Tenancies) (Scotland) Act 2016 be amended to make it clear that a heritable creditor cannot evict a tenant whose lease was granted prior to the creation of the security?

(Paragraph 8.52)

Yes.

38. What comments do consultees have on the situation where a heritable creditor is enforcing its security and there is a residential tenant whose lease was granted after the security?

(Paragraph 8.55)

The standard security should be enforceable as per the above (assuming e.g. relevant publicity requirements are met) but subject to certain protections that apply to homeowners, e.g. under the Home Owner and Debtor Protection (Scotland) Act 2010 – the relevant provisions of which should be applied to tenants (with appropriate modifications).

39. The holder of a private residential tenancy should prior to enforcement be unaffected by a prohibition on leasing in a standard security encumbering the property unless that person knows of the prohibition at the date of entry under the lease.

(Paragraph 8.57)

Ordinarily, a tenant should be expected to have knowledge of what is on the Land Register (as noted in our response to question 35). The prohibition should require to be ascertainable from the Land Register and if it is then the lease could be ended by the security holder. However, we accept that there is a policy argument that the position ought to be somewhat different in the case of a private residential tenancy (PRT). Where a PRT tenant has actual knowledge of a prohibition on leasing in a standard security, there is a stronger argument that the security holder should be able to terminate the PRT (in comparison to where the tenant may be considered to have only constructive knowledge by virtue of the content of the Land Register). Yet we also wonder what disadvantage is suffered by a standard security holder where the property is subject to a PRT prior to the enforcement of the standard security by way of realisation of the encumbered property (or otherwise). If it is to be possible in any circumstances for a standard security holder to end a PRT and evict a tenant at this earlier stage, perhaps it should be necessary for them to demonstrate valid cause – e.g. by showing detriment to their security interest as a result of the PRT. In any event, if the standard security holder is to be able to enforce, this should be subject to the protections noted in relation to question 38 above.

In passing, it is worth considering that there might be competing human rights concerns here, namely a tenant's right to private and family life (in terms of Article 8 of the European Convention on Human Rights) and a creditor's peaceful enjoyment of possessions (in terms of Article 1 of the First Protocol to the ECHR). With that in mind, perhaps it would be useful to note that it has recently been confirmed that a private landlord is not subject to any additional human rights law controls when recovering possession of someone's home, per the UK Supreme Court decision of *McDonald v McDonald* [2016]

UKSC 28; [2017] A.C. 273 and the subsequent European Court of Human Rights decision in *FJM v United Kingdom* (Admissibility) (76202/16). (Indeed, as noted in paragraph 44 of *FJM*, a finance company was in fact involved in that case, albeit the tenant was the child of those who had furnished the property as security.) It had been argued for the tenant in *FJM* that proportionality might come into play when a home was being recovered, but ultimately it did not in cases concerning private landlords. Any significant change in the legal regime that secured lenders are faced with in this area would need to keep this in mind.

40. Do consultees have any comments on the interaction of standard securities with agricultural leases?

(Paragraph 8.58)

No.

41. Where property is encumbered by a standard security and the debtor carries out a juridical act in relation to a right affecting that property without the creditor's consent, the creditor should be entitled to reduce the debtor's act if the security is enforced.

(Paragraph 8.64)

Yes – as long as the prohibition is on the Land Register, as per the answers in relation to leases above. There is also the possibility of non-registered information coming to the notice of a party and attention will need to be given as to whether the “offside goals rule” should be left to apply or whether specific statutory provision should be made. The latter may be preferable by providing clarity in a highly uncertain area of law; however, making such provision to cover relevant scenarios is likely to be difficult.

42. Should the creditor prior to enforcement be entitled to reduce any juridical act by the debtor which is prohibited in the security documentation?

(Paragraph 8.65)

Yes, as long as the prohibition is on the Land Register (or perhaps also if the relevant party has notice of the prohibition). The security holder should not have to wait for realisation of the encumbered property to enforce its entitlement in this context.

43. It should continue to be possible to vary a standard security as under the 1970 Act, except that there should be no mandatory form of deed.

(Paragraph 9.14)

Yes.

44. It should continue to be impermissible to vary a standard security to increase the encumbered property.

(Paragraph 9.16)

Yes, a new standard security can be granted in relation to the additional property.

