RESPONSE FOR THE FACULTY OF ADVOCATES

TO

DISCUSSION PAPER ON HERITABLE SECURITIES: PRE-DEFAULT

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?

The Faculty does not hold any relevant data in this regard.

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 The Conveyancing and Feudal Reform (Scotland) Act 1970 should be repealed and replaced with a new statute regulating heritable securities.

The Faculty considers that there would be benefit in producing a new statute rather than simply amending the 1970 Act.

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

The Faculty agrees with this proposal.

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

The Faculty agrees with this proposal.

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

The Faculty has not identified any other transfers that ought to be prohibited.

6. The term "standard security" should be retained?

The Faculty agrees that the term "standard security" should be retained. Use of alternative terminology could lead to confusion.

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

The Faculty is not aware of any need for a non-accessory form of standard security. Parties can limit their exposure contractually should they wish to do so.

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.

The Faculty agrees. There are circumstances where a party may wish to provide security for the debt of another. One issue which may require consideration is the extent to which the third party providing that security is aware of the consequences of providing security for an "all sums" obligation.

(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.

The Faculty agrees. There may be commercial lending situations where the structure requires a security to be granted to someone other than the creditor.

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

No. The Faculty considers that this is an area where those involved in drafting of the arrangements are likely to have wider experience.

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

Yes

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

Yes

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

The Faculty agrees. The question of liability of successors would be better left to the general law.

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.

The Faculty agrees.

(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).

The Faculty agrees.

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.

The issues arising involve questions of policy. The Faculty sees the merit in a separate project to consider the protection of option agreements. If that is to be the case, we consider that option (a) would be preferable in the meantime.

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.

The Faculty agrees.

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

The Faculty agrees.

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

The Faculty agrees.

(b) What term should be used?

The Faculty agrees that the phrase “land or a real right in land” is somewhat cumbersome. However, one option would be to include this phrase in the definition section of the act and then assign a shorter name to it for the purposes of subsequent sections.

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

The Faculty agrees.

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

The Faculty does not see any reason in principle why a standard security should not be granted over a proper liferent. However, it is recognised that the rules for enforcement of such a security would require to be tailored to meet the

specific issues that are outlined in the Consultation Paper. If there is little appetite for the use of securities over proper liferents, it may be that it is preferable to simply prohibit their being granted rather than create a bespoke enforcement procedure which will not be used.

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.

The Faculty agrees.

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

The Faculty agrees.

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?

The Faculty considers that it should remain possible to create a standard security over a standard security. A further benefit of this approach is that the fact that the standard security is the subject of a security itself will be clear from the Register.

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

The Faculty considers that, on enforcement of its security, the secured creditor should become the holder of the standard security which formed the security subjects. That would then provide the creditor with the same rights as the original holder of the standard security.

Consideration would require to be given to whether the sole remedy would be to sell the security to a third party or whether it should be possible for the creditor to obtain satisfaction from the debtor in the accordance with the terms of the standard security.

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

The Faculty is not aware of any other types.

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.

(b) Form A should be abolished.

The Faculty agrees with the policy suggested in this question. Abolition of Form A would favour freedom of contract between borrower and lender. It would also allow securities to be drafted without the necessity of attempting to comply with

the statutory form, an exercise which, experience suggests, is not always easily accomplished.

If Form A (and Form B) are to be abolished, there may be merit in providing standard forms for parties to use in order that inexperienced or non legally-qualified drafters have a simple style to follow. For this reason, the Faculty agrees with the proposal in question 24.

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".

The Faculty agrees with the policy set out in this question for the reasons given in answer to question 22.

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

The Faculty agrees with the policy set out in this question for the reasons given in answer to question 22.

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

The Faculty agrees with the proposal that the present requirements for identification of the encumbered property should be retained. In our experience, however, difficulties can be caused where a party seeks to encumber only part of a registered or recorded title. We would suggest that provision is made in the legislation to ensure that this is done with adequate certainty.

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

The Faculty agrees that a flexible approach should be adopted. In our experience, the relatively inflexible requirements of Forms A and B can lead to convoluted drafting.

