



SECURING PROPERTY IN SCOTLAND

The methods of taking security over property in Scotland and England are different. Scots law does not recognise the concept of an equitable charge and does not distinguish between a mortgage and a charge. There is no sub-categorisation into legal or equitable mortgages and fixed charges. Accordingly, the deposit of title deeds with a mortgagee, for example, gives no security over the property to which the deeds relate.

There are basically 6 ways to secure property in Scotland: by way of standard security, floating charge, assignation in security, pledge, lien and hypothec. This note will look at the different types of security most widely used in Scotland focussing on those used in connection with heritable property. Along the way it will highlight the main differences from the securities available under English law.

Whilst in England legal and equitable mortgages and charges can in principle be granted over all property, different types of security in Scotland are used to secure different types of property.

Hypothec and Lien

Hypothec and lien are security rights over moveables which arise by operation of law without the need for agreement by the parties. A lien is where a creditor in possession of the debtor's moveable property uses that property as security for an unpaid debt and hypothec is where the creditor obtains a security over the debtor's moveables without possession thereof.

The most classic example of lien is that of the garage mechanic holding on to a vehicle until he receives payment for repairs. The landlord's hypothec whereby the landlord may recover furniture equipment and stock (but not money or the tenant's tools of trade) on business premises to secure up to a year's rent is the most commonly used hypothec in Scotland. The landlord's hypothec has priority over the claim of the liquidator or receiver, but if exercised, the landlord becomes responsible for settling the Crown debts of the tenant (ie. taxes). The Bankruptcy and Diligence etc Bill currently going through the Scottish Parliament is proposing to abolish the current method of enforcing a landlord's hypothec, that is, by way of a sequestration for rent.

Assignations in Security and Pledges

Assignations in security are generally used where security is required over incorporeal moveable property such as, for example, rents payable or book debts. The security is only effective once it has been intimated to the party against whom the assigned rights are held.

Where a standard security has been granted over leased property in Scotland, it is common for the creditor to request an assignation of rents in security of the debt payable. The debtor may be reluctant to advise tenants of the security over the property. In such cases, creditors often agree to accept and hold the executed assignation of rents from the debtor in abeyance and only complete that assignation by intimation to the tenants in the event of default. In doing so the lender is taking the risk that the security has not been completed and also that the debtor may assign the rents to a third party who proceeds to intimate prior to the original creditor's intimation.





The security of pledge arises when the owner of corporeal moveables places them in the hands of his/her creditor to be retained until the obligation is satisfied. Whilst delivery is vital, it may be actual, symbolic or constructive. It is therefore possible to pledge goods held in a third party warehouse where, for example, the keys to the warehouse are delivered to the creditor. Another example is where shares of a Scottish registered company are used for security by way of pledge, the funder will be entered in the Register of Members as a shareholder in respect of those shares. Scots law interprets delivery fairly strictly so the creditor must be in control of the goods secured for the security to be effective.

Standard Security

Turning to heritable property, the only fixed charge available is the standard security. It is a statutory form of charge introduced in Scotland by the Conveyancing and Feudal Reform (Scotland) Act 1970 ("the 1970 Act") which may be granted by individuals, companies and limited liability partnerships. There is no other way of securing a debt over land/heritable property in Scotland.

A standard security may be granted over heritable property owned by the debtor or held by the debtor under a lease which is for a term of 20 years or more. In Scotland, fewer properties are held under long leases than in England. The maximum duration for a long lease in Scotland is now 175 years.

The standard security operates to create a security interest over the interest which it is granted, that is, over the ownership or long leasehold interest. The debt secured by a standard security may be any obligation due or which may become due to repay money or an obligation "ad factum praestandum" (to perform a particular task).

Registration and Ranking of Standard Securities

To create a standard security it must be registered in either of the Property Registers, that is, the Land Register or Register of Sasines. If granted by a company the standard security must also be registered in the Register of Charges at Companies House within 21 days of creation (the date of creation being the date of registration in the Property Registers).

Just as in England, a number of factors will affect how a charge is ranked in Scotland. The date of creation of the charge, statute, agreements between creditors and the content and type of prior registered charges will all be relevant when determining the ranking position of a standard security. Where a standard security is competing with other forms of security, the date of creation will determine where the standard security ranks. However, if there is a ranking agreement between creditors or negative pledges in floating charges, the standard security may be postponed notwithstanding its prior date of creation.

Enforcement of Standard Securities

A creditor is entitled to exercise any of the rights conferred on him under the standard security as considered appropriate when the debtor is in default. The rights available are to carry out necessary repairs, enter into possession and recover rents, sell the security subjects and apply to the court for a decree of foreclosure which will give the creditor absolute title to the security subjects. Before exercising these rights the creditor must take some preliminary steps.





Firstly, a creditor may serve what is known as a calling up notice demanding repayment of the whole outstanding loan, including interest and expenses. Calling up notices are generally served when the debtor is in arrears of mortgage payments but the creditor could choose to serve it at any point if the terms of the security allow. If the debtor fails to repay the loan the creditor may exercise any of the powers conferred by the standard security.