45. It should continue to be possible to restrict a standard security:

(a) as under the 1970 Act, except that there should be no mandatory form of deed; or

(b) by means of a consent in gremio in a disposition transferring the property.

(Paragraph 9.23)

Yes to both.

46. Should (a) the assignation of the secured debt alone be sufficient to transfer the standard security, or should (b) registration of a document assigning the standard security continue to be required?

(Paragraph 10.34)

Our preference would be for (b). Approach (a) would undermine the Land Register as a source of information as to who holds the real right.

47. If registration should still be required, should the effect of registration be to transfer the debt (without intimation to the debtor)?

(Paragraph 10.34)

There is some merit in this, rather than having to do two transfers. But there would need to be protection for a debtor paying the wrong party, e.g. a recipient of an incorrect payment could be considered to hold money in trust for the party to whom the debt is now owed.

A further issue to consider here is how to facilitate different parties holding the standard security and being the creditor of the secured debt (see question 8 above). For example, X holds a standard security and the claim (debt) secured by the standard security and wishes to retain the claim but transfer the standard security to Y. If the transfer of the standard security automatically transfers the claim, this would defeat the intention of X (and Y), as both the standard security and the claim will transfer. So there will need to be a mechanism to stop the claim from always automatically transferring. This could be done by way of a rule that provides that ordinarily the claim automatically transfers with the standard security but that a standard security document can specify that the claim is not to transfer and this information will be registered in the Land Register.

48. (a) There should be no mandatory form of deed for the assignation of a standard security.

Agreed.

(b) The same deed may assign multiple standard securities.

Yes.

(c) Upon registration the assignation should give the assignee the benefit of any corroborative and substitutional obligations, the right to recover expenses from the debtor and the right to rely on any notices sent or enforcement procedure started by the assignor.

(Paragraph 10.38)

Yes.

49. The effect of an assignation of a standard security should not be to limit the standard security to the amount due at the time of the assignation and future advances made by the assignee may be secured depending on the terms of the security contract.

(Paragraph 10.68)

Agreed.

50. (a) Should there be any restrictions on what an all sums standard security may secure?

(b) In particular, should there be restrictions on

(i) pre-assignation debts owed to the assignee; and

(ii) debts originally owed to other parties

being secured?

(Paragraph 10.72)

Yes, we consider that there should be restrictions regarding (b)(i) and (ii). The standard security should not automatically cover such debts but it may be advisable to allow for pre-assignation debts owed to the assignee and debts originally owed to other parties to be secured if there is agreement. The assignee and debtor agreeing with respect to extending the security to these debts will allow for the triggering of the law of unfair preferences, where relevant. Also, it may be advisable for affected lower-ranking security holders to have to give permission too, at least in certain instances.

51. It should continue to be possible to discharge a standard security in whole:

(a) as under the 1970 Act, except that there should be no mandatory form of deed; or

(b) by means of a consent in gremio in a disposition transferring the property.

(Paragraph 11.9)

Yes to both.

52. (a) Do consultees consider that the law should require creditors to discharge standard securities where there is no outstanding debt?

(b) If so, should such a rule be restricted to residential cases and should there be exceptions? What should be the sanction for non-compliance?

(Paragraph 11.12)

Yes, the debtor should be able to request discharge and the creditor should be obliged to grant the discharge (in both residential and non-residential cases). Specific implement and damages should be available as remedies for non-compliance.

53. Section 41 of the 1970 Act should be restated and clarified by means of a new statutory provision.

(Paragraph 11.14)

Yes, in the manner proposed in the Discussion Paper.

54. (a) Do consultees agree that the rules on redemption should be replaced with a general rule entitling the debtor to a discharge on the secured obligation being performed in terms of the contractual arrangements between the parties and a court procedure for discharge where the creditor has disappeared or refuses to grant a discharge?

Yes.

(b) What comments do consultees have on the owner of the encumbered property (where that person is not the debtor) having the right to have the security discharged by paying the value of the property?

(Paragraph 11.39)

We can see some merit in this but it may be difficult to determine the value of the property at a given time. Legislation would need to outline how the value was to be determined.