We are conscious, however, that litigation concerning standard securities often involves parties who have been unaware as to precisely the nature of the secured obligation. Particular issues, in our experience, result where there is joint borrowing (often in the husband and wife context), and where one party takes on liability for the other's failure to perform his or her obligations. The

question of to what extent protection for borrowers is desirable in such a situation is one of policy on which the Faculty does not express a view. These issues, however, are, in our view, worthy of consideration.

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

The Faculty agrees.

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

The Faculty agrees.

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.

In our experience, registration in both the Register of Companies and the Land Register has practical advantages for practitioners. In particular, registration of securities in the Register of Companies allows a party to discover quickly and easily the full extent of a company's secured borrowing (something which cannot be done in the same way with the Land Register). Such information is often required with a degree of urgency. In our view it is also desirable that the practice for Scottish and English companies should be the same, in order to avoid confusion.

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

The Faculty agrees that this may be of use in certain situations, and that it should, accordingly, be possible.

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.

The Faculty agrees.

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?

The Faculty considers that this proposal is more desirable than the alternative proposal (question 33). In our view, the standard conditions should be contained in secondary legislation in order to allow for easier updating.

In our experience, the standard conditions are almost always varied by larger lenders (and often combined with further sets of default terms and conditions). As such, it seems to us likely that major lenders will wish to use a single, standard set of conditions. The present interaction between these lenders' standard terms and conditions and the standard conditions in Schedule 3 to the Conveyancing and Feudal Reform (Scotland) Act 1970 is unsatisfactory (and often produces security documentation that is hard to read or, worse, contradictory). In our view, therefore, it would be best if the new standard conditions remained default conditions only, with parties free to disapply them in their entirety.

The question of which conditions should be included is one of policy upon which the Faculty does not have a view. In drafting the standard conditions, however, we would suggest that the most likely users of the default conditions would be smaller lenders and borrowers. The emphasis, in our view, should therefore be on a relatively simple set of conditions which can be used for a basic standard security by those who do not necessarily have the resources to produce more complex documentation.

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?

For the reasons given in answer to question 32, the Faculty considers that a set of default conditions is preferable.

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.

The extent of a tenant's rights in this situation is a matter of policy upon which the Faculty does not express a view.

We note, however, that the underlying law in this area is complex and unclear. Whatever the result of the policy decision in this regard, we would be in favour of a legislative statement of parties' rights in order to further legal certainty.

At present (if the offside goals rule does apply), third parties are protected under the offside goals rule by the requirement for bad faith. If the law is reformulated to allow reduction, consideration should be given to the ways in which third parties may be protected by the requirement for knowledge. This may, in particular, create issues where the prohibition is contained in contractual documentation which is not easily available. If such a rule is enacted, consideration should be given to a requirement that any prohibitions should appear on the face of the Land Register.

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?

See question 34.

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?

See question 34.

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?

This is a matter of policy upon which the Faculty does not express a view.

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?

This is a matter of policy upon which the Faculty does not have a view.

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.

This is a matter of policy upon which the Faculty does not have a view.

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)

The Faculty agrees with this proposal.

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)

See question 34.

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)

The Faculty agrees with this proposal.

44. It should continue to be impermissible to vary a standard security to increase the encumbered property. (Paragraph 9.16)

The Faculty agrees with this proposal.

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)

The Faculty agrees with this proposal.

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)

The Faculty considers that registration of a document assigning the standard security should continue to be required.

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)

No. Faculty is of the opinion that there should be intimation to the debtor.

48.

(a) There should be no mandatory form of deed for the assignation of a standard security.
(b) The same deed may assign multiple standard securities.
(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)

The Faculty agrees with these proposals.

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)

The Faculty agrees with this proposal.

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

This is a question of policy. However, we consider that it also raises three important issues which will require further consideration.

The first relates to the interaction of the law of securities with the law of insolvency. There is an obvious risk of creditors seeking to circumvent the order of priority in insolvency if a standard security can provide security for debts originally owed to other parties.