Secondly, if a debtor in a standard security is in default of any of the other provisions of the standard security apart from the monetary arrears, and the default can be remedied, the creditor may serve a notice of default calling on the debtor to remedy the default. The debtor is generally given one month to comply with the default notice.

Finally, section 24 of the 1970 Act permits a creditor to raise court proceedings against a debtor without first serving a calling up notice or a notice of default. This procedure is not widely used since it gives the debtor no advance notice of the action. When the debtor receives notice of the court action he will be given 21 days to notify the court as to whether they intend to defend the action. If there is no defence, decree will be obtained and the creditor can proceed to exercise the powers under the standard security.

In practice after expiry of the period of notice in either a calling up notice or a notice of default, a creditor will proceed to obtain an order from the court granting warrant to exercise all rights open to them, including the right to enter into possession of the security and to eject the debtor and any other occupiers.

Floating Charges

A floating charge may be granted by companies and limited liability partnerships over heritable and leasehold property in Scotland as well as moveable property. It cannot be granted by individuals or traditional partnerships. The floating charge was introduced in Scotland in 1961 following on the English precedent.

As in England it is a charge floating over a moving pool of assets and will fix upon those assets owned by the company at either (a) the date of commencement of winding up, or (b) the date when a receiver is appointed. At that point, the charge becomes a fixed security and the creditor obtains a real right in respect of the property. There is no statutory prescribed form of charge.

A floating charge may secure any debt or other obligation incurred or to be incurred by the company or any other person.

Registration and Ranking of Floating Charges

A floating charge must be registered in the Register of Charges kept by the Registrar of Companies within 21 days of its creation. Provided it is so registered it will be deemed to have been created on the date of its execution. A floating charge does not require to be registered in the Property Registers even if it covers heritable or long leasehold property.

In England there is no constructive notice of a prohibition on the creation of prior mortgages since the Form 395 does not require such details. Only when a subsequent mortgagee has actual notice of a restrictive clause will his security be postponed. This is not the case in Scotland. When registering a floating charge in Scotland the Form





410 differs from a Form 395 in England, in that it requires details of any prohibitions on the creation of further security and on the ranking of the floating charge.

The 1985 Companies Act provides 3 possibilities for ranking:

- (i) a floating charge in competition with a fixed security arising by operation of law, such as lien - the fixed security always has priority;
- (ii) when there are express ranking clauses, the ranking provisions will prevail. Note however that a pre-existing charge or fixed security will not be affected by such ranking provisions unless it also contains a corresponding clause;
- (iii) where there are no ranking provisions (a) a fixed security which has become real by registering in the Property Registers before the floating charge attaches to the property ranks before a floating charge; (b) two or more floating charges if and when they attach to the property rank according to their respective dates of registration.

The Bankruptcy and Diligence etc Bill currently going through the Scottish Parliament provides for a Register of Floating Charges to be held by the Keeper of the Property Registers of Scotland. The provisions of the Bill as currently drafted also have implications for the granting of floating charges by English companies over Scottish assets and the ranking of floating charges.

Enforcement of a floating charge

In Scotland as in England crystallisation of a floating charge will occur in the following circumstances:

1. when a winding up order is made in relation to the debtor; and
2. when the creditor appoints a receiver.

The floating charge itself may also contain other instances of default which may trigger crystallisation. However, unlike in England, automatic crystallisation of floating charges does not occur in Scotland.

As in England, receivers enforce the floating charge on behalf of its holder. However, the Enterprise Act 2002 limited the ability of lenders in Scotland and in England to appoint receivers and provided for the appointment of administrators under the revised administration procedure created by the Enterprise Act for floating charges created on or after 15 September 2003.

Cross-border conflict

The term “debenture” in this note is referring to an English law document through which a company grants fixed and/or floating charges over some or all of its present and future property.

It is common for a debenture to limit a floating charge to all assets of the debtor which have not been effectively charged by the fixed charges and assignments contained in the debenture. If the Scottish property is purportedly charged by the clauses creating the fixed charge it will not be covered by the floating charge. This can cause problems





when it comes to enforcing the debenture as the fixed charges would not be recognised under Scots law, and no floating charge would be in place.

If the fixed charge is taken over heritable property, Scots law will only recognise a standard security. If the fixed charge is over corporeal moveable property, Scots law will not recognise it unless the creditor is in control of the property charged. If the fixed charge is over incorporeal moveable property, Scots law will only recognise an assignation of that property that is completed by intimation to the relevant parties. Looking then to the floating charge for security, the floating charge will fail to catch the Scottish property covered by the fixed charges created by a standard form debenture, leaving the creditor with no enforceable security over that property.

It is therefore essential if a debenture is to cover Scottish property that the floating charge is stated to extend to all assets situated in Scotland whether or not effectively charged by the fixed charges and assignments. Any creditor, wishing to create a fixed charge over Scottish heritable property should do so by way of standard security.

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