There may be scenarios in which the owner of encumbered property seeks to take advantage of a low point in the property market to unencumber the property at a time when the standard security holder is unwilling or unable to enforce. Maybe it is worthwhile relying on what exactly has been agreed by the parties as to whether a party can unencumber its property. Analogies with the law of cautionary obligations may be of some assistance, and that is particularly so where the owner of the encumbered property and the debtor are distinct persons. The problem discussed at para 11.37 of the Discussion Paper (whether the granter of a security currently worth £200,000 for another party's debt of £250,000 has a right to redeem the security by paying £200,000) is loosely analogous to the following problem: a cautioner has agreed to be liable for £200,000 when the principal debtor's total debt is £250,000. How much must the cautioner pay (£200,000 or £250,000) before he or she is able to demand an assignation of the creditor's heritable security rights/rank on the debtor's insolvent estate to the effect of recovering the £200,000 in relief? The question is one of construction of the contract between the cautioner and creditor. On one construction, the cautioner simply becomes liable for a debt of £200,000; on another construction, the cautioner becomes liable for a debt of £250,000 subject to a cap of £200,000 (see, e.g., *Harvie's Trustees v Bank of Scotland* (1885) 12 R 1141 and *Veitch v National Bank of Scotland* 1907 SC 552). It is only in the former case that the cautioner could pay the £200,000 and demand an assignation of securities from the creditor/rank on the debtor's estate. In like manner, the question whether the provider of a heritable security for another's debt is entitled to redeem it when the value of the security is lower than the value of the debt is arguably a question of construction of the agreement between granter and creditor. For instance, on a construction favourable to the granter, the granter may redeem even if the present value of the encumbered property is lower than the value of the debt.

If it is considered desirable to deal with the matter in legislation, it may be appropriate to adopt a course whereby the default rule is that the owner of the encumbered property would not have the right to have the security discharged by paying the property's value but that this could be departed from by agreement. The default rule could also be switched or varied in certain cases so that value of the

property may be paid to unencumber except where there is contrary agreement. (The latter default rule may be particularly appropriate in the case where the debtor and owner of the encumbered property are distinct, for the owner will then be in a position analogous to that of a cautioner, and so arguably more deserving of protection than someone who is both owner and debtor). The benefit of having a default rule (or default rules) is that it minimises difficult questions of construction. Of course, even if an owner can unencumber property by paying its full value, the standard security creditor will still have a right against the debtor, albeit on a potentially unsecured basis.

55. Section 11 of the Land Tenure Reform (Scotland) Act 1974 should be repealed.

(Paragraph 11.43)

Agreed.

56. The doctrine of confusio should not extinguish a standard security.

(Paragraph 11.49)

Yes, flexibility of standard securities and a commercial approach is desirable here. Obviously, there could be no enforcement at the point at which a standard security is held by the owner of the encumbered property.

57. Should there be a sunset rule for standard securities? If so, what should be the period be? If not, why not?

(Paragraph 11.52)

No. We should be very careful about removing the property rights of parties. This could trigger ECHR Art 1 of Protocol 1 issues. If negative prescription has operated regarding the secured debt, the standard security will not be enforceable anyway. Where such prescription has occurred, a debtor should have the ability to demand a discharge, as per above at question 52 (or otherwise have the standard security removed from the Land Register).

58. The existing statutory provisions on the older forms of heritable security should be repealed. Where necessary, appropriate provision should be made in the new legislation.

(Paragraph 12.6)

Yes, agreed.

59. The rules in relation to transactions involving, and the enforcement of, a

(a) bond and disposition in security, or

(b) bond of cash credit and disposition in security,

should be the same as for the standard security with appropriate modifications. Any sunset rule for standard securities should also apply to these securities.

(Paragraph 12.12)

Yes. However, see our comment at question 57 above regarding a sunset rule. The same applies here.

60. Section 40 and Schedule 9 of the 1970 Act (which provide for a form of discharge for the ex facie absolute disposition) should be repealed and not replaced.

(Paragraph 12.18)

Yes, agreed.

61. Should the new legislation make provision to bring ex facie absolute disposition arrangements to an end? If so, how?

(Paragraph 12.25)

No. We are of the view that the law on this point should be left to “wither on the vine”. There could be unforeseen consequences if the law is interfered with, especially if parties lose their property rights unwarrantably.