The second relates to the protection of family homes. A creditor will not normally be in a position to repossess a family home where the debtor makes appropriate proposals for the repayment of the secured debt or of any arrears. We understand that the legislative intention is to provide that a person will not be removed from their home unless they are unable to make payments of the secured indebtedness. It is not clear how this policy would sit with a policy which allowed for the secured obligations to be increased without reference to the debtor. This could put a debtor who had carefully managed the level of his indebtedness to his mortgage provider in a position where he could no longer repay the secured liability and so would be removed from his home.

The third issue relates to the execution of “all sums securities” by more than one person or by third parties. This is particularly important when one considers the case of “all sums” securities granted by spouses over a family home. It is often not understood that an “all sums” security will cover other borrowing which the spouse has with the lender. The matter would be further complicated if the security could cover other debts of the spouse due to a third party. Careful consideration would require to be given to the protections to be put in place if this were to be allowed.

(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?

See answer (a) above for some potential consequences of inclusion of debts of this type.

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)

The Faculty agrees with these proposals.

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?

We consider that it is desirable for provision to be made to require creditors to discharge securities where there is no outstanding debt. Such a provision would, in our view, be necessary should the standard conditions be abolished. In our view, it would be desirable for the new provision expressly to address its interaction with 'all sums' securities which are, in practice, a very significant proportion of securities granted.

The issue of undischarged securities appears to us likely to affect both residential and non-residential properties. Other bodies are likely to have greater experience of whether lenders may wish to retain the ability to retain securities in case of future lending. One possibility for dealing with this might simply be to make the provision requiring discharge a default provision which could be disapplied should parties so choose.

In our experience this issue does not cause difficulties of such a scale as to justify a greater compulsion than that presently contained in standard condition 11.

53. Section 41 of the 1970 Act should be restated and clarified by means of a new statutory provision. (Paragraph 11.14)

The Faculty agrees with this proposal.

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?

(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?

The Faculty agrees with the proposal in part (a) of this question for the reasons given in answer to question 52. We have discussed the possibility of a court procedure in answer to question 57.

We consider that the proposal in part (b) of the question is likely to cause difficulties in practice. The present value of the property and the value of the lending secured on the property are not always the same. The former fluctuates (or may be expected to change on the occurrence of some event). Giving control to the owner of the encumbered property would present, in our view, the possibility of abuse, where occupiers sought to maximise a difference between the value of the property and the sum advanced. Particular difficulties might be caused where property was transferred by the original borrower to a connected party who would then be able to take advantage of the redemption provisions.

55. Section 11 of the Land Tenure Reform (Scotland) Act 1974 should be repealed. (Paragraph 11.43)

The Faculty agrees with this proposal.

56. The doctrine of confusio should not extinguish a standard security. (Paragraph 11.49)

The Faculty agrees with this proposal.

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)

Views of the committee of members of Faculty who have prepared this response are divided on this point. On one view, there is no pressing requirement for such a rule. The majority of the committee, however, are of the view that there would be merit in such a rule, as the situation of undischarged, but old, securities can cause problems in practice. It may be that such a rule should not be based on time alone, but rather on a range of criteria (including time). This would allow the rule to apply in situations where only a short period of time had elapsed, but the creditor in the security cannot be traced. The duration of the period (or other qualifying conditions) which should apply are, however, matters of policy upon which the Faculty has no view.

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)

The Faculty agrees with this proposal.

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)

The Faculty agrees with this proposal.

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)

The Faculty agrees with this proposal. Consideration, however, would have to be given to whether the necessity for a reconveyance would give rise to a liability to LBTT or for registration charges.

61. Should the new legislation make provision to bring ex facie absolute disposition arrangements to an end? If so, how? (Paragraph 12.25)

The Faculty is of the opinion that matters should be left as they stand, with no new legislation to bring such arrangements to an end. There is no evidence of existing arrangements being problematic or unfair in practice, and the complexities and potential difficulties in designing and implementing a workable 'solution' are obvious.